



Consumer Federation of America

April 21, 1998

To: The Honorable Henry J Hyde, Chairman
The Honorable John Conyers, Jr., Ranking Minority Member
House Judiciary Committee Members

Dear Mr. Chairman, Mr. Conyers and Committee Members:

We urge you to oppose HR 3150, the Bankruptcy Reform Act of 1998, scheduled for mark up this Thursday at 10am. This bill proposes radical reforms which will not work while throwing struggling American families even deeper into crisis. We support HR 3146, the Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998, because it is balanced and carefully-crafted to weed out abuses by both debtors and creditors, without unduly burdening the bankruptcy courts, the taxpayer or honest debtors.

CFA joins the many bankruptcy judges and legal scholars in urging this Committee to put the brakes on a hasty process to amend the current Code. Critiques of HR 3150 by neutral scholars and judges raise a red flag and caution against the adoption of dangerous legal precedents. Additionally, many key provisions of HR 3150 were rejected as recommendations by the National Bankruptcy Review Commission.

The record number of personal bankruptcies during the past few years, while deeply troubling, is not caused by the Bankruptcy Code. Indeed, all available empirical evidence suggests that changes in bankruptcy code do not affect the number of filings [1]. Differences in debt levels, however, have a direct impact; it is well-documented that a rise in the number of personal bankruptcies follows a rise in consumer debt levels. [2]. CFA has issued reports about the debt crisis facing millions and millions of American families, not just those who have filed for bankruptcy; and, of course, a debt crisis is certainly also a "savings" crisis for those families. However, HR 3150 will not, indeed cannot, provide the fix. Our justice system must be available--without hardship--to those who need it.

While no single cause for most bankruptcies has been identified, we believe that aggressive credit card marketing practices and irresponsible extensions of credit have tipped the balance for many individuals and families [see attached Credit Card Debt fact sheet]. Record levels of credit card debt, when coupled with an unexpected life event [the three major bankruptcy-related events being employment interruption, medical crisis and divorce], have forced honest debtors to seek bankruptcy protection.

Of course, there are a relatively few dishonest debtors who game the bankruptcy

courts. These "high rollers" seem to get the lion's share of press and anecdotal attention. They, like abusive and/or irresponsible creditors, must not be allowed to benefit from the system. But changes to the Code to deal with these offenders must be carefully targeted.

Accordingly, changes to the Code should be consistent with the following principles.

1. Honest, destitute debtors should not be denied or struggle for access to the bankruptcy system and the Bankruptcy Court should focus its time on those who are more likely able to pay and/or who have deliberately gamed the system.

HR 3150 is premised on the concept of needs-based bankruptcy, a concept that creditors have pitched to Congress without success for over 30 years. In this round, the creditors largely rely on a study [often called the "Staten" study], which has been severely criticized by scholars and the GAO.

Hr 3150 would prevent a large number of filers from obtaining Chapter 7 relief unless they made a showing that would drive up the cost of bankruptcy and require substantial court time. It pulls all those with 75% of median income into its presumption that such debtors could repay debt in Chapter 13--this despite the fact that 67% of those who now voluntarily file for Chapter 13 fail to complete their plans.

In contrast, HR 3146 would focus the court's time on those apparently best able to pay: debtors with family income over \$60,000. It also gives the court additional ability to dismiss a Chapter 7 case for abuse.

2. Creditors who have extended credit irresponsibly should not be allowed to benefit to the detriment of women and children, the IRS and responsible creditors.

HR 3150 would create a presumption that consumer debts incurred within 90 days of bankruptcy are nondischargeable. Both scholars and industry analysts have opined that HR 3150 would have the effect of encouraging even more extension of credit. [3] Additionally, the NBRC explicitly rejected such an extension and instead recommended that the current law be changed from 60 to 30 days. This would allow credit card debt made nondischargeable to "compete" with other creditors including women seeking alimony and child support payments and the IRS.

In contrast, HR 3146 would disallow the claims of creditors under circumstances including:

- where creditor knew or should have known that the extension of credit pushed the debtor's aggregate unsecured debt to over 40% of the debtor's annual gross income
- where the creditor's practices violated the Home Ownership and Equity Protection Act [ex: making high-rate home equity loans without regard to the ability to re-pay]
- where the creditor has refused to waive interest as part of a credit counseling program
- where the credit was extended in or near a gambling facility.

3. Debtors should be protected against abusive practices by creditors

Creditors have engaged in abusive practices even in cases where the debtor has never missed a payment. These practices include seizure of property and payment schedule acceleration. Further, widespread improper re-affirmations [a debtor contracts with a creditor to "reaffirm" a debt, making him or herself liable for the debt after it is discharged in bankruptcy] have been coerced by creditors, the recent Sears case perhaps being the most glaring example. Technically, re-affirmations are allowed under current law, but they must be approved by the court; this is seldom the case. Creditors also claim security interests in household goods of minimal value and then use false threats of repossession to coerce debtors to re-affirm.

HR 3150 [Sec. 123 & 128] would exacerbate these problems. In contrast, HR 3146 would protect a debtor who is current in his/her payment against such practices. It would specifically prohibit re-affirmations. It also prevents creditors from retaining liens in household goods with minimum value.

4. The Bankruptcy Court, funded by the taxpayer, should not be burdened by unnecessary litigation and other administrative burdens.

In a departure from current practice, HR 3150 would allow the creditor to bring a motion to dismiss. We expect that many such motions would be filed, tying up substantial court time and running up legal fees for debtors.

A recent letter by well over 100 bankruptcy judges to Congress noted this concern in particular:

Without sufficient study and consideration, it is likely that the proposed bills will (1) fail to fully accomplish their intended purpose, (2) generate unnecessary litigation over unclear terms, and (3) impose excessive costs on all of the participants in the bankruptcy system

We must take the time and care to do bankruptcy reform right. We stand ready to work with you on this effort. Please call me if you have any questions.

Sincerely



Mary Rouleau
Legislative Director

[1] See, eg., Domowitz & Tamer, Two Hundred Years of Bankruptcy: A Tale of Legislation and Economic Fluctuations, [May 1997]

[2] See, eg., Statement of Kim Kowalewski, Congressional Budget Office, on Consumer Debt and Bankruptcy before the Subcommittee on Administrative Oversight and the Courts, US Senate, 4/11/97

[3] See, eg., Congress might make debt harder to escape, The Boston Globe, 3/10/98; Ausubel, Credit Card Defaults, Credit Card Profits, and Bankruptcy, 71 American Bankruptcy Law Journal 249 [1997]

CREDIT CARD DEBT PRESENTS SERIOUS RISK FOR MANY HOUSEHOLDS

As of late 1997:

*\$1.6T in credit lines approved--about \$20K for each household with at least one credit card

*\$450B in revolving debt--double what it was in 1990--is carried by 55-60M households that revolve debt

*the average debt per "revolving" household is \$7000, and those households paid more than \$1000 in interest and fees during the past year

*lower middle income households are especially burdened by credit card debt--their consumer debt-to-income ratios are far higher than those of other income groups

*based on research numbers generated by Georgetown's Credit Research Center, Chapter 7 bankrupts studied in 1996 had after-tax incomes averaging \$19,800 and credit card debts averaging \$17,544

*In June 1997, the Opinion Research Corp. asked, on behalf of CFA, a sample of 1006 persons: "How concerned are you about meeting your credit card monthly payments?" 36% of all households said "very concerned" and among lower income households [\$15-25,000] that number was 42%

[See "Expanding Credit Card Debt: The Role of Creditors and the Impact on Consumers, CFA, December 16, 1997]

BECAUSE THE PROFITABILITY OF CREDIT CARDS IS SO HIGH, COMPANIES CONTINUE TO AGGRESSIVELY MARKET, DESPITE WARNINGS OF RISK AND RISING CHARGE-OFF RATES

*In September 1996, the Office of the Comptroller of the Currency issued an Advisory Letter to alert national banks to risks associated with preapproved solicitations of credit cards. The OCC encouraged management to "take appropriate action to limit its exposure to unwarranted risks". [OCC Advisory Letter 9/25/96]

*During the first half of 1997, credit card solicitations were at a record level; the second quarter mailing of 881M was the highest on record [CFA, 12/16/97]

*From 1995 to 1996, credit card telemarketing expenses rose 30% [CFA 12/16/97]

*From 1995 to 1996, credit card ad expense rose 14% [CFA 12/16/97]

*Credit card banks [defined as those which engage primarily in consumer lending; more than 90% of their loans involve credit cards] attain a return on assets that is double the return on assets of commercial banks [Credit Card Charge-Offs, Subprime Lending and High-LTV Loans, Beverly Burden, 1998]

*The difference between the roughly 14-16% yield on credit cards and the 3-5% cost of funds is much larger than that on other kinds of consumer credit [The Consumer Impacts of Expanding Credit Card Debt, CFA, February 1997]

*Banks are also able to securitize and sell credit card debt and may now receive more favorable tax treatment [Burden]

*But, the present rate of charge-offs, about 5%, is the highest rate recorded [CFA 2/97, Burden] And profit levels on credit cards have fallen [CFA, Burden, WSJ 11/5/97]

April 9, 1998

To All Members of the United States Congress:

Dear Senator or Representative:

We are a group of 110 United States bankruptcy judges. Most of us have been bankruptcy judges for more than ten years, and we have applied the complex provisions of the Bankruptcy Code to thousands of bankruptcy cases filed by individual debtors. Although we come from different political, intellectual and economic perspectives, and represent districts from every federal judicial circuit, we share a single, deep concern—that legislation presently before Congress would make fundamental changes in bankruptcy for individual debtors that have not been sufficiently considered.

The proposed bills—H.R. 2500, H.R. 3146, H.R. 3150, and S.1301—all impose new limits on the availability of bankruptcy relief. Since 1898, an individual's debts have been discharged upon surrender of the individual's nonexempt property, and the property has been liquidated to pay the individual's creditors. The proposed legislation would deny this basis for discharge in many cases, requiring instead that individuals make payment out of their future earnings, for as much as seven years. The bills also propose major changes in what debt may be discharged, in the relative amounts paid to secured and unsecured creditors, and in the extent to which documentation must be filed and processed in connection with a bankruptcy case.

We do not take any position on the merits of these bills. However, we strongly believe that these bills are too important and their proposed changes too sweeping to be acted upon without thorough consideration. We are alarmed by how little study appears to have been given to the pending bills. Although we understand that these bills are on the verge of floor consideration, fewer than a dozen hearings have been held on all of the bills combined. The oldest of the bills, H.R. 2500, was introduced little more than six months ago. The haste with which these bills are being processed can be seen by a comparison with the changes made by the Bankruptcy Code of 1978. That legislation was enacted only after sixty days of hearings during a five-year period of consideration.

Without sufficient study and consideration, it is likely that the proposed bills will (1) fail to fully accomplish their intended purpose, (2) generate unnecessary litigation over unclear terms, and (3) impose excessive costs on all of the participants in the bankruptcy system. As those charged with responsibility for applying the bankruptcy laws, we urge that the pending bills be given the full attention that they require, including additional hearings, held after sufficient time has been accorded for thorough study by all interested organizations, legal scholars, and participants in the bankruptcy process.

Respectfully,

The Honorable Louise D. Adler
The Honorable Frank R. Alley
The Honorable J. Vincent Aug

Southern District of California
District of Oregon
Southern District of Ohio

Letter To Congress
April 9, 1998

The Honorable Ronald S. Barliant	Northern District of Illinois
The Honorable Redfield T. Baum	District of Arizona
The Honorable Joyce Bihary	Northern District of Georgia
The Honorable William T. Bodoh	Northern District of Ohio
The Honorable Richard L. Bohanon	Western District of Oklahoma
The Honorable Henry J. Boroff	District of Massachusetts
The Honorable Peter W. Bowie	Southern District of California
The Honorable Philip H. Brandt	Western District of Washington
The Honorable Jerry A. Brown	Eastern District of Louisiana
The Honorable Samuel L. Bufford	Central District of California
The Honorable Charles M. Caldwell	Southern District of Ohio
The Honorable Donald E. Calhoun	Southern District of Ohio
The Honorable Ellen Carroll	Central District of California
The Honorable Catherine Carruthers	Middle District of North Carolina
The Honorable Charles G. Case	District of Arizona
The Honorable Leif M. Clark	Western District of Texas
The Honorable Tom R. Cornish	Eastern District of Oklahoma
The Honorable A. Jay Cristol	Southern District of Florida
The Honorable Sarah Sharer Curley	District of Arizona
The Honorable Sara E. deJesus	District of Puerto Rico
The Honorable Henry H. Dickinson	Western District of Kentucky
The Honorable Russell A. Eisenberg	Eastern District of Wisconsin
The Honorable Joan N. Feeney	District of Massachusetts
The Honorable Jerome Feller	Eastern District of New York
The Honorable Lisa Hill Fenning	Central District of California
The Honorable Gerald D. Fines	Central District of Illinois
The Honorable Judith K. Fitzgerald	Western District of Pennsylvania
The Honorable John T. Flannagan	District of Kansas
The Honorable Steven H. Friedman	Southern District of Florida
The Honorable Robert F. Fussell	Eastern and Western District of Arkansas
The Honorable Stephen D. Gerling	Northern District of New York
The Honorable William H. Gindin	District of New Jersey
The Honorable James A. Goodman	District of Maine
The Honorable Robert E. Grant	Northern District of Indiana
The Honorable James D. Gregg	Western District of Michigan
The Honorable James R. Grube	Northern District of California

Letter To Congress
April 9, 1998

The Honorable Alfred C. Hagan	District of Idaho
The Honorable James B. Haines	District of Maine
The Honorable John J. Hargrove	Southern District of California
The Honorable Polly S. Higdon	District of Oregon
The Honorable Russell J. Hill	Southern District of Iowa
The Honorable William C. Hillman	District of Massachusetts
The Honorable Marvin A. Holland	Eastern District of New York
The Honorable Jeffrey Hopkins	Southern District of Ohio
The Honorable Laurence E. Howard	Western District of Michigan
The Honorable Lewis M. Killian	Northern District of Florida
The Honorable John M. Klobucher	Eastern District of Washington
The Honorable Robert L. Krechevsky	District of Connecticut
The Honorable Enrique S. Lamoutte	District of Puerto Rico
The Honorable Kathleen T. Lax	Central District of California
The Honorable Joan Lefkow	Northern District of Illinois
The Honorable Larry L. Lessen	Central District of Illinois
The Honorable Paul B. Lindsey	Western District of Oklahoma
The Honorable Basil H. Lorch	Southern District of Indiana
The Honorable Paul Mannes	District of Maryland
The Honorable Robert A. Mark	Southern District of Florida
The Honorable Robert D. Martin	Western District of Wisconsin
The Honorable Mark B. McFeeley	District of New Mexico
The Honorable Margaret D. McGarity	Eastern District of Wisconsin
The Honorable Kenneth J. Meyers	Southern District of Illinois
The Honorable Dennis Montali	Northern District of California
The Honorable Robert G. Mooreman	District of Arizona
The Honorable Marilyn Morgan	Northern District of California
The Honorable Geraldine Mund	Central District of California
The Honorable Randall J. Newsome	Northern District of California
The Honorable George B. Nielsen	District of Arizona
The Honorable Karen A. Overstreet	Western District of Washington
The Honorable Jim D. Pappas	District of Idaho
The Honorable Alexander L. Paskay	Middle District of Florida
The Honorable John K. Pearson	District of Kansas
The Honorable John L. Peterson	District of Montana

Letter To Congress
April 9, 1998

The Honorable James A. Pusateri
The Honorable James F. Queenan
The Honorable Julie A. Robinson
The Honorable Robert K. Rodibaugh
The Honorable Dana L. Rasure
The Honorable John A. Rossmeissl
The Honorable David E. Russell
The Honorable John E. Ryan
The Honorable Gerald H. Schiff
The Honorable David A. Scholl
The Honorable John D. Schwartz
The Honorable Mary Davies Scott
The Honorable James E. Shapiro
The Honorable Blackwell N. Shelley
The Honorable David F. Snow
The Honorable John H. Squires
The Honorable Paul Snyder
The Honorable Rodney R. Steele
The Honorable Jo Ann C. Stevenson
The Honorable David T. Stosberg
The Honorable Stephen A. Stripp
The Honorable Laura Taylor Swain
The Honorable Leslie J. Tchaikovsky
The Honorable S. Martin Teel, Jr.
The Honorable John TeSelle
The Honorable Douglas O. Tice
The Honorable Thomas M. Twardowski
The Honorable Thomas S. Utschig
The Honorable Mark W. Vaughn
The Honorable Arthur N. Votolato
The Honorable Thomas F. Waldron
The Honorable Eugene R. Wedoff
The Honorable Arthur S. Weissbrodt
The Honorable James H. Williams
The Honorable Patricia C. Williams
The Honorable Vincent P. Zurzolo

District of Kansas
District of Massachusetts
District of Kansas
Northern District of Indiana
Northern District of Oklahoma
Eastern District of Washington
Eastern District of California
Central District of California
Western District of Louisiana
Eastern District of Pennsylvania
Northern District of Illinois
Eastern and Western Districts of Arkansas
Eastern District of Wisconsin
Eastern District of Virginia
Northern District of Ohio
Northern District of Illinois
Western District of Washington
Middle District of Alabama
Western District of Michigan
Western District of Kentucky
District of New Jersey
Eastern District of New York
Northern District of California
District of District of Columbia
Western District of Oklahoma
Eastern District of Virginia
Eastern District of Pennsylvania
Western District of Wisconsin
District of New Hampshire
District of Rhode Island
Southern District of Ohio
Northern District of Illinois
Northern District of California
Northern District of Ohio
Eastern District of Washington
Central District of California

Letter To Congress
April 9, 1998

Addendum

The following bankruptcy judges expressed their willingness to sign this letter after the initial mailing:

The Honorable C. Timothy Corcoran, III

The Honorable Meredith A. Jury

The Honorable James M. Marlar

The Honorable Margaret Murphy

The Honorable Albert Radcliffe

The Honorable Lynne Riddle

Middle District of Florida

Central District of California

District of Arizona

Northern District of Georgia

District of Oregon

Central District of California



Leadership Conference on Civil Rights

1629 "K" St., NW, Suite 1010
Washington, D.C. 20006
Phone: 202/466-3311
Fax: 202/466-3435
TTY: 202/785-2859

June 4, 1998

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National Association of Attorneys
Jackie DeFazio

American Association of University Women
Anita Perez Ferguson

National Women's Political Caucus
Matthew Flincone

African Pacific American Labor Alliance
Marcia Greenberger

National Women's Law Center
Harry Gunther

National Council of Senior Citizens
Rebecca Isaacs

People for the American Way
Patricia Ireland

National Organization for Women
Elaine Jones

NAACP Legal Defense & Educational Fund, Inc.
Joseph Lowery

Southern Christian Leadership Conference
Loren Lynch

United Streamline of America
Kwesi Muneo

NAACP
Laura Murphy

American Civil Liberties Union
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National Urban League
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Union of American Business Consultants
Richard Womack

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Disability Rights Education and Outreach Fund
Stephen P. Yokich

International Union, United
Automobile Workers of America
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Karen McGill Lewison

LEGISLATIVE ASSISTANT
Brian Komar

Dear Representative:

On behalf of the Leadership Conference on Civil Rights (LCCR), a coalition of 180 national organizations representing people of color, women, labor unions, persons with disabilities, older Americans, major religious groups, gays and lesbians and civil liberties and human rights groups, we urge you to oppose H.R. 3150, the "Bankruptcy Reform Act of 1998."

As you know, bankruptcy reform has not been, per se, an issue of traditional concern to the LCCR. The LCCR was founded to enhance and protect civil and human rights. However, H.R. 3150 poses significant concerns for the civil rights of all working persons in the United States.

Introduction

As a general matter, every economic discrimination suffered by disadvantaged groups in our society is reflected in the bankruptcy courts. For women, the cumulative effects of lower wages, reduced access to health insurance, the devastating economic consequences of divorce, and the disproportionate financial strain of rearing children alone is reflected in why women heads of households find themselves in bankruptcy courthouses.

Older Americans who are pushed out of jobs and encounter discrimination in hiring, who lose their health insurance benefits along with their jobs and cannot buy replacement insurance, who are victims of credit scams and home improvement frauds that put their homes and their security at risk, are disproportionately in the bankruptcy courts.

African American and Hispanic American families, suffering from discrimination in home mortgage lending and in housing purchases and facing inequality in hiring opportunities, wages, and health insurance coverage, also turn to bankruptcy to stabilize their economic circumstances and protect the middle class lives they have struggled so hard to achieve.

For more than one hundred years, working in bipartisan fashion, Congress has carefully constructed and maintained an "insolvency relief system" that provides a fresh start for those honest, hard-working families and businesses that find themselves overburdened with debt and in severe financial distress. Most often, the people who use the bankruptcy courts to stabilize themselves are working class and middle class individuals who have encountered a short-term financial crisis.

(Continued)

"Equality In a Free, Plural, Democratic Society"

June 4, 1998

H.R. 3150 "The Bankruptcy Reform Act"

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Studies by independent economists, the Congressional Budget Office, and the Federal Deposit Insurance Corporation (FDIC) link the rise in consumer bankruptcies directly to the rise in consumer credit.¹ Deregulation in consumer credit interest rates has prompted aggressive marketing and a loosening of underwriting standards that have caused a rise in consumer bankruptcies.² By marketing high-risk debt to customers who are at substantial risk for non-payment, credit card issuers' have contributed to the rise in consumer bankruptcies.³ As bankruptcy levels have risen, total credit card profitability has grown--credit card lending is now twice as profitable as all other lending activities.⁴

Industry consultants estimate that credit card companies could cut their bankruptcy losses by more than 50% if they would institute minimal credit screening.⁵ Instead, the credit issuers have spent a reported \$40 million on lobbyists and lawyers to urge Congress to become the collection agent for their bad loans—even as their profits reach into the billions of dollars.

The underlying provisions of H.R. 3150 would disproportionately affect the constituencies that comprise the Leadership Conference on Civil Rights. For example, children and single parents would be adversely affected by slower repayments of past-due support obligations in Chapter 13 as support obligations lose their repayment priority. Older Americans and minority homeowners would be adversely affected by rigid income and expense threshold tests for eligibility for Chapter 7.

The Present Crisis

Nearly 1.4 million families filed for bankruptcy last year, a record number. The families that used the bankruptcy system were those middle class Americans who are most vulnerable economically. They include:

Single parents and their children In 1997, about 300,000 bankruptcy cases involved child support and alimony orders.⁶ For about half, women were creditors seeking payments from their ex-husbands following a divorce. Support obligations are protected under current bankruptcy laws: a support order is one of the only debts to survive a bankruptcy filing and is entitled to repayment priority in Chapter 13. In addition, nearly 400,000 women heads-of-households filed for bankruptcy to stabilize their economic conditions. Many dealt with debts incurred during marriage, including debts their ex-husbands had been ordered to pay but for which the wives remained legally responsible when their ex-husbands did not pay. Without bankruptcy, these women would have been forced to choose between spending their now-reduced family incomes on rent, groceries and utilities or on past-due credit card bills.

Older Americans About 280,000 Americans aged 50 and older filed for bankruptcy during 1997.⁷ Older Americans are more vulnerable to the consequences of a job loss; someone pushed out of a job at age 54 has a very hard time coming back economically. Medical coverage is limited just as their medical needs increase. Among Americans older than 65,

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H.R. 3150 "The Bankruptcy Reform Act"

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about a third explained that medical bills not covered by medicare had pushed them to economic collapse. Altogether, more than two-thirds of older Americans attributed their financial problems to uninsured medical bills and job losses.

Hispanic American and African American Homeowners About 650,000 homeowners filed for bankruptcy last year trying to save their homes.⁸ For *all* homeowners, bankruptcy gave them a chance to stabilize economically and focus their incomes on paying their mortgages to save their homes. The economic struggle for Hispanic American and African American homeowners is harder than for any other group. While 68% of whites own their own homes, only 44% of African Americans and Hispanic Americans own their homes. Both African American and Hispanic American families are likely to commit a larger fraction of their take-home pay for their mortgages, and their homes represent virtually all their family wealth. It is no surprise, then, that African American and Hispanic American homeowners are *six hundred percent* more likely to seek bankruptcy protection when a period of unemployment or uninsured medical loss puts them at risk for losing their homes.

Problematic Provisions of H.R. 3150

By hastily amending the nation's complex bankruptcy laws, H.R. 3150, if enacted, would significantly reduce protections for vulnerable working families, women and children.

- 1) The proposed legislation is designed to put more money into the hands of credit card issuers and other large institutional credit lenders at the expense of the financially troubled families who file for bankruptcy and of other creditors, such as child support recipients, who collect from those debtors. Virtually every one of the more than 70 consumer provisions in the bills is designed to increase collection by creditors and the leverage creditors have over average consumers.
- 2) The proposed legislation will force more people out of the middle class. More families will lose their homes and their cars. More families will never be able to discharge high interest credit card debt no matter how long they pay. More families will be driven into the underground economy to provide for their families.
- 3) Access to the courts will be lowered for families with few resources while the courts remain open to those with substantial assets. By significantly increasing the complexity of the bankruptcy system and leaving open a few loopholes that only the very wealthy can use, the proposed legislation will make the bankruptcy system subject to abuse by a few affluent debtors while it denies relief to the vast majority of financially distressed families who need it.

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Conclusion

The families in bankruptcy are the backbone of the American middle class — working people struggling to hang on to the lives they have worked so hard to create. For more than a century, we have had a balanced bankruptcy system designed to help families back on their feet while treating all their creditors fairly. The free market has adjusted interest rates to reflect risks, and the federal government has stayed out of the collection business. The proposed bankruptcy legislation would structurally alter the bankruptcy system, imposing hardships that would fall hardest on the most vulnerable among us. We urge you to oppose its adoption.

Thank you for your consideration of our views.

Sincerely,

A handwritten signature in black ink, appearing to read "W. Henderson", with a long horizontal flourish extending to the right.

Wade Henderson
Executive Director

END NOTES

1. Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate*, Bank Trends 98-05 (Division of Insurance, FDIC February 1998); Lawrence Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 Am. Bankr. L.J. 249 (1997); Statement of Kim Kowalewski, Chief, Financial and General Macroeconomic Analysis Unit, Congressional Budget Office, before the Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, United States Senate, p. 4 (April 1997); Jagdeep S. Bhandari & Lawrence Weiss, *The Increasing Bankruptcy Filing Rate: A Historical Analysis*, National Conference of Bankruptcy Judges (Winter 1993).

2. E.g., Ellis, *Consumer Interest Rate Deregulation*, *supra* note 1, at 5 ("Unfettered by any legal limitation on the income they could earn, lenders began to increase the depth of the market by looking for customers further down the spectrum of credit quality").

3. E.g., Ellis, *Consumer Interest Rate Deregulation*, *supra* note 1, at 5-6 ("The dismantling of usury laws opened wide the doors to new markets for credit card lenders. . . [W]hen interest rates were deregulated, less credit rationing occurred and higher-risk borrowers were allowed into the market. . . . [I]nterest rate deregulation altered the credit markets and led to a substantial expansion in credit availability, which has led to an increase in the level of borrower credit problems, including personal bankruptcy.").

4. Federal Reserve Board, *The Profitability of Credit Card Operations of Depository Institutions* (August 1997); Ausubel, *Credit Card Profits*, *supra* note 1.

5. August, Fair, Isaac & Co. Released a new bankruptcy predictor that it says can eliminate 54% of bankruptcy losses by eliminating potential nonpayers from the bottom 10% of credit card holders. *Credit Cards: Fight for Bankruptcy Law Reform Masks Truth*, 162 Am. Banker 30 (September 8, 1997).

6. The reported data are from Health and Human Services (support data) and Teresa A. Sullivan, Elizabeth Warren, Jay Lawrence Westbrook, *Bankruptcy and the Family*, 21 Marriage and Family Review 193 (Haworth Press 1995).

7. Teresa Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, *From Golden Years to Bankrupt Years*, NORTON BANKRUPTCY LAW ADVISER 1 (forthcoming July 1998). Teresa Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, *Baby Boomers and the Bankruptcy Boom*, NORTON BANKRUPTCY LAW ADVISER 1 (April 1993).

8. Teresa Sullivan, Elizabeth Warren, and Jay Westbrook, *The Fragile Middle Class: Americans in Financial Crisis* (forthcoming Yale University Press 1999); Teresa Sullivan, Elizabeth Warren, and Jay Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* 128-144 (Oxford University Press 1989).

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DEBORAH R. AKERS

PRACTICE LIMITED TO
DOMESTIC RELATIONS LAW

June 10, 1998

Senator Christopher J. Dodd
Subcommittee on Children and Families
Committee on Labor and Human Resources
444 Russell Senate Building
Washington D.C. 20510

Re: H.R. 3150 and S. 1301

Dear Senator Dodd:

As past chair of the Family Law Section of The American Bar Association, I have had a great interest in the pending bills concerning bankruptcy "reform" now pending in the House and in the Senate. I enclose a copy of my formal statement dated May 13, 1998 which I believe was made a part of the record of the House Judiciary Committee hearings on H.R. 3150 by Representative Jackson-Lee of Texas. While I cannot speak officially on behalf of The American Bar Association, I am aware that at my request the governing council of the Family Law Section recently voted unanimously to seek approval of The American Bar Association Board of Governors for blanket authority to oppose H.R. 3150 and S. 1301.

I have recently reviewed a copy of a letter dated June 4, 1998 supporting H.R. 3150 purportedly written on behalf of the California Family Support Council to Representative Gekas, the principal sponsor of H.R. 3150. What is immediately striking about the content of the letter is that it's tone, syntax, and language are virtually identical to other writings I have reviewed which were written by credit card industry proponents of these bills.

The pending bills in their present form obviously have been bought, paid for and written by the credit card industry and it's lap-dog campaign finance beneficiaries in Congress to suit the agenda of the banking industry to the eventual detriment of well-meaning people who need to rely upon the bankruptcy laws of this nation. Men and women of good will who sometimes unfortunately go through a divorce and also find themselves before the bankruptcy courts of this nation need the protection of the bankruptcy laws to permit them to collect and pay past due alimony and child support obligations following a bankruptcy. The letter from the California Family Support

Senator Christopher J. Dodd
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Council ignores this principle and is simply more of the same irrelevancies and inaccuracies that previously have been submitted as testimonials for these big business bills.

The correspondence from the California Family Support Council limits it's laudatory comments to that which will occur during a bankruptcy proceeding, thereby completely ignoring the disastrous consequences that the bills' provisions would have after a discharge in bankruptcy or the approval of a payment plan under Chapter 13. Similarly, the fact that "plans could not be confirmed or discharges granted unless all post petition support payments were made..." is highly illusory and fails to meet the objections set forth earlier by me in the attached statement. The evil is not that alimony and child support arrearages will not be paid at all, the evil is that women and children who need the money for their basic sustenance today will have less funds available to them immediately. They will be left to fight for scraps left behind by the professional collectors-credit card companies-therby receiving the past due alimony and child support needed for daily expenses over a long period of time into the future (and without the benefit of the interest rates charged by the professional creditors on unpaid balances).

It is true that Congress provides many tools to give the collection of alimony and child support an impetus. However, these various tools outlined by the California Family Support Council have absolutely nothing to do with the current debate or the bankruptcy laws. To include them in a discussion of pending bankruptcy bills is to muddy the water of the debate with irrelevancies. Moreover, if H.R. 3150 is passed in it's present form, these other tools previously provided by Congress will be diluted.

The California Family Support Council is far more limited in it's scope and interest than others who deal with the collection of alimony and child support. The Council is primarily interested in the state's recoupment of welfare funds from deadbeat dads whose families are being supported with state funds. Their statement to Representative Gekas that his "...proposed amendments would make the effect of bankruptcy on a child support creditor negligible" would be humorous if it weren't so incredibly and patently mean spirited and wrong! Those who deal with individual's interests as opposed to the state's interests in recovering welfare funds do not share the views of the group of district attorneys referred to as The California Family Support Council.

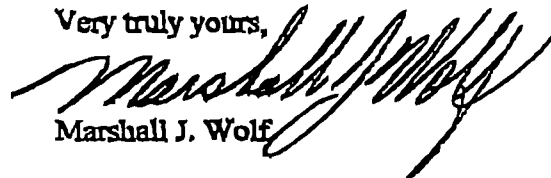
The California district attorneys acknowledge that there is opposition to H.R. 3150 because of the effect non-dischargeability of credit card debt would have on alimony and child support collection. However, they naively excuse the effects of H.R. 3150 by stating that child support collection is in competition with credit card companies now. What the Council either ignores or intentionally refuses to consider is that the "competition" that they see now occurring will be exaggerated and prolonged if H.R. 3150 is adopted. Currently the "competition" referred to by

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the California group between alimony and child support creditors and credit card companies ends if the payor can discharge his credit card debt in bankruptcy. Without discharged creditors to compete with, more disposable funds are attachable by the alimony and child support creditor because the "competition" for these dollars has ended. By eliminating the dischargeability of some credit card debt, H.R. 3150 prolongs the "competition." This fact is lost on the California district attorneys group.

As public policy, the comments of The California Family Support Council and the bill that they support is bad policy, injurious to people and beneficial only to big banking. As a legal argument, the comments of the Council are unpersuasive and badly reasoned. The district attorneys in California and the support recipients they serve would be better served if the Council would address California's woeful lack of compliance with federally mandated collection standards.

Very truly yours,



Marshall J. Wolf

MJW/jp

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PREPARED STATEMENT OF MARSHALL J. WOLF

REGARDING H.R. 3150 AND S. 1301

MAY 13, 1998

Marshall J. Wolf is an attorney in the Cleveland, Ohio law firm of Wolf and Akers, whose practice is limited to family law. Mr. Wolf is a past chair of the Family Law Section of The American Bar Association, a Fellow of the American and International Academies of Matrimonial Lawyers and, in 1993 served as the Chief United States delegate and keynoter to the First World Congress on Family Law and Rights of Children in Sydney, Australia. He is a frequent writer and lecturer on matters of family law throughout the United States and is regularly listed in various publications of outstanding lawyers in the field of family law.

Ladies and Gentlemen:

My name is Marshall J. Wolf. I am an attorney in Cleveland, Ohio and practice exclusively in the area of family law. For thirty years I have seen first hand the emotional and economic strains that members of our society and their children experience following a divorce.

Although I appear here today solely as an individual and not in any official capacity on behalf of any group, I am past chair of the Family Law Section of The American Bar Association, a Fellow of the American and International Academies of Matrimonial Lawyers and, in 1993, served as the Chief United States delegate and keynote speaker at the First World Congress on Family Law and Rights of Children in Sydney, Australia.

I appear here today to voice the objections I share with my colleagues in family law to those portions of H.R. 3150 and S. 1301 that seek to amend the bankruptcy laws so that a portion of credit card debts become nondischargeable in Chapter 7 bankruptcy proceedings. These bills further seek to amend the bankruptcy laws so that debtors in Chapter 13 proceedings are required to pay all unsecured debt in pro rata installments with nondischargeable debts - specifically including child support and alimony.

My colleagues in family law including, unanimously, the governing counsel of the Family Law Section of The American Bar Association who are currently seeking endorsement of its position by the entire Bar Association object to those portions of H.R. 3150 and S. 1301 for these reasons:

1. Portions of these bills will have disproportionate and unfair effect on single parents and divorce recipients of child support and alimony by reducing the ability of such recipients to receive child support or alimony following a discharge in bankruptcy of the support payor. If credit card debt is added to the current list of items that are now not dischargeable

(alimony and child support, taxes and educational loans), after a bankruptcy of a support payor, the alimony and child support recipient will be forced to compete with the well organized, well financed, and obscenely profitable credit card companies to receive payments from the limited income of the poor guy who just went through a bankruptcy. It is not a fair fight and it is one that women and children who rely on support will lose!

2. The proposed amendments to the bankruptcy code contained in these bills will make it more difficult for the support payors to provide for family members in need of such support. It is not true that all support payors refuse or don't want to pay their court ordered support obligations. If, however, aggressive credit card collection procedures are allowed to continue even after a bankruptcy, the well meaning support payors will be stymied in their attempts to clear their debts, start over and be able to honor their family support obligations, as they desire to do.

3. Recipients of alimony and child support who go bankrupt will still have outstanding credit card obligations following a bankruptcy if the pending bills are enacted in present form. The result will be that, after a bankruptcy, the support recipient will be forced to use funds received as support, not for current or future support, but for payment of past due credit card debt not permitted to be discharged in bankruptcy.

4. The proposed language of H.R. 3150 and S. 1301 will further encourage the reckless extension of credit by, and the unnecessary protection of the extraordinarily profitable credit card industry. Because one of the leading causes of divorce in our society is the stress and strife created by financial pressures upon the family, there can be no reasonable dispute that if family members are prevented from discharging credit card debt in appropriate circumstances, the financial stress upon a family will cause a significant rise in divorce in our society.

Men, women and children whose lives are in upheaval following a divorce will not benefit from this proposed legislation. They will suffer! These men, women and children cannot expend the vast sums that have been expended by the credit card banking industry on lobbying efforts in support of these bills. Rather, these men, women and children must rely on the social responsibility of their legislators to consider these issues based upon what benefits people (people who vote), not banks.

On behalf of those who cannot speak for themselves and on behalf of my colleagues whose profession it is to speak for them, I urge you to oppose the portions of H.R. 3150 and S. 1301 to which I have referred.



CONGRESSIONAL BUDGET OFFICE
PRIVATE-SECTOR MANDATES STATEMENT

June 10, 1998

H.R. 3150

Bankruptcy Reform Act of 1998

*As Reported by the House Committee on the Judiciary
on May 18, 1998*

ARMSTRONG & ASSOCIATES
10310 Main St Ste 202
Fairfax, VA 22030
703 273 8185 / 703 802 0207 Fax

SUMMARY

H.R. 3150 would make many changes and additions to the federal bankruptcy laws. By amending the bankruptcy code, the bill would affect consumer debtors, business debtors, secured and unsecured creditors, bankruptcy trustees, attorneys, debt relief counselors, and other entities in the private sector. Certain provisions in H.R. 3150 that incorporate means-testing in the bankruptcy system would impose new private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA) with costs that exceed the statutory threshold (\$100 million in 1996, adjusted annually for inflation). Specifically, new enforceable duties would be imposed on private trustees who administer bankruptcy cases, attorneys, debt relief counselors, and utilities, as defined in the bill. H.R. 3150 would also impose additional duties on parties who file for relief under the bankruptcy system, although new requirements for bankruptcy filers would not be considered new mandates for purposes of UMRA. Furthermore, H.R. 3150 contains provisions that could impose costs on certain categories of creditors who receive distributions from bankruptcy estates by delaying payments to creditors and by raising administrative costs. Increased administrative costs would reduce the pool of funds available for creditors.

PRIVATE-SECTOR MANDATES AND EFFECTS

H.R. 3150 would establish a system of means-testing provisions for determining the eligibility of consumers for relief under the bankruptcy system. Participants in consumer bankruptcy proceedings would be most affected by the bill. Under current law, most individual debtors who seek bankruptcy relief have two options: liquidation (Chapter 7) or reorganization (Chapter 13). H.R. 3150 would institute a "needs-based system" for relief

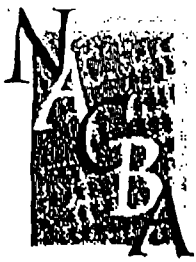
under Chapter 7 by requiring individuals (and households) who file for bankruptcy to seek debt relief under Chapter 13 if they earn a regular income equal to or greater than the national median income (adjusted for household size) and could pay at least 20 percent of their unsecured debts and \$50 per month. In addition, H.R. 3150 would amend other provisions in federal bankruptcy law, including those covering family farmers and municipalities, collection of bankruptcy data, single-asset real estate debtors, the treatment of certain taxes, and cross-border bankruptcy cases.

CBO estimates that the direct costs to the private sector of complying with mandates in H.R. 3150 would exceed the statutory threshold in UMRA in each of the first five years that new mandates were effective. The lion's share of costs would be imposed on private trustees who administer bankruptcy estates, providers of debt relief counseling services, and attorneys. Most mandate costs would stem from new requirements to investigate and verify financial information provided by bankruptcy filers. Costs would be imposed on debt relief counselors by enacting new consumer protection regulations. Some estimates of increased costs for attorneys and private trustees in Chapter 7 filings have been several hundred dollars per case, and estimates for Chapter 13 filings have ranged from several hundred dollars to over \$1,000 per case per year. More than 1.3 million bankruptcy filings occurred in 1997. Because reliable national data on the costs of the bankruptcy system are lacking, CBO does not have sufficient information to place a reasonable upper bound on its estimate.

CBO's estimate excludes: financial transfers between debtors and creditors that would result from enacting H.R. 3150; costs that could result from delaying distributions from bankruptcy estates to certain creditors; and potential reductions in debtor repayments if the costs of administration for the bankruptcy system rise by more than payments by debtors.

Attorneys and trustees in Chapter 13 cases would be able to recoup most mandate costs. Administrative costs in Chapter 13 cases, which include attorneys' and trustees' costs, receive priority treatment in Chapter 13 cases and, therefore, those costs would likely be offset by increased payments from bankruptcy estates. Mandate costs for Chapter 7 trustees, however, would reduce trustee income because provisions are lacking for reimbursement for increased trustee costs from Chapter 7 debtor estates.

To the extent that the bill would delay payments from liquidated or reorganized bankruptcy estates, the bill could impose costs on certain creditors. However, by increasing the number of debtors who are required to file under Chapter 13, the bill would likely increase the pool of funds available to creditors, which would benefit creditors. Again, offsetting a portion of the benefits to creditors would be the higher costs of administering a bankruptcy system that uses means-testing. As a result, some creditors could ultimately receive smaller distributions.



5/22/98

WHY THE CHILD SUPPORT AMENDMENTS WHICH PURPORT TO "FIX" H.R. 3150 WON'T WORK

THE PROBLEM:

As pointed out by President Clinton, the First Lady, numerous organizations, and academics, H.R. 3150 would seriously reduce the ability of custodial parents to collect child support from bankrupt supporting parents. Contrary to the claims of Chairman Gekas, and Congressmen McCollum, Boucher and Moran, the amendments made to the bill in the House Judiciary Committee do not fix this problem.

H.R. 3150 would cause this harmful result in the following ways:

(1) The far fewer debtors who would be eligible for bankruptcy relief would receive much less debt relief under H.R. 3150 than under current law. A substantial portion of credit card debt incurred by debtors in good faith would not be discharged in bankruptcy under new rules imposed by H.R. 3150. Additionally, in Chapter 7 cases debtors would be required to assume unsecured debt post-bankruptcy in order to keep cars necessary to get to work or keep necessary home furnishings. By making more non-support debt survive bankruptcy, the bankrupt debtor would be subject to the continued effective harassment and wage garnishment of creditors holding newly nondischargeable claims against the debtor and competing with the custodial parent needing support, for the limited funds of the bankrupt debtor.

(2) Regarding Chapter 13 relief, by placing an emphasis on repaying unsecured credit card debt, H.R. 3150 would require all of a Chapter 13 debtor's "monthly net income" to be paid on those unsecured debts. While the calculation of "monthly net income" accounts for the repayment of priority debt including child support, H.R. 3150 stretches out the repayment of priority debt over the entire length of the plan, rather than paying it early in the plan. Under current law, payments are targeted first to secured and priority claims, and priority claims are usually fully paid before any of the debtor's limited funds are paid on unsecured (credit card) claims.

(3) Finally, by imposing an extremely harsh "means-test" H.R. 3150 would make substantial numbers of debtors ineligible for Chapter 7 relief. Under current bankruptcy law, a Chapter 7 debtor is able to pay all of his/her post-bankruptcy disposable income to the custodial parent for child support. If the supporting parent is unable to obtain Chapter 7 relief, he/she will continue to be burdened by unresolved other debt and will often be unable to pay the needed support.

AMENDMENTS TO H.R. 3150 WHICH PURPORT TO "FIX" THIS PROBLEM:

In response to criticisms of H.R. 3150, the following amendments have been passed with the claim of having corrected this problem:

(1) Congressman Boucher's Amendment [Sec. 102]

This amendment leaves intact the requirement that all the debtor's "monthly net income" be paid to unsecured claims such as credit card debt. The amendment purports to fix the problem by allowing the payment of child support obligations at "times provided for in the plan ... [which shall] specify how payments to other creditors ... will be accordingly adjusted".

This amendment fails to correct the problem of making more non-support debt survive bankruptcy and compete for collection from the debtor's post-bankruptcy income. It also fails to correct the problem of making fewer bankrupt debtors eligible for Chapter 7 relief and therefore more financially able to pay child support.

The actual meaning of this amendment is not at all clear. Plan payments are always supposed to be made at the times provided for by the plan. And, since the flawed payment formula was not removed from the bill, other creditors could still argue that it has to be followed, especially since the House Judiciary Committee rejected amendments to change the formula to ensure that support debts would be paid first. It would be completely consistent with this amendment for a Chapter 13 plan to follow the flawed payment formula and make payments at the times provided in the plan.

Even if the amendment would allow the plan to adjust the timing but not the amount of payments to unsecured creditors, this amendment would not solve the child support problem. As a practical matter, even if the debtor would propose to only adjust the timing of payments to unsecured creditors, the banks would have the financial resources and incentive to oppose confirmation of such a plan. On the other hand, the custodial parent would be unlikely to have the resources needed to pay for legal representation to propose such a plan provision. Therefore, this provision is legally cumbersome, completely ineffective as a solution in the Chapter 7 context, and expensive to litigate for both the debtor and the custodial parent. There is no justification for changing the existing law requiring payment of priority claims such as child support ahead of payments to unsecured creditors.

(2) Chairman Hyde's Amendment [Sec. 141]

This amendment does not attempt to fix the child support problem, but has the effect of making it worse. The amendment adds a priority, at a level which is lower than that of child support, for a new type of nondischargeable debt. The classification of a nondischargeable debt at a lower priority than child support still creates an additional obligation which the debtor must be able to pay in full through the Chapter 13 plan. This additional debt burden in many cases will make the Chapter 13 plan infeasible from the beginning, or may later detrimentally affect the debtor's ability to successfully complete the plan. So, rather than improving the ability of the bankrupt debtor to pay the custodial parent, this provision worsens the debtor's repayment ability. Legal costs of determining whether other debts would be dischargeable under this section are likely to be substantial and would result in fewer dollars being available for payment of the support claim.

(3) Congressman Boucher's Amendment [Sec. 144]

This amendment appears to continue the current stay of collection proceedings against non-bankrupt codebtors which is applicable in Chapter 13 plans if the Chapter 13 debtor is obligated to pay the creditor pursuant to a divorce decree. The amendment would eliminate the codebtor stay for most other debts, including car loans where the bankrupt parent is voluntarily paying for the supported parent under commonly used but less formal arrangements. The amendment does nothing to fix the child support problem caused by the bill.

(4) Congressman Boucher's Amendment [Sec. 150]

This amendment would make federal bankruptcy law override state debt collection laws after bankruptcy, and on that basis is constitutionally questionable.

The amendment intends to make certain debts which survive bankruptcy subject to the collection of court-ordered support. In reality, this amendment is likely to have little practical value for the custodial parent. Enforcement of bankruptcy nondischargeability judgments may be through the U.S. Marshal's office, which would have no knowledge of conflicting child support obligations. Or, if the nondischargeability judgment is enforced through state collection procedures, it is extremely improbable that those collection procedures would be capable of tracking information about competing child support demands. In many states, the same state court does not have jurisdiction over both support and non-support debt collection, or family court proceedings are confidential and unavailable for other courts to review. Another complication would arise if the support order was issued in another state if the debtor has relocated.

More importantly, most nondischargeable debts are not collected through court action. Credit card debts are most frequently handled by collection agents who harass the debtor with calls and letters. Is the collection agent likely to ask the debtor whether paying its debt would impair the debtor's ability to pay child support? And, if the debtor's answer is "yes", would the collection agency stop harassing the debtor and allow him/her to pay the support? Probably not. It is much more likely that a debtor will pay a well-funded judgment creditor to stop or prevent creditor harassment, and will then be unable to afford to pay even the current monthly child support, much less past-due support.

(5) Chairman Gekas' Amendment [Sec. 502]

This amendment would appear to create a federal lien on the debtor's otherwise exempt property for child support and most income tax debts, overriding even state homestead exemption statutes. This amendment does not improve the ability of bankrupt debtors to pay support to custodial parents, but subjects the property of the debtor to competing claims by tax agencies. The amendment would also override state tenancy by the entirety property laws and for the first time jeopardize a separated spouse's interest in such property as to tax claims that are solely against the bankrupt spouse.

ILLUSTRATION OF THE EFFECTS OF H.R. 3150, AS AMENDED:

John Smith is divorced and, due to two periods of unemployment within the last two years, has fallen behind on his income taxes, child support, and credit card debt (some of which he incurred for living expenses while he was unemployed). He is on good terms with his ex-wife, Mary, and wants to catch up on his child support as soon as possible. In consultation with his attorney he determines that under the new law he will need to file Chapter 13.

John's Income & Expenses

Annual gross income	\$36,000
Monthly gross	3,000
Withholding taxes	-650
Net monthly income	2,350

Living Expenses per IRS Guidelines:

Housing, utilities, taxes, repairs	875
Car maintenance, gas, insurance	300
Food, clothing, laundry, etc.	537
Continuing child support	400
Total living expenses	2,112

Amortized tax payment*	-50
Amortized support payment**	-34

Monthly net income 154 would be paid to unsecured (credit card) debt
(per H.R. 3150: $\$2,350 - 2,112 - 50 - 34 = 154$)

Total Chapter 13 payment \$238 (50 + 34 + 154)

John's Debts

Priority taxes	\$3,000
Priority child support	2,000
Unsecured credit card	30,000
Total debt	35,000

Amortized monthly payments

* Taxes: $\$3,000 / 60 \text{ mos} = 50/\text{mo}$
** Support: $2,000 / 60 \text{ mos} = 34/\text{mo}$

John's income (\$36,000) exceeds the national median "one-earner household income" applicable under H.R. 3150, which is \$27,895. Because John's income exceeds this amount, he will be required to perform a 5-year Chapter 13 plan rather than a 3-year plan. [An apparent error in the bill would actually apply this test at 75% of that median income, or \$20,921.]

Prior to the mark-up of H.R. 3150 at the full Judiciary Committee, under H.R. 3150 John would have had to propose the above Chapter 13 plan with payments of \$238 per month. From that payment, John's ex-wife, Mary, would only receive \$34 per month for the past-due support, as compared with the credit card companies which would receive \$154 per month. John would also have to pay his attorney to litigate the dischargeability of the credit card debt, some of which he accrued while he was unemployed and which, at that time, he did not have a "reasonable ability to repay".

Even if Congressman Boucher's amendment would allow John to propose a plan with a different distribution of payments, the approval or disapproval of the proposed distribution scheme would be up to the bankruptcy judge. Consequently, such a plan provision would

likely be the subject of heated litigation. If John proposed to initially pay Mary \$150 per month instead of \$34, the unsecured credit card banks would likely oppose that as being unfair to them. John would have to pay his attorney to litigate the contested proposed plan, and Mary would be well advised to retain her own attorney to support the plan proposed by John. Neither John nor Mary would have the financial resources which are available to the banks to fund the contentious litigation which could result. Because of their limited funds, John and Mary would likely have to give in in both proceedings, perhaps with John agreeing to treat the credit card as a priority claim and threatening the feasibility of any Chapter 13 plan for him. Alternatively, the money that John would have paid to Mary for support would be spent funding the litigation in the bankruptcy court.

Maureen Thompson, NACBA Liaison 703-276-1116 x 2

Norma Hammes, President, NACBA 408-297-8750

**A CHAPTER THIRTEEN TRUSTEE'S
PROBLEM POINTS WITH
H.R. 3150**

1. The use of an arbitrary template for the purposes of defining debtor eligibility by means of the National Median Family Income is unworkable. There is no "policeman" to enforce the threshold test nor is there an effective means to compensate the objecting party. While it is true that the creditors can seek to enforce the eligibility test, to do so would require attorney involvement and increased transactional costs.
2. Many debtors with income greater than the median national family income will seek to invoke the "exception" imposed by the use of the IRS template. To challenge the effort to deviate from the template, a creditor will be forced to employ counsel, increasing transactional costs. No other party has the resources or the inclination to enforce the IRS template.
3. The use of the IRS template - conferring upon the Internal Revenue Service the opportunity to establish the living standards of debtors in bankruptcy - debtors against whom the IRS may well hold a claim - without the protections of administrative procedure for the promulgation of those standards. There is no judicial review of the validity of the standards unless a debtor seeks to invoke the "extraordinary standards" exception.
4. A chapter 7 trustee is obligated to "investigate and verify" the debtor's projected monthly net income and file a report with the court within 30 days. There is no indication as to how a trustee is to both investigate and verify the income. Given that both terms are used, it must be more than accepting the debtor's statement of income, payment advices, or tax returns. No means to compensate or reimburse for the cost of the investigation is present.
5. A chapter 13 trustee is obligated to "investigate and verify" a debtor's income on an annual basis and file annual reports with the court with copies to holders of claims (all scheduled creditors since no proofs of claim would be required anymore). Most chapter 13 trustees have estimated a time between 1.5 and 2.25 hours per debtor to investigate, verify, prepare a report, and mail the report. For my office this would involve an increase in staff by 34% and a corresponding increase in costs. These costs are borne, not by debtors, but by the creditors.
6. Chapter 13 plans would have to pay \$50 per month to unsecured creditors each month under the plan. This would have the effect of requiring the curing of mortgage defaults and child support defaults at the end of a 5 or 7 year plan. Although an amendment to Section 102 of the bill seems to permit a deviation as to child support arrearages it is unclear as to what the amendment means.
7. The bill requires a 5 year plan and permits a 7 year plan for a debtor whose income is greater than the median national family income. For a debtor that has income greater than the national median but has at the time an amendment is offered, income less than the median family income, the debtor would be compelled to cram what was confirmed as a 7 year plan into five years.
8. The bill encourages another ripoff of debtors seeking to work their way out of debt by institutionalizing a new predatory industry of consumer credit counseling that will be certified by the Justice Department. Debtors would be denied access to the bankruptcy courts unless they had availed themselves of the services of a certified consumer credit counselor. No standards for certification are put forward in the bill. Might one assume that an attorney that represents debtors on a regular basis could qualify as a consumer credit counselor?

9. While providing basic consumer debt and credit educational programs is a good thing and should be encouraged, there is no indication as to how chapter 7 educational programs would be funded.
10. A chapter 13 debtor may propose to dedicate 15% of his or her gross income to a charity, and the trustee and unsecured creditors would be precluded from challenging the reasonableness of the contribution. The statute would not require that the contribution actually be made nor that the debtor had made the contributions in the past. This will clearly lead to abuse.
11. A creditor with a lien on property would be allowed to retain that lien until the debtor obtains a discharge, even where the amount of the secured creditor's claim had been satisfied. This will principally involve automobiles. Where a debtor has satisfied the secured portion of the creditor's claim, how could the debtor "trade in" the vehicle prior to the discharge? Could the court permit the transfer (a sale with a lien worth \$0 attaching to the proceeds?) or would the creditor be entitled to hold the debtor hostage to have its unsecured component paid in full ahead of all other unsecured creditors?
12. Creating an artificial value in a chapter 13 case for PMSI property acquired within 180 days of filing of the petition would take funds away from the general unsecured creditors and violates the basic principle of bankruptcy - that distributions of available assets (including income) be made equitably amongst creditors in the same class. Chapter 13 plans would pay more than value to weed eaters and stereos and less to doctors, hospitals and credit cards.
13. Retail values instead of liquidation values for a debtor's property is another artificial value that takes available funds from one class of creditors for the benefit of other creditors. What the car creditors gain, the medical and general consumer credit claimants will lose. This violates the basic principal of bankruptcy that available funds be distributed equally amongst creditors of the same class.
14. Elevating debts to pay priority debts to priority themselves invites extraordinary litigation. If a debtor gets a cash advance - a year ago - and uses a portion of the proceeds to pay child support, the credit card debt becomes priority. How is a court or a trustee to know from an examination of the claim that the obligation is to be treated as priority? Similarly, if a debtor uses a cash advance from a bank to pay her regular tax installment to the IRS, the cash advance withdrawal would be nondischargeable. How is a trustee, a court or even the creditor to know whether the claim that they hold is nondischargeable? Creditors will need to engage in significant litigation over this one.
15. How can a debtor rebut the presumption of nondischargeability of recent credit extensions?
16. If the codebtor stay is sometimes applicable if the codebtor was to be protected by the debtor under a divorce decree, how will the creditor know that actions taken against the codebtor are permissible? How will the creditor know which codebtor got the benefit of the loan?
17. If a chapter 13 plan cannot be confirmed until the debtor has paid all amounts due for support between the time of filing and the time of confirmation, how can a court or a trustee verify the debtor's compliance with this obligation?
18. The death of chapter 13 funding is contained in section 162 of the bill. Requiring debtors to pay directly certain claims deprives the trustee of any funds to pay for the administration of the case especially during that time of the plan when the trustee incurs the greatest expense. The accounting for these direct payments will be virtually impossible without a status hearing before the court which will again require creditors to employ counsel, increasing again the transactional costs. If prompt payment of claims is desired, the process should be speeded up and not slowed down. If the creditors seek an interest in early payments, require debtor's attorney payments to be paid over time and not bunched up at the

front end of a plan. Give the creditors an interest in funds held by the trustee - but do not let debtor's make their own payments.

19. Why delay meetings of creditors? I thought that creditors did not want to wait for the distributions under a plan? (Section 401 should allow earlier meetings of creditors but permit a creditor to seek reconsideration of confirmation for a period of 30 days after confirmation).
20. The doomed filed rule in section 403 is insane. Debtors do not know of their debt balances. They do not have complete addresses (that's what the creditors have always stated). Without a written proof of claim, there is no protection from creditor fraud for "filing" a false claim. Trustees will be unable to verify the contracts upon which the claim is based. Trustees will be forced to "object" or contest claims asserted to be secured to verify the validity of liens and perfection of the security interest. This will again compel creditors to appear in court increasing transactional costs for the creditors.
21. Who will pay for 1/100 case audits that is made under generally accepted auditing standards. The cost may vary from \$500 to \$2000 per audit. Debtors will not be able to afford it. Will chapter 13 trustees be compelled to pay for the audits of chapter 13 debtors audited? Will there be an appropriation for the UST to pay for the audits?
22. Since tax returns would now become public record, how would the trustee obtain access to them? Where would the tax returns be stored? What is the consequence if the debtor does not have copies of his or her tax returns?
23. Will the IRS be obligated to provide a statement that a chapter 13 debtor has filed all tax returns prior to the meeting of creditors so that the trustee can be in compliance with proposed new 1308? Can a trustee rely upon the statement of the debtor that all tax returns have been filed?
24. Making 523(a)(1) debts nondischargeable works a painful hardship on debtors. While it is appropriate for obligations resulting from unfiled or fraudulent tax returns to be excepted from discharge, it is wrong to make all taxes under 523(a)(1) nondischargeable. This would mean that a debtor seeking to pay all past due taxes under chapter 13 would still owe the unpaid interest on the taxes that accrued during the chapter 13 case even if that debtor completed a 100% plan. Current law (and the law under the bill) precludes the payment of post petition interest on an unsecured claim, even a priority unsecured claim.
25. Making all 523 (a) (2),(4) and (6) claims nondischargeable in chapter 13 will require the filing of thousands of adversary actions contesting dischargeability in cases where the action might be irrelevant (as where the debtor does not consummate the plan or where the plan satisfies the claim in full). This will, of course, increase the transactional costs to debtors and creditors substantially.

Henry Hildebrand
Standing Chapter 13 Trustee, Nashville TN.
Chairman, National Assn. of Chapter 13 Trustees
615-259-9344
615-242-4214 fax

FOR IMMEDIATE RELEASE

Contact: Kenneth Klee (310) 825-7460
Randal Picker (773) 702-0864

**NATIONAL BANKRUPTCY CONFERENCE BLASTS
CREDIT INDUSTRY'S REFORM PROPOSALS AS MEAN SPIRITED**

Washington, D.C. — March 9, 1998 -- The National Bankruptcy Conference (NBC) today blasted the consumer-credit industry's "needs-based" bankruptcy proposals as "mean-spirited," offering in their place what the group termed "a more sensible package of reforms" aimed at limiting the number of consumers who improperly file for Chapter 7 bankruptcy. The group also criticized Congress for "rushing to judgment" on consumer bankruptcy reform for what it called political reasons.

The National Bankruptcy Conference is a voluntary organization of judges, academics, and practitioners dedicated since the 1930s to the fair operation of the bankruptcy system. The NBC does not make recommendations on behalf of any interest group, nor does it have any lobbyists.

In its Report on Consumer Bankruptcy Reform, the nonprofit, nonpartisan group said that bankruptcy abuse could be contained without radically restructuring the system. Instead, the NBC called for "a modest amendment of current bankruptcy law," which would, among other things, limit homestead exemptions, audit consumer cases, and restrict repeat filings.

The group also suggested that bankruptcy cases be dismissed when evidence reveals obvious bad faith, such as the likelihood of substantial future income that would allow a potential bankrupt to repay all his or her debts within a short time, or the existence of

excessive amounts of property protected under state law exemptions.

The NBC report takes sharp issue with the assumptions on which the consumer-credit industry has based its calls to limit debt relief for families making as little as \$21,000 a year. It notes that the possibility of debt relief has been a cornerstone of U.S. economic and social policy -- not to mention federal law -- for more than a century now, and to deny it to families of modest incomes that have mismanaged their affairs or been victimized by financial catastrophes, such as job lay-offs or medical emergencies, is bad public policy.

"Means testing is mean-spirited," said Kenneth Klee, UCLA Professor of Law, an author of the 1978 U.S. Bankruptcy Code and chairman of the legislative committee of the NBC. "It is not 'needs-based' bankruptcy."

Specifically, the report disputes the consumer-credit industry's contention that the recent significant rise in consumer bankruptcy filings -- to 1.35 million in 1997 -- is attributable to the ease of access to the bankruptcy system. Rather, says the NBC report, the problem is the ease of access to consumer credit. Changes in bankruptcy laws have little effect on filing rates, the report notes. What really seems to matter is the rise in consumer debt and the huge proliferation of credit cards.

The report also questions the consumer-credit industry's assertion that the current access to the bankruptcy system costs each American family \$400 a year. The problem, the report points out, is the result of consumers' inability to pay their obligations, not their access to the bankruptcy system. Thus, the vast majority of these debts would go unpaid whether or not consumers were able to file for bankruptcy.

In addition, the report rejects the consumer-credit industry's claim that a third of all families in bankruptcy are actually capable of paying at least 30 percent of their general

Congressional Budget Office.

Among other things, the NBC points out that these credit industry reports ignore two fundamental factors: (1) the fact that many consumers who file for bankruptcy today have exhausted all their other options -- meaning they probably would still file under a more restrictive system; and (2) the fact that two-thirds of all voluntary repayment plans currently fail -- meaning it is not realistic to expect the bankruptcy system to collect substantial sums from forced repayment plans.

The NBC said that it was unfair to "cram down" legislation in response to pressure from lobbyists and other groups.

"In 1978, the U.S. House of Representatives held 35 days of hearings, during which 2,700 pages of testimony were received from more than 100 witnesses," said Mr. Klee, who is also a member of the Los Angeles law firm of Stutman, Treister & Glatt. "The Senate held 21 days of hearings and received over 2,300 pages of testimony from more than 90 witnesses." In the current Congress, five days of hearings are planned in the House and two days in the Senate.

"This issue is too important to just push through," added Mr. Klee. "Congress should take ample time to deliberate on consumer bankruptcy reform. It is a complex area with far-reaching social ramifications."

###

March 31, 1998

PRESS RELEASE—FOR IMMEDIATE RELEASE

Law Professors Urge Congress To Slow Down On Bankruptcy Reform

Fifty-seven (57) law professors today delivered a letter to Congress calling the pace and deliberation of current bankruptcy reforms "ill-considered, rushed and unbalanced." These professors, who collectively have spent 875 of years teaching and writing about bankruptcy law, come from all across the country. They represent all political, academic and economic perspectives.

The professors do not advocate any position on any pending bill. Rather, they urge Congress to "to pause, to hold full hearings on the issues, and to seek out a balanced, reasoned approach" to reform of the nation's bankruptcy laws.

The professors are reacting to Congress' attempts to reform the nation's bankruptcy laws. In the last six months, legislators have introduced at least two bills (S. 1301 and H.R. 3150) which, the professors state, would bring about "dramatic and far-reaching changes" to the nation's bankruptcy laws. Despite the extraordinary scope of the proposed changes, Congress has held only five hearings on these bills. In contrast, when Congress last reformed the nation's bankruptcy law in 1978, it debated a number of approaches for more than five years, and held more than 60 hearings during that time.

Both bills are scheduled for mark-up sessions (the stage of legislation immediately preceding floor consideration) within the next several weeks, with S.1301 scheduled for mark-up by the Senate Judiciary Committee on April 2. The professors state that "the pace related to the examination of this legislation has been fast, and the study of its consequences superficial."

Aside from the tax code and the Social Security laws, no other federal law affects more Americans than the Bankruptcy Code. In this light, the professors ask Congress not to rush into ill-considered reform, but that it adopt a more deliberate consideration of all sides of the issues.

The letter was drafted by Bruce A. Markell of Indiana University School of Law-Bloomington, who coordinated the obtaining of the other law professors' signatures. The letter was delivered to every member of the House and Senate Judiciary Committees. The text of the letter can be obtained from Professor Bruce Markell (see below), or can be viewed on the Internet at: <http://www.law.indiana.edu/~bmarkell/slowdown.html>.

For Further Information, Contact:

Bruce A. Markell, Professor of Law
Indiana University School of Law-Bloomington
Office: (812) 855-2253
Fax: (812) 855-0555
Email: bmarkell@indiana.edu

March 31, 1998
Bruce A. Markell
Professor of Law
211 South Indiana Avenue
Bloomington, IN 47405
bmarkell@indiana.edu

To all members of the House and Senate Judiciary Committees:

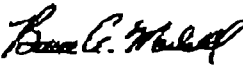
We are fifty-seven (57) academics who are deeply concerned about proposed legislation seeking to reform the federal bankruptcy law affecting consumers. We teach and study bankruptcy, and together have over 875 years of experience with bankruptcy matters. We come from different political, academic and economic perspectives, and from every region of this country.

We do not write to support or oppose any particular piece of legislation. Rather, we write to urge Congress to consider more carefully the pending reform proposals. If enacted, any of the current drafts of legislation would bring about dramatic and far-reaching changes. Yet the pace related to the examination of this legislation has been fast, and the study of its consequences superficial. In less than a year, at least three bills proposing radical changes to the consumer provisions of the bankruptcy code are on the verge of floor consideration by both houses of Congress. Combined, there have been fewer than five hearings on all bills. In contrast, the 1978 revision of the federal bankruptcy law consumed more than five years, and over 60 days of hearings in both houses.

We are also concerned about the quality of information presented at the few hearings which have been held. The studies that have been the driving force behind many proposed reforms appear to have been inadequate, and to have emphasized the interests of institutional creditors. To date, virtually no one has spoken for those Americans who have declared bankruptcy or who may one day be forced into that position.

Aside from the tax code and the Social Security laws, no other federal law affects more Americans. Most individuals who file bankruptcy are average, middle class Americans. Focusing on one interest -- that of creditors (and in particular creditors who hold credit card debt) -- tends to mute the voices of the millions of other Americans affected by bankruptcy law. This imbalance affects more than debtors; when debt institutions hold the stage and suggest the changes, non-institutional creditors -- such as former spouses with support claims -- stand to lose.

In conclusion, we believe that the current debate is ill-considered, rushed and unbalanced. Before undertaking changes affecting all Americans whose lives are touched by bankruptcy, we urge you to pause, to hold full hearings on the issues, and to seek out a balanced, reasoned approach.



Professor of Law

The following law professors have read this letter and join me in signing it. Their institutions have been given for identification purposes only.

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Terry M. Anderson	Professor of Law	Craigton University-School of Law	Omaha, NE	26

(Signatures Continued . . .)

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Christine M. Arguello	Associate Professor	The University of Kansas School of Law	Lawrence, KS	7
Allan Axelrod	Brennan Professor of Law (Emeritus)	Rutgers, The State University of New Jersey School of Law -- Newark	Newark, NJ	38
Douglas G. Baird	Harry A. Bigelow Distinguished Service Professor and Dean	The University of Chicago-The Law School	Chicago, IL	15
Cynthia A. Baker	Assistant Professor of Law	Emory University-School of Law	Atlanta, GA	6
Patrick B. Bauer	Professor of Law	University of Iowa-College of Law	Iowa City, IA	19
Susan Block-Lieb	Professor of Law	Ston Hall University-School of Law	Newark, NJ	8
Douglas G. Boshkoff	Robert H. McKinney Professor Emeritus	Indiana University -- Bloomington-School of Law	Bloomington, IN	39
William E. Boyd	Professor of Law	The University of Arizona College of Law	Tucson, AZ	20
Jean Braucher	Visiting Professor of Law	Cornell Law School	Ithaca, NY	12
Ralph Brubaker	Assistant Professor of Law	Emory University-School of Law	Atlanta, GA	3
Mark E. Budnitz	Professor of Law	Georgia State University-College of Law	Atlanta, GA	15

Letter to House and Senate Judiciary Committees

March 31, 1998

Page 3

(Signatures Continued . . .)

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Daniel J. Bustel	Professor of Law	University of California at Los Angeles-School of Law	Los Angeles, CA	6
Marianne Culhane	Professor of Law	Craigton University-School of Law	Omaha, NE	17
Paulette J. Delk	Associate Professor	The University of Memphis-Cecil C. Humphreys School of Law	Memphis, TN	10
A. Michele Dickerson	Assistant Professor of Law	The College of William & Mary-Marshall-Wythe School of Law	Williamsburg, VA	3
Scott B. Ehrlich	Associate Dean & Professor of Law	California Western School of Law	San Diego, CA	18
Thomas L. Eovaldi	Professor of Law	Northwestern University School of Law	Chicago, IL	30
Jeffrey T. Fectell	Professor of Law	Capital University Law School	Columbus, OH	20
Martin A. Frey	Professor	The University of Tulsa-College of Law	Tulsa, IL	25
Dale Beck Furnish	Professor of Law	Arizona State University-College of Law	Tempe, AZ	25
Nicholas L. Georgakopoulos	Associate Professor of Law	The University of Connecticut School of Law	Hartford, CT	5
S. Elizabeth Gibson	Burton Craige Professor of Law	The University of North Carolina at Chapel Hill-School of Law	Chapel Hill, NC	15
Kathryn R. Heidt	Professor of Law	University of Pittsburgh-School of Law	Pittsburgh, PA	13
Richard A. Hesse	Professor of Law	Franklin Pierce Law Center	Concord, NH	10

(Signatures Continued...)

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Ingrid M. Hillinger	Associate Professor of Law	Boston College Law School	Newton, MA	13
Margaret Howard	Visiting Professor of Law	Duke University-School of Law	Durham, NC	17
Sarah Jane Hughes	University Scholar and Fellow in Commercial Law	Indiana University -- Bloomington-School of Law	Bloomington, IN	10
Lawrence P. King	Charles Schigron Professor of Law	New York University-School of Law	New York, NY	39
Kenneth N. Klee	Acting Professor of Law	University of California at Los Angeles-School of Law	Los Angeles, CA	19
John W. Larson	Associate Professor	The Florida State University-College of Law	Tallahassee, FL	25
Robert M. Lawless	Associate Professor of Law	University of Missouri-Columbia-School of Law	Columbia, MO	5
Robert W. Lloyd	Professor of Law	The University of Tennessee College of Law	Knoxville, TN	14
Lynn M. LoPucki	A. Robert Noll Professor of Law	Cornell Law School	Ithaca, NY	18
Ronald J. Mann	Associate Professor of Law	University of Michigan-Law School	Ann Arbor, MI	4
Judith L. Maute	Visiting Professor of Law, Professor of Law	University of Cincinnati; University of Oklahoma	Cincinnati, OH; Norman, OK	10
Richard E. Mendales	Professor of Law	University of Miami-School of Law	Coral Gables, FL	10

(Signatures Continued . . .)

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Gary Neustadter	Professor of Law	Santa Clara University-School of Law	Santa Clara, CA	22 f
Randal C. Picker	Paul and Theo Leffmann Professor of Commercial Law	The University of Chicago Law School	Chicago, IL	9
Lawrence Ponoroff	Professor of Law	Tulane University- School of Law	New Orleans, LA	12
Nancy B. Rapaport	Associate Professor of Law & Associate Dean for Student Affairs	The Ohio State University-College of Law	Columbus, OH	7
Doug Rendleman	Huntley Professor	Washington & Lee University-Law School	Lexington, VA	10
Stephen L. Sepinuck	Associate Dean for Academic Affairs	Gonzaga University School of Law	Spokane, WA	10
Charles Shafer	Professor of Law	University of Baltimore School of Law	Baltimore, MD	18
Charles J. Tabb	Professor	University of Illinois at Urbana- Champaign College of Law	Champaign, IL	14
Bernard Trujillo	Assistant Professor of Law	University of Wisconsin School of Law	Madison, WI	2
Frederick Tung	Associate Professor	University of San Francisco-School of Law	San Francisco, CA	5
Robert M. Viles	President and Professor of Law	Franklin Pierce Law Center	Concord, NH	20
William T. Vukowich	Professor of Law	Georgetown University-Law Center	Washington, DC	25

(Signatures Continued . . .)

<u>Name</u>	<u>Title</u>	<u>Institution</u>	<u>Location of School</u>	<u>Years experience</u>
Elizabeth Warren	Leo Gottlieb Professor of Law	Harvard Law School	Cambridge, MA	19
Elaine A. Wells	Associate Professor of Law	University of Wyoming-College of Law	Laramie, Wyoming	3
Jay L. Westbrook	Benno C. Schmidt Chair of Business Law	University of Texas School of Law	Austin, TX	24
William C. Whitford	Professor of Law	University of Wisconsin-Law School	Madison, WI	24
Mary Jo Wiggins	Professor of Law	University of San Diego-School of Law	San Diego, CA	7
William F. Young	James L. Dohr Professor Emeritus	Columbia University- Law School	New York, NY	30
Luize E. Zubrow	Professor of Law	George Washington University National Law Center	Washington, DC	17

Finance

COMMENTARY

By Dean Foust and Debra Sparks

BANKRUPTCY REFORM: EVERYBODY'S MAD—AND THAT'S FINE

After two years of research, thousands of interviews, and hundreds of witnesses testifying at 21 hearings, the National Bankruptcy Review Commission on Oct. 20 unveiled a 1,300-page report to Congress on how to fix the nation's

found a reasonable middle ground that cracks down on abuses by the wealthy while protecting financially distressed borrowers from the clutches of lenders who have tried unfairly to portray all delinquents as the new welfare queens.

infuriated lenders by preserving the right of individuals to pursue a Chapter 7 liquidation—which often leaves little for creditors, because courts will wipe a debtor's slate clean. Banks had wanted the commission to press for more “means testing,” which would force many delinquents to continue paying off their old obligations. The truth is that for all the publicity surrounding spurious bankruptcy filings of the rich and famous, most filers are working stiffly victimized by a corporate downsizing, divorce, or other calamity—folks who need a clean break from the past. “A very tiny percentage [of filers] are wise guys trying to take advantage of the system,” says Albert Tobut, a New York bankruptcy attorney.

If bankers and retailers really want to reverse the bankruptcy spiral, they should spend less time lobbying Congress and more time re-

LENDERS ARE LIVID...

“The recommendations would lead to an increase in the already record-high number of bankruptcy filings.”

PAUL A. SCHOSBERG

President, America's Community Bankers

bankruptcy laws. And its 172 proposals managed to please... almost nobody. The recommendations “would shift the delicate balance between debtor and creditor interest clearly in favor of creditors,” protested the National Association of Consumer Bankruptcy Attorneys. “Seriously flawed and too one-sided” for debtors, fumed Paul A. Schosberg, president of America's Community Bankers, representing more than 2,000 savings and loans and banks. “The recommendations would lead to an increase in the already record-high number of bankruptcy filings.”

Even within the commission, deep divisions led four of the nine members—mostly private lawyers and federal judges—to issue a scathing dissent. Edith H. Jones, a conservative federal judge from Houston, blasted the majority for advocating proposals “that are not only unrealistic, [but] are simply deaf to the public debate over frustration with the nation's bankruptcy system.”

MIDDLE GROUND. Does this brawl suggest that the commission was a dud? Hardly. Given the heated emotions swirling around the bankruptcy debate, howls of protest were inevitable. Still, the panel's suggestions would fix a system that is clearly broken. Despite the current economic boom, bankruptcy filings by individuals have soared by roughly half (table). The commission

Admittedly, bankruptcy once carried more of a social stigma. But since the 1970s, when Congress made it easier to declare insolvency, it has become fashionable for millions of individuals—from the working

poor to the super-rich—to duck their financial obligations. “The word has gotten around that bankruptcy provides a very attractive financial planning tool for individuals tired of paying their bills,” says Philip S. Corwin, an outside lobbyist for the American Bankers Assn. There's a cost: Retailers and other creditors claim they will lose \$40 billion this year.

Consumer advocates are upset because the commission, to its credit, proposed reining in some of the most abusive practices that helped consumers but were also widely abused by the rich. But the commission also

...AND BORROWERS ARE FUMING, TOO

The recommendations “would shift the delicate balance between debtors and creditor interest clearly in favor of creditors.”

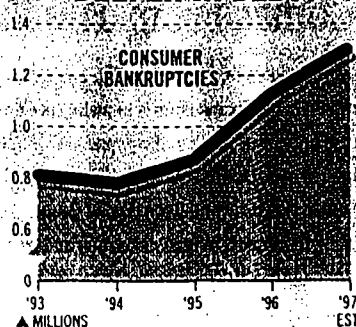
National Association of Consumer Bankruptcy Attorneys

forming their promiscuous marketing practices. Despite their repeated vows to tighten lending standards, creditors will likely mail out as many as 3 billion credit-card solicitations this year—some, ironically, to individuals who used bankruptcy to clear old credit-card debts.

The commission is trying to encourage greater responsibility by borrowers so they can't simply walk away from their debts. But lenders have to be responsible, too, by keeping credit cards out of the hands of known deadbeats. The commission's proposals would help foster accountability on both sides, which is what's necessary to cure the bankruptcy epidemic.

Foust writes about finance from Washington. Sparks covers money and banking in New York.

DEEPER IN DEBT



DATA: NATIONAL BANKRUPTCY REVIEW COMMISSION, AMERICAN BANKRUPTCY INSTITUTE



NEWS RELEASE

Administrative Office of the U.S. Courts

February 27, 1998

Contact: Karen Redmond

Calendar Year 1997 Shows Bankruptcy Filings Up 19 Percent Over 1996

The number of bankruptcy petitions filed in calendar year 1997 was up 19.1 percent over the same 12-month period ending December 31, 1996, according to data released today by the Administrative Office of the U.S. Courts. This follows 1997 fiscal year (September 30, 1996-October 1, 1997) filings that were 23 percent higher than in FY96.

Filings in the calendar year period ending December 31, 1997, totalled 1,404,145, the 7th consecutive record high for a 12-month period since filings passed the one-million mark for the first time in the 12-month period ending June 30, 1996. Filings have risen steadily since.

The number of bankruptcies filed during the first quarter of FY98 (October 1-December 31, 1997)—347,685—was down slightly from the last quarter of FY97 when filings totaled 353,515. Filings in the first quarter of FY97 (October 1—December 31, 1996) totaled 311,131, at that time the highest number of petitions filed for a quarter.

As the number of bankruptcy filings has increased, so has the workload of the 93 federal bankruptcy courts. The Judiciary has asked Congress for additional bankruptcy judgeships to handle the rising caseload. New bankruptcy judgeships were last created in 1992. The Bankruptcy Judgeship Act of 1997, H.R. 1596, would authorize a total of 18 new bankruptcy judgeships, seven new permanent bankruptcy judgeships and 11 temporary judgeships. The House passed H.R. 1596 in the first session of the 105th Congress. So far in the second session, no bankruptcy judgeship bill has been introduced in the Senate.

Total Filings for the Twelve-Month period ending	
Dec. 31, 1995	926,601
March 31, 1996	980,126
June 30, 1996	1,042,110
Sept. 30, 1996	1,111,964
Dec. 31, 1996	1,178,555
March 31, 1997	1,247,065
June 30, 1997	1,316,999
Sept. 30, 1997	1,367,364
Dec. 31, 1997	1,404,145

Bankruptcy Filings in the District Courts

Among the U.S. bankruptcy courts, the Central District of California remained the district reporting the largest number of filings—118,335—for the 1997 calendar year, a 15.3 percent increase over calendar year 1996. The Districts of New Jersey and Maryland, the Eastern District of Virginia, the Northern District of Illinois, the Northern and Eastern Districts of California, the Middle District of Florida and the Northern District of Georgia all showed over 30,000 bankruptcy filings in this period. Only two districts reported a decline in filings in this calendar year.

(MORE)

year: the District Court for the Northern Mariana Islands and the Southern District of Alabama.

Filings by Chapter

Of the total number of bankruptcy filings for the 12-month period ending December 31, 1997, there were 989,372 Chapter 7 filings, an increase of 22.1 percent over the 810,400 filings in the same period in 1996. The next largest group of filings were Chapter 13 filings at 403,025, a 13.5 percent increase over the 355,123 filings in the same period in 1996. Chapter 11 filings dropped to 10,765 in calendar year 1997 from 11,911 in 1996. Chapter 12 filings also fell in this period, from 1,083 in 1996 to 949 in 1997. Business filings totaled 54,027. Non-business filings totaled 1,350,118, up 20 percent from the total non-business filings of 1,125,006 in calendar year 1996.

Business and Non-business Bankruptcy Cases Filed, By Chapter During the Three-Month Period Ended December 31, 1997

Total Filings	Chapter 7	Chapter 11	Chapter 12	Chapter 13
347,685	243,441	2,278	205	101,759
Total Business	Chapter 7	Chapter 11	Chapter 12	Chapter 13
12,653	7,881	2,051	205	2,514
Total				
Non-Business	Chapter 7	Chapter 11		Chapter 13
335,032	235,560	227		99,245

Chapter 7 is designed to allow individuals to keep certain exempt property while the remaining property is sold to repay creditors. Under Chapter 13 bankruptcy, creditors may be repaid in installments, in full or in part, over a 3- to 5-year period. Chapter 11 provides for a business to continue operations while formulating a plan to repay its creditors. Chapter 12 is designed to meet the needs of financially distressed family farmers.

A breakdown of the latest data on bankruptcy filings follows and also is available on the home page of the Judiciary at www.uscourts.gov.

Quarterly Bankruptcy* Filings 3-Month Period

Ending	Total Filings
DEC. 31, 1997	347,685
SEPT. 30, 1997	353,515
JUN. 30, 1997	367,168
MAR. 31, 1997	335,073
DEC. 31, 1996	311,131
SEPT. 30, 1996	303,309
JUN. 30, 1996	297,162
MAR. 31, 1996	266,149
DEC. 31, 1995	244,494
SEPT. 30, 1995	233,593
JUN. 30, 1995	235,302
MAR. 31, 1995	212,626
DEC. 31, 1994	201,618
SEPT. 30, 1994	208,187
JUN. 30, 1994	216,213
MAR. 31, 1994	206,565
DEC. 31, 1993	206,570
SEPT. 30, 1993	215,498
JUN. 30, 1993	229,406
MAR. 31, 1993	222,694
DEC. 31, 1992	228,562
SEPT. 30, 1992	236,810
JUN. 30, 1992	250,622
MAR. 31, 1992	252,733
DEC. 31, 1991	234,383
SEPT. 30, 1991	231,743
JUN. 30, 1991	246,496
MAR. 31, 1991	231,017
DEC. 31, 1990	209,798
SEPT. 30, 1990	192,555

*Because of ongoing correction to the bankruptcy database, the quarterly data may not total to the most recent annual figures.

TABLE F-2 U.S. BANKRUPTCY COURTS
BUSINESS AND NONBUSINESS BANKRUPTCY CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE,
DURING THE TWELVE-MONTH PERIOD ENDED DECEMBER 31, 1997

CIRCUIT AND DISTRICT	TOTAL FILINGS	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL BUSINESS FILINGS*	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL NON- BUSINESS FILINGS	CHAP. 7	CHAP. 11	CHAP. 13
TOTAL...	1,404,145	989,372	10,765	949	403,025	54,027	32,255	9,694	949	11,095	1,350,118	957,117	1,071	391,930
DC.....	2,530	1,630	63	-	836	100	33	48	-	18	2,430	1,597	15	818
1ST...	54,154	38,756	484	11	14,903	1,804	1,139	442	11	212	52,350	37,617	42	14,691
ME.....	4,218	3,822	16	4	376	310	212	16	4	78	3,908	3,610	-	298
MA.....	23,892	20,475	298	1	3,118	965	561	288	1	115	22,927	19,914	10	3,003
NH.....	4,902	4,586	41	3	272	187	142	40	3	2	4,715	4,444	1	270
RI.....	5,472	5,237	19	-	216	180	146	19	-	15	5,292	5,091	-	201
PR.....	15,670	4,636	110	3	10,921	162	78	79	3	2	15,508	4,558	31	10,919
2ND...	90,128	74,541	1,343	44	14,193	3,522	1,794	1,181	44	496	86,606	72,747	162	13,697
CT.....	13,499	11,895	134	4	1,466	205	93	105	4	3	13,294	11,802	29	1,463
NY,N....	16,173	13,559	88	24	2,502	777	493	85	24	175	15,396	13,066	3	2,327
NY,E....	29,459	23,967	400	-	5,092	566	233	326	-	7	28,893	23,734	74	5,085
NY,S....	15,972	13,604	621	-	1,740	846	244	568	-	27	15,126	13,360	53	1,713
NY,W....	13,114	9,762	73	9	3,270	964	625	71	9	259	12,150	9,137	2	3,011
VT.....	1,911	1,754	27	7	123	164	106	26	7	25	1,747	1,648	1	98
3RD...	88,121	63,636	1,361	31	23,090	3,228	1,665	1,189	31	340	84,893	61,971	172	22,750
DE.....	2,646	1,697	189	1	759	214	25	188	1	-	2,432	1,672	1	759
NJ.....	42,434	29,826	635	2	11,969	1,112	567	517	2	24	41,322	29,259	118	11,945
PA,E....	21,773	13,661	277	12	7,822	561	259	255	12	34	21,212	13,402	22	7,788
PA,M....	9,593	8,141	96	7	1,349	852	507	88	7	250	8,741	7,634	8	1,099
PA,W....	11,601	10,259	155	9	1,178	472	299	132	9	32	11,129	9,960	23	1,146
VI.....	74	52	9	-	13	17	8	9	-	-	57	44	-	13
4TH...	121,087	80,283	858	34	39,912	4,467	2,735	793	34	905	116,620	77,548	65	39,007
MD.....	31,991	23,403	292	4	8,292	1,678	1,092	278	4	304	30,313	22,311	14	7,988
NC,E....	9,788	4,692	57	10	5,029	426	207	54	10	155	9,362	4,485	3	4,874
NC,M....	9,289	2,483	37	3	6,766	212	151	35	3	23	9,077	2,332	2	6,743
NC,W....	7,126	3,072	29	2	4,023	82	50	29	2	1	7,044	3,022	-	4,022
SC.....	11,232	6,061	95	7	5,069	346	133	85	7	121	10,886	5,928	10	4,948
VA,E....	31,921	23,417	235	3	8,266	767	410	202	3	152	31,154	23,007	33	8,114
VA,W....	11,198	9,173	63	3	1,959	589	438	61	3	87	10,609	8,735	2	1,872
WV,N....	3,475	3,252	22	2	199	179	124	22	2	31	3,296	3,128	-	168
WV,S....	5,067	4,730	28	-	309	188	130	27	-	31	4,879	4,600	1	278
5TH...	115,156	60,167	973	170	53,844	4,439	2,025	890	170	1,352	110,717	58,142	83	52,492
LA,E....	7,365	4,844	79	3	2,439	141	70	67	3	1	7,224	4,774	12	2,438
LA,M....	2,805	1,836	19	1	949	52	29	18	1	4	2,753	1,807	1	945
LA,W....	12,988	5,517	52	54	7,365	481	242	50	54	135	12,507	5,275	2	7,230
MS,N....	6,602	3,915	28	12	2,646	153	78	27	12	35	6,449	3,837	1	2,611
MS,S....	12,667	7,021	37	5	5,604	146	87	34	5	20	12,521	6,934	3	5,584
TX,N....	25,373	12,282	279	53	12,758	1,546	681	265	53	546	23,827	11,601	14	12,212
TX,E....	9,734	4,389	56	17	5,272	522	202	53	17	250	9,212	4,187	3	5,022
TX,S....	19,508	10,578	248	15	8,667	754	308	213	15	218	18,754	10,270	35	8,449
TX,W....	18,114	9,785	175	10	8,144	644	328	163	10	143	17,470	9,457	12	8,001

TABLE F-2 U.S. BANKRUPTCY COURTS
BUSINESS AND NONBUSINESS BANKRUPTCY CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE,
DURING THE TWELVE-MONTH PERIOD ENDED DECEMBER 31, 1997
(CONTINUED)

CIRCUIT AND DISTRICT	TOTAL FILINGS	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL BUSINESS FILINGS*	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL NON BUSINESS FILINGS	CHAP. 7	CHAP. 11	CHAP. 13
6TH...	167,850	109,942	775	64	57,068	3,627	2,026	736	64	800	164,223	107,916	39	56,268
KY,E....	9,558	8,270	22	3	1,263	273	198	21	3	51	9,285	8,072	1	1,212
KY,W....	12,129	9,643	46	6	2,434	176	110	46	6	14	11,953	9,533	-	2,420
MI,E....	27,348	19,992	223	10	7,123	595	328	215	10	42	26,753	19,664	8	7,081
MI,W....	12,261	9,145	78	14	3,024	511	295	74	14	128	11,750	8,850	4	2,896
OH,N....	26,200	21,451	67	9	4,673	480	312	65	9	94	25,720	21,139	2	4,579
OH,S....	27,570	20,728	110	8	6,724	526	316	104	8	98	27,044	20,412	6	6,626
TN,E....	16,254	8,268	53	7	7,926	422	171	50	7	194	15,832	8,097	3	7,732
TN,M....	12,478	6,593	103	3	5,779	457	222	96	3	136	12,021	6,371	7	5,643
TN,W....	24,052	5,852	73	4	18,122	187	74	65	4	43	23,865	5,778	8	18,079
7TH...	119,959	96,612	549	75	22,722	3,684	2,665	522	75	421	116,275	93,947	27	22,301
IL,N....	44,087	32,578	274	1	11,233	854	548	257	1	47	43,233	32,030	17	11,186
IL,C....	12,854	11,215	25	17	1,597	295	216	25	17	37	12,559	10,999	-	1,560
IL,S....	7,013	5,263	28	7	1,715	639	478	28	7	126	6,374	4,785	-	1,589
IN,N....	13,658	11,768	53	12	1,825	213	127	50	12	24	13,445	11,641	3	1,801
IN,S....	23,150	19,231	83	10	3,826	470	312	79	10	69	22,680	18,919	4	3,757
WI,E....	12,940	10,869	26	6	2,039	348	272	26	6	44	12,592	10,597	-	1,995
WI,W....	6,257	5,688	60	22	487	865	712	57	22	74	5,392	4,976	3	413
8TH...	82,102	61,077	330	199	20,494	4,912	3,408	317	199	986	77,190	57,669	13	19,508
AR,E....	9,942	5,153	31	8	4,750	283	144	30	8	101	9,659	5,009	1	4,649
AR,W....	5,701	3,700	21	8	1,972	256	129	18	8	101	5,445	3,571	3	1,871
IA,N....	3,996	3,839	13	9	135	235	192	12	9	22	3,761	3,647	1	113
IA,S....	5,847	5,271	20	4	552	270	222	19	4	25	5,577	5,049	1	527
MN,....	20,225	15,422	78	28	4,697	2,478	1,860	78	28	512	17,747	13,562	-	4,185
MO,E....	14,897	9,155	50	5	5,687	300	205	48	5	42	14,597	8,950	2	5,645
MO,W....	11,218	9,570	72	9	1,567	433	276	68	9	80	10,785	9,294	4	1,487
NE,....	5,949	4,946	22	53	926	281	163	21	53	42	5,668	4,783	1	884
ND,....	1,961	1,840	9	38	74	155	92	9	38	16	1,806	1,748	-	58
SD,....	2,366	2,181	14	37	134	221	125	14	37	45	2,145	2,056	-	89
9TH...	316,026	251,700	2,484	137	61,695	16,356	10,464	2,143	137	3,602	299,670	241,236	341	58,093
AK,....	1,373	1,223	18	-	132	147	98	17	-	32	1,226	1,125	1	100
AZ,....	25,069	19,580	309	7	5,172	846	424	273	7	141	24,223	19,156	36	5,031
CA,N....	34,781	25,153	338	2	9,286	2,116	1,046	274	2	792	32,665	24,107	64	8,494
CA,E....	36,976	31,552	180	38	5,204	2,624	1,755	162	38	667	34,352	29,797	18	4,537
CA,C....	118,335	96,418	907	6	21,003	6,184	4,395	757	6	1,025	112,151	92,023	150	19,978
CA,S....	19,407	14,516	96	1	4,793	213	130	71	1	10	19,194	14,386	25	4,783
HI,....	4,463	3,960	50	-	453	187	123	45	-	19	4,276	3,837	5	434
ID,....	6,973	5,381	39	51	1,502	532	289	36	51	156	6,441	5,092	3	1,346
MT,....	3,572	2,777	21	17	757	278	161	16	17	84	3,294	2,616	5	673
NV,....	13,427	9,596	157	-	3,671	399	173	151	-	72	13,028	9,423	6	3,599
OR,....	18,197	14,630	43	2	3,522	1,434	1,056	41	2	335	16,763	13,574	2	3,187
WA,E....	7,052	5,831	61	8	1,152	448	286	61	8	93	6,604	5,545	-	1,059
WA,W....	26,285	20,995	262	5	5,023	926	509	236	5	176	25,359	20,486	26	4,847

TABLE F-2 U.S. BANKRUPTCY COURTS
BUSINESS AND NONBUSINESS BANKRUPTCY CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE,
DURING THE TWELVE-MONTH PERIOD ENDED DECEMBER 31, 1997
(CONTINUED)

CIRCUIT AND DISTRICT	TOTAL FILINGS	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL BUSINESS FILINGS*	CHAP. 7	CHAP. 11	CHAP. 12	CHAP. 13	TOTAL NON BUSINESS FILINGS	CHAP. 7	CHAP. 11	CHAP. 13
GUAM...	114	87	2	-	25	21	19	2	-	-	93	68	-	25
NMI.....	2	1	1	-	-	1	-	1	-	-	1	1	-	-
10TH..	76,584	58,435	416	108	17,621	3,208	2,073	396	108	627	73,376	56,362	20	16,994
CO.....	19,146	15,727	99	20	3,298	518	361	97	20	38	18,628	15,366	2	3,260
KS.....	13,131	10,391	73	24	2,643	412	230	66	24	92	12,719	10,161	7	2,551
NM.....	7,560	5,361	54	4	2,141	384	217	50	4	113	7,176	5,144	4	2,028
OK,N....	6,007	4,942	37	3	1,025	648	488	33	3	124	5,359	4,454	4	901
OK,E....	3,462	3,139	22	15	285	176	118	22	15	20	3,286	3,021	-	265
OK,W....	13,100	10,278	50	32	2,740	545	365	49	32	99	12,555	9,913	1	2,641
UT.....	12,147	6,811	63	6	5,266	434	247	61	6	119	11,713	6,564	2	5,147
WY.....	2,031	1,786	18	4	223	91	47	18	4	22	1,940	1,739	-	201
11TH..	170,448	92,593	1,129	76	76,647	4,680	2,228	1,037	76	1,336	165,768	90,365	92	75,311
AL,N....	22,732	8,328	100	3	14,301	442	171	93	3	175	22,290	8,157	7	14,126
AL,M....	6,670	2,820	31	7	3,812	284	152	31	7	94	6,386	2,668	-	3,718
AL,S....	4,774	2,239	26	1	2,508	150	64	23	1	62	4,624	2,175	3	2,446
FL,N....	4,787	3,979	33	-	775	129	63	30	-	36	4,658	3,916	3	739
FL,M....	42,388	33,465	323	12	8,587	1,217	647	291	12	266	41,171	32,818	32	8,321
FL,S....	26,308	19,948	331	2	6,025	816	467	307	2	38	25,492	19,481	24	5,987
GA,N....	34,946	13,379	207	3	21,357	1,130	486	187	3	454	33,816	12,893	20	20,903
GA,M....	15,136	5,516	38	39	9,543	202	65	36	39	62	14,934	5,451	2	9,481
GA,S....	12,707	2,919	40	9	9,739	310	113	39	9	149	12,397	2,806	1	9,590

*THESE FIGURES INCLUDE THE FOLLOWING CASES NOT REFLECTED ELSEWHERE:

DC..... SECTION 304 = 01	NY,S.... SECTION 304 = 07	NJ..... SECTION304 = 02
PA,E.... CHAPTER 9 = 01	MS,N.... CHAPTER 9 = 01	TX,N.... CHAPTER9 = 01
TN,W.... CHAPTER 9 = 01	IL,N.... SECTION 304 = 01	NE..... CHAPTER9 = 02
AZ..... CHAPTER 9 = 01	CA,N.... SECTION 304 = 02	CA,E.... CHAPTER9 = 01
CA,E.... SECTION 304 = 01	CA,C.... SECTION 304 = 01	CA,S.... SECTION304 = 01
NV..... SECTION 304 = 03	CO..... CHAPTER 9 = 01	CO..... SECTION304 = 01
OK,E.... CHAPTER 9 = 01	UT..... SECTION 304 = 01	FL,M.... SECTION304 = 01
FL,S.... SECTION 304 = 02		

Federal Reserve Bank of Boston

REGIONAL REVIEW

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OPEN 24 HOURS



THE TWILIGHT ZONE
Working
at odd hours

ALSO: THE BOOM IN BANKRUPTCIES, REGIONAL GROWTH

the BOOM BUSTSⁱⁿ

By
John
Campbell

Bankruptcy is the last hope for someone crippled by debt. An integral part of the American legal system, indeed a directive expressed in the Constitution, bankruptcy law promotes individual liberty and productivity through the discharge of debt. And it is well used in our credit-driven market economy. Last year, a record 1.34 million Americans, roughly 1 percent of households, filed for personal bankruptcy. Filing rates have been rising for most of the period after World War II, but the increase has been sharp since the early 1980s.

Public responses to the rise in filings tend to take on a moral timbre. Media reports on bankruptcy, for example, often feature a pathetic credit card junkie or a high-spending actor. The image of the bankrupt individual as a "deviant," observes legal historian Iain Ramsay, has long been a staple of popular culture. This image now has the upper hand in shaping policy. Since the early 1980s, it has led to more restrictions on what debt can be canceled, and intense lobbying by the credit industry for further limitations.

*Despite its
bad press,
bankruptcy
provides
essential
insurance
against
calamity.*

But willful abuse, if one means people intentionally piling up debt, then filing in order to renege and start spending again, probably mars only a small fraction of bankruptcies. Under the broadest measurable definition of abuse — someone who files more than once after waiting the necessary six years — the evidence suggests that this group composes a small fraction of all people who file, perhaps in the range of 2 percent or more, and a far smaller proportion of the millions who could benefit from filing, but choose not to.

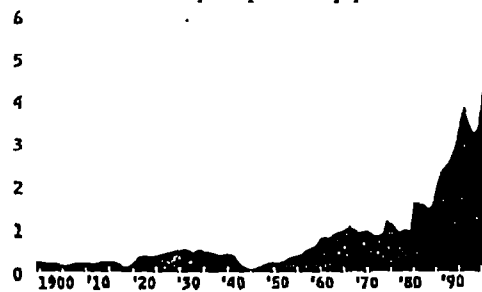
Reformers who seize on anecdotes of abuse want to force more bankruptcy filers into plans that require repayment of debt. Yet most repayment plans now in existence fail because the debtor cannot meet the obligation. Many reform proposals, moreover, would do little to counter the underlying forces that have caused insolvencies to surge in the first place. More attractive initiatives would reduce the incentives to file, while continuing to ensure that the casualties of our modern, credit-driven economy have the chance to start over after they fail.

FROM COERCION TO RELIEF

Insolvent debtors have been scorned in virtually all societies, and in the past were dismembered, enslaved, or imprisoned. Bankruptcy law is believed to have started in England under King Henry VIII in 1542,

Shock Absorber

U.S. bankruptcies per 1,000 population



SOURCE: LAW DEPARTMENT, ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, AND U.S. BUREAU OF THE CENSUS.

and for much of the time since remained a form of criminal law, a legal coercion to reach all of a debtor's assets. Colonial Americans, some of whom were fleeing England's debtors' prisons, adopted bankruptcy laws that departed from their English counterparts in fundamental ways. The colonies granted discharge of debt not just to merchants and traders but to anyone who became insolvent, and they preferred voluntary bankruptcy, declaring that it was primarily the debtor rather than the creditor who needed help. The Constitution in 1787 gave Congress the power "to establish ... uniform laws on the subject of bankruptcies," but Congress generated three systems that aborted before it implemented a permanent regime of bankruptcy relief in 1898.

This concept of a forgiving "fresh start" creates a sense of fairness, and allows individuals to function as productive risk-takers, providing us with a form of insurance that we can't buy privately. In a serfdom, life is stable and there are no defaults, but in an entrepreneurial economy, where credit is the universal solvent, reversals are inevitable. *Hunt's Merchant's Magazine* in 1841 saw utility in the risk management provided by bankruptcy: "The American people are proverbially enterprising; and a facility for obtaining credit, co-operating with a temperate active and sanguine, constantly tempts to enterprises of peculiar hazard, and oft-times singularly disastrous in their results."

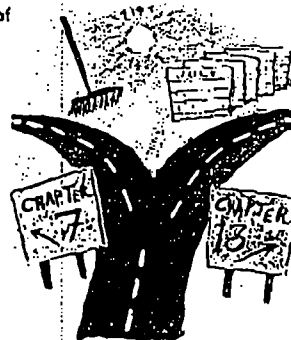
The salvation through bankruptcy of "citizens lost to themselves, lost to their country" comes at a cost, of course. Part of it is borne by the filers themselves in the form of at-

Liquidation versus Repayment

Our federal bankruptcy system gives debtors one of two basic alternatives. Chapter 7 of the federal code discharges, or wipes away, most unsecured debt; any assets left are liquidated and distributed to creditors. But secured debt must be paid off or the property will be repossessed, so home mortgages and car loans are nearly always paid in full. Thus the ability to repay under Chapter 7 is based on the debtor's wealth, not future earnings. Chapter 7 also permits someone to "reaffirm" and repay certain debts, and some credit card issuers and retail chains are aggressive in convincing debtors to sign this legal obligation. Roughly one-third of debtors reaffirm one or more of their debts.

Chapter 13, available to any individual "with regular income," offers a completely different deal, one based on the debtor's future earnings rather than on wealth. The debtor can keep more assets, but agrees to pay creditors some or all of the debt over three to five years. Home mortgage payments cannot be rescheduled, but the debtor can stretch out mortgage arrears while maintaining the regular payments. Two out of three debtors fail to complete their payment plans and receive no discharge.

Under either chapter, certain debts such as recent income taxes, alimony, child support, and government-supported student loans cannot be discharged.



torney and court fees. In New England, these range from \$700 to \$1,100 for a filing under Chapter 7 discharge, and \$900 to \$1,700 for a Chapter 13 repayment filing. More broadly, taxpayers (who pay for the bankruptcy courts) and creditors

and some borrowers share the cost of this social insurance. The cost of customer defaults on credit card balances, for example, comes largely out of the credit card issuers' profits, says economist Lawrence Ausubel. The companies are willing to bear this cost, he says, because the spread between credit card interest rates and the cost of funds is sufficiently large that it remains profitable to lend even to relatively risky customers.

In response to the rise in bankruptcy filings, various changes over the past two decades have restricted the fresh start. Exceptions to the discharge of debt, including alimony and student loans, have prolifer-

A Heavier Burden

Median income, assets, and debts for bankruptcy petitioners (1991 dollars)

	Family Income	Assets	Debt	Debt/Income Ratio
1991	\$18,000	\$16,765	\$11,077	1.7
1981	22,436	21,014	31,399	1.4

SOURCE: TERESA SULLIVAN, ELIZABETH WARREN, AND JAY LAWRENCE WESTBROOK, "COMPARING DEBTORS TEN YEARS LATER: A FINANCIAL COMPARISON OF CRIMINAL BANKRUPTCY FILERS 1981-1991," AMERICAN BANKRUPTCY LAW JOURNAL, VOL. 68, 1994

debt, with the median obligation totaling nearly twice their annual income; median nonmortgage debt, the short-term, high-interest kind, totaled more than one year's income. And between 1981 and 1991, the filers had generally become poorer: Their median income and assets had dropped, both absolutely and relative to the general population, over this period.

For some, descent into bankruptcy is a plunge, for others, a slow slide. The range of trajectories can be seen in a windowless hearing room in Manchester, New Hampshire, where about thirty people are having their bankruptcy court hearing with Jeffrey

Most bankruptcies are triggered by a shock to income such as a layoff or an uninsured illness.

ated. Legal changes that encourage Chapter 13 repayment rather than Chapter 7's fuller discharge have expanded, making that alternative more common — from a fourth of filers in 1980 to about a third today. The usage of Chapter 13 varies widely across bankruptcy districts, so for debtors in many parts of the country, bankruptcy may now typically provide a "stale" start rather than a fresh start, in the phrase of law professor William Whitford.

WHO FILES?

Despite these restrictions, filings have continued to rise in all states and all districts. To understand why, it helps to know who is filing.

Sociologist Teresa Sullivan and law professors Elizabeth Warren and Jay Lawrence Westbrook examined a sample of bankruptcy filers in 1981 and again in 1991. They found that in many respects, filers are a broad cross-section of middle America, resembling the general population in occupational prestige, age, and education, although lower in income. There are important differences between filers and the rest of the population, however. Nearly half of filers in 1991 reported a layoff, job termination, or other work interruption in the preceding two years. More of them were self-employed, which leads to more variable income, and to the use of credit cards to finance risky startups. By the time they filed, they were in deep

Schreiber, a Chapter 7 trustee and also an attorney. Schreiber, who represents the interests of unsecured creditors, quickly examines each person's petition, and then fires off a routine series of questions. The interrogations usually last about five minutes. The filers hold, or held, ordinary jobs — a plumbing and heating contractor, a receptionist, purchasing agent, waitress, appraiser, real estate broker, surveyor, law school student. Two cases raise Schreiber's suspicions. One man may have fraudulently transferred title of his house to his wife. Another wants to make his Individual Retirement Account an exempt asset. All of these people mention some calamity such as a layoff, illness, divorce, or accident. And many have run up credit card debt to a level they could not sustain.

Jeffrey Kittaeff, a trustee and bankruptcy lawyer in North Andover, Massachusetts, is in Manchester for several cases. Most of his clients, Kittaeff says, do not know how much debt they owe. Instead, when they receive their monthly credit card statements, they look at the box to the upper right: "minimum payment." Can they swing that month's payment? Next, they look at "available credit." Often, their credit limit has been raised, giving a false sense of security. After a layoff, a reduction in hours, or a medical problem that's not insured, they realize that they can't pay the minimum on all of their cards, and the bills are growing. "When they sit down with me, it's the first

time they've totaled up their debt," Kirtaef says.

INDEBTED

There are several plausible explanations for the long rise in bankruptcy rates. The evidence points to two phenomena in particular: the expansion of household debt and the growing volatility of incomes.

As recently as thirty years ago, most Americans had meager credit choices, and prospective borrowers probably had to pledge collateral to a bank if they got the loan at all, points out Robert Litan, an authority on finance at the Brookings

Institution. Payments were made by check or cash, and the few people who qualified for a credit card tended to use it only for special occasions.

Since then, the revolution in information technologies and the development of sophisticated financial instruments have created a profusion of choices at lower cost. Access to home mortgages and secured

The Price of States' Rights



Despite the intent of the Constitution, U.S. bankruptcy law is anything but uniform in practice. Changes to the federal code in 1978 introduced asset exemptions that were more generous than were many state exemptions. For political reasons, Congress allowed the states to opt out of the federal exemptions, and most states do. So homestead and property exemptions now vary from unlimited in Texas and Florida to zero in Rhode Island.

This wide variation in asset exemptions gets incorporated into the price of certain types of credit, and thus borne by some borrowers. Economists Reint Gropp,

Michelle White, and John Karl Scholz find that the probability of consumers being turned down for a loan is 6 percentage points higher in a state with an unlimited homestead exemption, compared to a low-exemption state. States with generous exemptions also increase the amount of credit held by high-asset households and reduce the availability and amount of credit to low-asset households.

ages 25 to 34. (To consume some of their greater wealth, people have been borrowing more rather than selling assets.) This democratization of credit raises living standards and helps fuel our entrepreneurial, risk taking economy. But it also allows people to get deeper into a hole. Household debt as a share of disposable income has risen to record levels. The growth

Household debt has expanded and incomes have grown more volatile. Both lead to more defaults.

consumer loans has become broader, thanks in part to the bundling of loans into securities bought by investors worldwide. Congress also helped broaden access to credit by promoting mortgage securities and prohibiting loan discrimination.

Demand for credit has increased along with rising household net worth, and as more of the population has moved into the high-borrowing years of

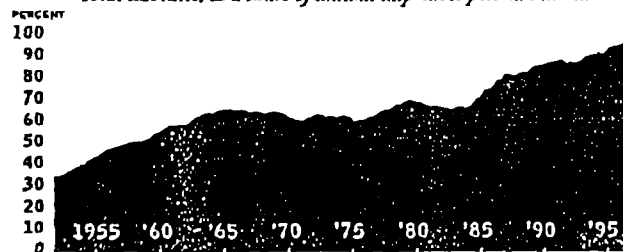
in unsecured credit has been even more dramatic: more than half and perhaps as many as 80 percent of U.S. households today use a credit card, up from 16 percent in 1970.

The new credit economy is especially treacherous for borrowers who are uninformed or under equipped. Lenders' easing of credit standards after the 1990-91 recession resulted in an explosion of credit

card mailings, says economist Mark Zandi of Regional Financial Associates, a forecasting firm. At the same time, mortgage lenders have been aggressively extending low down-payment loans, often to the same people getting credit card and consumer loan solicitations. The most precarious borrowers in recent years, Zandi observes, have been lower-middle income households, for whom debt service burdens

The Expansion of Household Debt

Total liabilities as a share of annual disposable personal income



SOURCE: BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE

spited up. Real incomes for many of these households have been stagnant, and earnings became more volatile during the '80s, as employers relied more heavily on contingent workers and reduced hours. As the cushion of savings for more households is eaten away, delinquencies and bankruptcies rise.

These are primarily economic explanations, but social factors may aggravate the economic trends. Law professors Frank Buckley and Margaret Brinig, studying the rise in bankruptcy filings from 1985 to 1991, conclude that changes in social norms explain some of the variation in filings over time and among districts. Filing rates, they find, are higher in regions with weaker social networks, as measured by such variables as intercounty migration, membership in a mainline religion, and the share of divorced residents.

Increased mobility and divorce, however, do not mean that the social stigma surrounding bankruptcy has disappeared. Careful studies find little evidence that the rise in bankruptcies has eroded a general sense of responsibility to pay debts. To the contrary, some evidence suggests a persistent reluctance to choose bankruptcy. Economist Michelle White, examining the balance sheets of American households, finds that roughly 15 percent of them would benefit from filing, compared to the 1 percent who actually did file last year. An even larger share of households would benefit if they acted strategically to shift assets from nonexempt to exempt bankruptcy categories. Evidently, it still takes a calamity to break the legal and social contract that credit entails.

There may be an erosion of social sanctions against people who declare bankruptcy. But that is just as likely to be a consequence of higher filing rates as a cause. If a friend or relative files, it becomes harder to think of bankrupt debtors as deviants.

The socioeconomic signs point to a continued surge of default on debts, many of which will tip into bankruptcy. Of late, there has been an expansion of the numbers of people at high risk for default and ultimately bankruptcy. These include compulsive gamblers, uninsured drivers, and perhaps most important, individuals with no, or minimal, health care insurance. Economists Ian Domowitz and Robert Sartain examined 1980 bankruptcy records and find that even small amounts of uninsured medical debt substantially raise the probability of someone's filing for bankruptcy. Medical debt in excess of 2 percent of income results in a propensity to file which is twenty-eight times that of the average household. The extent of health coverage, moreover, has diminished in the years since the records they studied, leading Domowitz to speculate that perhaps one-third of bankrupt individuals currently could be filing on the basis of medical debt alone.

ROUGH JUSTICE

Strange as it may sound, there is an optimal level of

All Over the Map

Personal bankruptcy, selected states (1996)

	FILING RATE PER 1,000 RESIDENTS	SHARE OF FILINGS IN CHAPTER 13 (%)
NEW ENGLAND		
Rhode Island	4.2	4
Connecticut	3.4	12
New Hampshire	3.1	7
Massachusetts	2.7	17
Maine	2.5	10
Vermont	2.1	7
HIGH-FILING STATES		
Tennessee	9.0	64
Georgia	7.3	68
Alabama	7.2	65
Nevada	6.3	27
California	5.4	19
United States	4.2	31

Bankruptcy filing rates, and the choice of Chapter 13 repayment or Chapter 7 discharge plans, vary substantially among states. New Englanders, for example, file relatively few bankruptcies, and overwhelmingly choose Chapter 7. Among the plausible explanations for such disparities is one offered by SMR Research, a consulting firm to the lending industry. SMR identifies four groups of Americans at relatively high risk for defaults and filings: more than 40 million people with no medical insurance; 25 million without automobile insurance; 2 to 3 million with a compulsive gambling problem; and 18 million divorced individuals.

Nevada residents, with a high rate of divorce, a low rate of medical coverage, and a high affinity for gambling, thus have a high bankruptcy rate despite the state's booming economy. Residents of the six New England states, on the other hand, have above-average medical coverage and low filing rates.

High filing rates tend to correlate with a high share of Chapter 13 filings, and occur in states with relatively tough wage garnishment laws, reports Mark Zandi of Regional Financial Associates. Such laws allow a creditor to take some of a debtor's paycheck. But creditors' rates of net losses caused by loan chargeoffs are very similar across the states, Zandi finds. Lenders lower their standards in states with relatively tough laws, resulting in higher bankruptcy rates.

SOURCE: AUTHOR'S CALCULATIONS, USING DATA FROM THE AMERICAN BANKRUPTCY INSTITUTE, AND THE FEDERAL OFFICE OF THE U.S. COURTS, AND THE U.S. BUREAU OF THE CENSUS

bankruptcy in a society based on a flexible or volatile employment system, a limited social safety net, and entrepreneurial risk taking. Buying a house, a car, furniture, or a vacation is commonly accepted behavior, and generally requires credit. Yet borrowers are subject to shocks they can't control. Since we can't buy explicit insurance against such shocks, bankruptcy fills that need. It is the end game of delinquency, a time when creditors can't get much more out of the debtor. Lenders, moreover, wouldn't make as much money if they extended credit only to people who are certain not to default.

Whether we are above the optimal level is not clear.

Without doubt, many of the people who file have overspent and mismanaged their finances. This has led a growing chorus in the credit industry and the legal system to advocate Chapter 13 repayment as a more responsible route than Chapter 7 discharge. Their moral argument motivates current legislation that would disallow Chapter 7 for most filers and force them into Chapter 13.

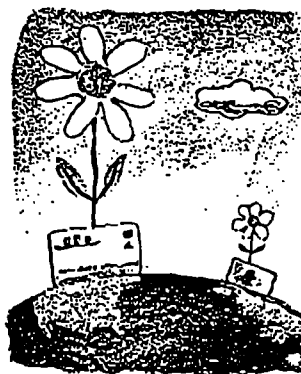
Many debtors presented with the choice of Chapter 7 or 13 also find the notion of repayment attractive. They typically are ashamed about their situation, would like to repay at least some of their debt, and exhibit classic debtor's optimism: They tend to underestimate their expenses and the future risks associated with credit. So if the local legal culture promotes Chapter 13, debtors will be influenced accordingly. "Many debtors do not choose a chapter with full understanding of the alternatives and their consequences," writes law professor Jean Braucher.

This might not be such a bad deal, except for the result: Two-thirds of Chapter 13 plans fail before, usually long before, repayments are complete. No one

The American Way

The United States has been unique in providing a fresh start through bankruptcy. Other developed countries offer severely limited protection from creditors, and require repayment. Of course, many of them provide more extensive safety nets through health care, unemployment insurance, and other social programs. And the use of personal credit is far less extensive abroad; the United States has significantly more credit card transactions per person than in any other country except Canada (where bankruptcy filings have also soared). Personal debt is still not looked on favorably in much of Europe and Asia.

As the safety nets are being scaled back, and personal credit expands modestly, some countries are now implementing more comprehensive bankruptcy laws. They are moving closer to the U.S. system, which, for all its flaws, holds out the essential promise of a fresh start.



Chapters 7 and 13 and combining them into a single procedure, as proposed by economist Michelle White. Filers would be obliged to repay part or all of their debt both from assets and from a fixed fraction of future earnings, but exemptions would exist for both. The asset exemptions could be uniform across the country, or vary among the states. Either way, White's

Further restricting the "fresh start" won't address underlying issues that cause defaults.

knows exactly what happens to these debtors after their plans fail, but the consensus guess is that most refile under Chapter 7, while the others are subject to creditors' claims once again. As for the ethical dimension of honoring one's debts, some bankruptcy scholars and practitioners raise a parallel concern of equal importance: the debtor's obligation to family, to rebuilding their lives through a fresh start. Once that is accomplished, the debtor always has the opportunity to repay debts on his or her own.

The weight of evidence shows that bankruptcy filers have grown poorer and that the increased usage of Chapter 13 repayment plans is neither completely voluntary nor very successful. Given these trends, there's little empirical basis for sharp restrictions on the debtor's chance for a fresh start.

Efficiency and fairness, however, can be improved. Since so many households have an incentive to file for bankruptcy, yet most repayment plans don't succeed, reformers might consider taking the best features of

reform is based on the principle that ability to repay depends on both wealth and future earnings. Even a minimal level of repayment reduces the incentive to file bankruptcy, which makes the system more efficient. At the same time, bankruptcy would still offer relief to households that have little ability to repay, by setting a relatively low rule for repayment, say 10 percent of future earnings over three years. This would concentrate more of the benefit from bankruptcy on the least affluent households.

Short of banning bankruptcies, new legislation won't stem the tide. Other remedies, focused on the underlying issues, might be more effective. Lenders could learn how to better underwrite and manage their consumer loans, to reduce defaults. High school students could receive a better education on handling their personal finances. And broader health coverage would reduce medical debt. Bankruptcy, meanwhile, still represents a rough justice that balances the interests of debtors and creditors. ☺



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

May 21, 1998

The Honorable George W. Gekas
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Gekas:

I am writing in response to your letter, dated May 11, 1998, to President Clinton. As the Justice Department noted in its letter to Chairman Hyde, dated May 7, 1998, the President supports bankruptcy reform that requires responsibility of debtors who have the ability to repay a portion of their debts and prevents abuse of the bankruptcy system by all relevant parties. However, the Administration strongly opposes H.R. 3150 in its present form. One provision of the bill would establish a rigid and arbitrary means test to determine whether a debtor could file for bankruptcy under Chapter 7 or would be required to file under Chapter 13 rules. Bankruptcy courts should have greater discretion to consider the specific circumstances of a debtor in bankruptcy.

H.R. 3150 also would make nondischargeable certain credit card debt. The Bankruptcy Code generally makes nondischargeable debts only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, or debts incurred by fraud. There has been no sufficient finding that current protections against fraud and debt run-up prior to bankruptcy are ineffective and that the additional debts made nondischargeable by this bill rise to that level of public priority. Moreover, by making these credit card debts nondischargeable, the bill puts them in competition with payments to a former spouse or custodial parent after the debtor leaves bankruptcy, which could diminish the ability of debtors to fulfill their child support and alimony obligations. Amendments made during the Judiciary Committee mark-up are improvements but do not effectively eliminate this problem.

The Administration looks forward to working with the Congress on a balanced package of reforms that addresses these concerns and requires responsibility on the part of both debtors and creditors.

Sincerely,

Jacob J. Lew
Acting Director

IDENTICAL LETTER SENT TO THE HONORABLE BILL MCCOLLUM,
THE HONORABLE JAMES P. MORAN, THE HONORABLE RICK BOUCHER

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ONE HUNDRED FIFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

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 MINORITY STAFF DIRECTOR

ADMINISTRATION OPPOSES H.R. 3150 BANKRUPTCY BILL IS BAD FOR CHILDREN BAD FOR MIDDLE CLASS FAMILIES

May 21, 1998

Dear Colleague:

We thought you would be interested to read the Administration's letter, reprinted on the reverse side, in opposition to bankruptcy legislation just reported by the Judiciary Committee.

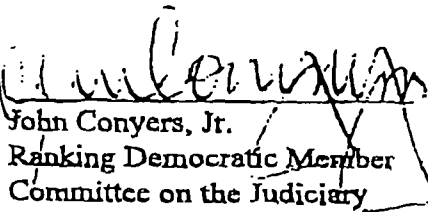
The Administration points out, contrary to what you may have been told:

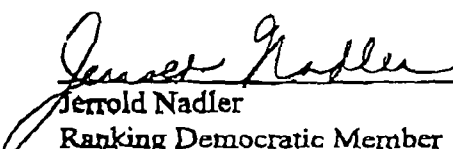
- H.R. 3150 does NOT fix the child support and alimony problem. It would still give credit card companies new rights to debtors' assets that are now reserved for children and families.

- H.R. 3150 uses an inflexible, one-size-fits-all formula for deciding how much debtors must repay, whether or not the formula reflects their real obligations and expenses.

Bankruptcy is a zero-sum game. If credit card companies are allowed to get more of the debtor's property in bankruptcy and after the case is over, then there will be less for other creditors, including children. It's simple arithmetic.

Sincerely,


 John Conyers, Jr.
 Ranking Democratic Member
 Committee on the Judiciary


 Jerrold Nadler
 Ranking Democratic Member
 Subcommittee on Commercial and
 Administrative Law

National Partnership
for Women & Families

June 9, 1998

Dear Representative:

The National Partnership for Women and Families and the undersigned women's and children's organizations write to express our deep concerns about H.R. 3150, the Bankruptcy Reform Act of 1998. By increasing the rights of credit card companies and other creditors, the bill further jeopardizes the precarious financial position of many women and children.

Women and children are affected by the bankruptcy system in two principal ways: as creditors due child support and as potential users of the bankruptcy system. As creditors, families entitled to support receive protection under the current bankruptcy system. Child support and alimony payments are among the few debts that cannot be discharged in bankruptcy; debtors who can get their finances re-ordered in bankruptcy are left in a better position to pay support. As potential users, the current bankruptcy system provides an avenue of relief for single mothers and children experiencing financial crises, in many cases as a result of nonpayment of child support.

H.R. 3150 does not directly reduce the priority of child support obligations. But it does increase the rights of other creditors such as credit card lenders, setting up a competition for scarce resources between mothers and children owed support and commercial credit card companies. In such a contest mothers and children, even if they are assisted by state child support enforcement agencies, will lose out.

State child support enforcement programs collect support in only one out of five cases. For cases with support orders in place, collections were made in just over a third of the cases (35 percent); only 52 percent of the current child support due was collected in fiscal year 1996.¹ Child support reforms adopted by Congress in 1988 and 1996 should increase the effectiveness of wage withholding and other enforcement measures. Unfortunately, implementation of these reforms has been slow. Some states have not yet developed the automated child support enforcement systems required by Congress a decade ago. Congress can and should do more to improve the effectiveness of state child support programs -- not set up new barriers to the collection of support, as H.R. 3150 would do.

Our specific concerns with H.R. 3150 are described in more detail below.

Under H.R. 3150, more debts, such as credit card debts, will survive bankruptcy, and compete for payment with child support.

¹Child Support Enforcement: FY 1996 Preliminary Data Report (August 1997).

The bill greatly expands the categories of debts that cannot be discharged in a bankruptcy proceeding, including a substantial portion of credit card debt (for example, debts incurred within 90 days of filing for bankruptcy, except for debts for necessities that total less than \$250, and debts which the creditor alleges were incurred without a reasonable expectation or ability to repay). Increasing the debts that survive bankruptcy means that more debts will be competing with child support payments for the limited resources of a bankrupt debtor. For custodial parents forced into bankruptcy, it means that there will be fewer resources available for them to support their children.

H.R. 3150 creates an arbitrary means test and other barriers that will make it more difficult and expensive to utilize the bankruptcy process.

In addition to expanding nondischargeable debts, H.R. 3150 contains several provisions that will make accessing the necessary protections of the bankruptcy system more difficult. H.R. 3150 imposes a strict means test for Chapter 7 relief, requires pre-filing credit counseling, and provides standing to creditors to challenge bankruptcy eligibility. Each of these provisions not only makes accessing the system more difficult but increases the creditors' opportunities for costly litigation. This has the potential for making bankruptcy a prohibitively expensive endeavor. Moreover, such costs divert more resources away from the support of children during a financial crisis.

H.R. 3150 generally strengthens the rights of credit card lenders and other creditors, further increasing the competition with child support.

In addition to making more credit card debt nondischargeable, H.R. 3150 strengthens the protections provided to credit card companies in other ways. Several provisions increase the credit card industry's ability to pressure debtors into reaffirming credit card debt by threatening the debtor with repossession or litigation. Through reaffirmation, even more credit card debts become nondischargeable in bankruptcy. Meanwhile, H.R. 3150 does nothing to control the aggressive marketing of high interest credit cards to vulnerable consumers.

The Amendments to H.R. 3150 Designed to Protect Child Support Are Insufficient.

In response to the concern over allowing credit card debts to survive bankruptcy and compete with child support, several amendments were made to the bill. For example, §150 purports to give priority to past child support debts after bankruptcy. Unfortunately, this provision will be virtually impossible to enforce. In Chapter 7 bankruptcies, the most common form of personal bankruptcy, the bankruptcy courts are involved for only a brief period of time. After the debtor's assets (if any) are liquidated, the bankruptcy court does not continue to supervise the debtor's affairs, and there is no other system for coordinating debt collection and child support enforcement. All creditors holding nondischargeable debts (including women owed child support and, under H.R. 3150, credit card companies) will be competing for payment, and there will be no referee to enforce the priority of child support. Collection agents or other creditor

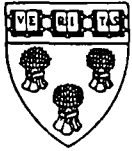
representatives have no incentive to advise the debtor that he should pay his child support first, and are unlikely to do so; even if they did, it would remain within the debtor's discretion whether to honor child support's priority. Even if the credit card companies use the judicial process to collect, the various courts to which they might take their claims will have no way of knowing that a priority child support order exists.

Language also was added that purports to protect the payment of child support in Chapter 13 bankruptcy plans. However, other provisions of H.R. 3150 require that "adequate income," and no less than \$50 per month, be committed to repaying non-priority, unsecured debt -- such as credit card debt -- in Chapter 13 plans. If a debtor in Chapter 13 bankruptcy also must make regular payments on credit card debts, payments on child support debt will have to be smaller, and spread out over a longer period of time. H.R. 3150 says that child support must be paid in full; but in the real world of limited resources, the bill makes it less likely that this will occur.

This Bankruptcy Reform Act will reduce the ability of parents to pay their most important debt -- their debt to their children. It is for these reasons that we strongly oppose H.R. 3150 and urge you to oppose it as well.

Very truly yours,

(List in development)



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Consumer Bankruptcy: Issues Summary

Professor Elizabeth Warren
Leo Gottlieb Professor of Law
Harvard Law School
April 2, 1998

The Rise in Filings

This year about 1.4 million families will file for consumer bankruptcy, a rise of about 400% since 1980.

Virtually all independent academic studies and all government studies of the increase in bankruptcy demonstrate that the rise in bankruptcy filings follows equally sharp rises in the amount of consumer debt per household. Bankruptcy filings began a sharp upward climb in 1986, with a slight dip in the early 1990s, followed by a steeper rise since 1994. This pattern closely tracks increases in consumer debt. As families carry more short-term, high interest credit card and similar debt, they are more at risk for financial failure. Because they have almost no savings and have already incurred as much debt as they can reasonably expect to repay, they have no cushion to help them survive a crisis. For a family loaded with debt, any set back--such as a job loss, an uninsured medical loss, or a divorce--will put the family over the edge of financial stability.

New academic research demonstrates that, as a group, the debtors who file for bankruptcy in the mid-1990s are worse off than their counterparts who filed in the early 1980s. Their incomes are lower and their debt loads are higher. These data suggest that, as a group, Americans are less willing to declare bankruptcy; they file when they are so pressed financially that they have no alternative.

Who Files?

Bankrupt debtors are a cross-section of America. People who file for bankruptcy have educational levels on par with all other middle class Americans. They work in the same occupations and in the same industries as other middle class Americans. They are employed and they own homes in roughly similar proportions to all other Americans. By every social measure, bankruptcy is a middle class phenomenon. They differ from their neighbors in that their incomes are substantially lower and their debts are substantially higher.

While the bankruptcy filers are a cross-section of middle class America, they are the most vulnerable among American families. They have been the hardest hit by economic reversals, and they are using bankruptcy as to gain a foothold to stop their slide into the lower class. Among the subgroups in bankruptcy are:

Older Americans Because they take on less consumer debt per household, older Americans end up in bankruptcy less frequently than their younger counterparts. When they do file, however, a larger fraction--nearly 40%--explain that they are driven to bankruptcy by medical debts they cannot pay. Older Americans also suffer from job losses and job erosion, so that two-thirds of the debtors aged 50-65 cite either a medical reason or a job reason for their bankruptcy filings.

Women Raising Families Both men and women are more likely to declare bankruptcy following divorce. Collectively, the bankruptcy sample has 300% more divorced people than the population generally. Families already laden with consumer debt cannot divide their income to support two households and survive economically. But women, often those rearing families, are hit the hardest. Divorced women file for bankruptcy in greater proportions than divorced men, using the bankruptcy courts to shed credit card and other debts so they can concentrate their incomes on paying current expenses.

Unemployed workers More than half the debtors who file for bankruptcy report a significant period of unemployment preceding their filings. For single-parent households, a period of unemployment can be devastating. Married couples fare slightly better, but do not escape employment problems; more than half the married couples in bankruptcy reported that both the husband and the wife were unemployed preceding the bankruptcy filing.

African American and Hispanic American Families Both African American and Hispanic American middle class families are over-represented in bankruptcy. They report the same problems of job loss and medical debts as their middle class white counterparts, but in greater numbers overall. For African American and Hispanic American families, the home represents a greater portion of their total family wealth and their savings toward retirements than their white counterparts who are more likely to have other assets, such as retirement plans, stock portfolios, other real estate investments, etc. A larger fraction of African American and Hispanic American homeowners use bankruptcy to prevent losing their homes.

What Does Bankruptcy Do For These People?

A family that files for Chapter 7 bankruptcy discharges all its short-term, high interest debt, principally credit card and finance company debt, along with some medical debts. After bankruptcy, however, the family must continue to make *all* payments on the family home, including interest, late charges, and penalties, or they will lose their homes. They must also pay off any second or third mortgages, plus any home equity lines of credit, or risk losing the house.

Debt secured by a home mortgage or home equity line of credit cannot be "stripped down" or reduced in any way in bankruptcy. Most families will also continue to make car payments; they need their cars and they will lose them if they don't pay in full. Families also must pay their tax debts and educational loans after bankruptcy. Those who have outstanding child support or alimony obligations must also pay those in full; none of these debts is dischargeable. In addition, if the debtors sign a reaffirmation agreement to pay any debts that would otherwise be discharged in bankruptcy, they will be legally obligated to do so.

Thus, for most families, Chapter 7 is not total debt relief. It is only an opportunity to concentrate their incomes on their current budgets and to save their homes and cars, make alimony and child support payments, and take care of back taxes and education loans. They leave the bankruptcy courthouse heavy with debt obligations.

The creditors that survive the Chapter 7 bankruptcy filing are dealing with a debtor who is more stable financially and more able to repay those debts. The home mortgage lender is more likely to collect, as are the ex-spouse and the IRS. To the extent that financially troubled debtors are kept out of the bankruptcy system, they are less likely to stabilize financially and make these payments. Even if the debtor successfully files for chapter 7, if more creditors are permitted to survive the Chapter 7 without a discharge, then these additional creditors compete for the debtor's limited funds, again reducing the likelihood of repayment for mortgage. This final point hits ex-spouses particularly hard because they lack the collection leverage of the mortgage or car lenders (repossession) or the IRS (property seizure).

Chapter 13 debtors are those who volunteer to pay some portion of their debts over three to five years. For over fifteen years, however, the two out of three of the debtors who file for Chapter 13 do not make it through a repayment plan. Many face repeated unemployment and some encounter significant unanticipated expenses. For many, however, the reason is simple: they do not earn enough money. When their Chapter 13 repayment plans fail, most debtors leave the bankruptcy system without having discharged any debt. Today, Chapter 13 provides little relief for many of those who try to repay.

The Data

The data about consumer filings and consumer debt are collected by several government agencies and widely reported. A number of academic studies have reported on the correlations. These data are available for citation.

The data about the economic profile of consumers in bankruptcy will be reported at 73 INDIANA LAW JOURNAL 1079 (forthcoming 1998). These data come from two research projects by my coauthors, Dr. Teresa Sullivan, Vice-President of the University of Texas, Professor Jay Westbrook, Benno C. Schmidt Chair of Business Law at the University of Texas, and I, data provided by Judge Barbara Sellers, and a research project by Professors Marianne Culhane and Michaela White of Creighton Law School. The data reported here build on a report made by my coauthors and I in *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-91*, 68 AMERICAN BANKRUPTCY LAW JOURNAL 121 (1994).. These data are

1

available for citation.

The data about the demographic groups that file for bankruptcy are from a study by my coauthors. The data will be reported more fully in our forthcoming book, *The Fragile Middle Class*, to be published next year by Yale University Press. A preliminary report on these data has been made available only as background for understanding the current bankruptcy policy debates. These data are not available for citation or circulation.



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Bankruptcy and Single Parents

Professor Elizabeth Warren

April 14, 1998

Many middle class families use the bankruptcy courts when they are in financial collapse. Both the Senate and the House have proposed legislation expressly to make access to bankruptcy harder and to change payment priorities for those in bankruptcy. (S. 1301 and H.R. 3150) The proposed changes would have a strong and disproportionate effect on single parents, mostly divorced women and other women relying on support payments to raise families.

During 1997, an estimated 243,000 to 325,000 bankruptcy cases involved child support and alimony orders.¹ In about half of these cases, women were *creditors* trying to collect alimony and child support from their bankrupt ex-husbands and others. In about half, women filed for bankruptcies themselves as they tried to stabilize their post-divorce economic condition. In the past five years, well over a million women collecting alimony and child support have been involved in bankruptcy cases.

Current law gives these women priority in collection. Alimony and support obligations are *not* dischargeable. The pending legislation, largely supported by the credit card companies, would put credit card charges on the same footing as support obligations, but there are only so many dollars available for collection from ex-partners.

¹The reported data are from the Consumer Bankruptcy Project, Phase II. Principal researchers are Dr. Teresa Sullivan, Vice-President of the University of Texas, Professor Jay Westbrook, Benno Schmidt Chair in Business Law, University of Texas, and Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School. These estimates are based on data collected in 1991 in sixteen judicial districts around the country. For more details about the study, see Sullivan, Warren and Westbrook, *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-91*, 68 AMERICAN BANKRUPTCY LAW JOURNAL 121 (1994). The data reported here will be discussed in fuller detail in Sullivan, Warren and Westbrook, *THE FRAGILE MIDDLE CLASS* (Yale University Press forthcoming 1999). These data have not yet been published and are not for citation without permission.

While the points listed below are equally applicable in gender-reversal cases (husbands who collect alimony and child support from their ex-wives), as a practical matter women rearing families would be hardest hit by the proposed changes. In effect, both husband and wife often want the ex-husband's bankruptcy to succeed so that he can make his legally-required support payments. An increasing number of unmarried people are the recipients of support orders; these provisions apply to them as well.

Women as Creditors in Bankruptcy Would Be Hurt by Pending Legislation

Currently, alimony and child support, past taxes and educational loans survive a Chapter 7 bankruptcy. Recipients of child support and alimony are benefitted when their financially troubled ex-spouses can discharge their other debts and get their finances in order so that they can make the payments on their non-dischargeable debts, including their alimony and support.

Because, in most cases, only the three debts listed above can survive a Chapter 7, a single parent who tries to collect post-discharge has a relatively clear shot at her ex-spouse's resources. Sadly, H.R. 3150 and S. 1301 would increase the amount of potentially non-dischargeable debt. For example, under the amendments, a debtor could not discharge credit card debt incurred within 90 days of bankruptcy or when the debtor could not reasonably contemplate repayment--or the compounding interest, penalties and late fees. A woman trying to collect child support would be in direct competition with credit card issuers and other commercial lenders in direct competition for the limited resources of the post-discharge ex-husband.

For debtors who file for Chapter 13, ex-spouses currently enjoy a preference in repayment. Typically, past-due alimony and child support can be paid on an accelerated schedule in Chapter 13. The proposed amendments would force debtors to pay all unsecured debt in pro rata installments with nondischargeable debts. This increases the length of time it will take a woman to collect past due support that she needs for basic living expenses while credit card issuers share pro rata with her. Because of the high failure rate in Chapter 13 (two of every three cases fail) and the impossibility of paying off the past due alimony and child support debt early in the plan, the proposals also increases the likelihood that a woman will never be repaid in full through a bankruptcy plan.

The proposed amendments also expand the range of nondischargeable debt in Chapter 13, so that more debt will survive bankruptcy, again increasing the competition for the ex-spouse's limited post-discharge income and decreasing the chance that nondischargeable alimony and support will, in fact, be paid.

Women as Debtors in Bankruptcy Would Be Hurt by Pending Legislation

Efforts to close the doors to the bankruptcy courts fall on single parents who are trying to

stabilize their falling economic fortunes. These women are jointly liable on debts incurred during the marriage, including past due tax obligations, and their post-divorce incomes are often inadequate to provide for their going-forward expenses, with nothing left over to pay off past due debts.

The express provisions of HR 3150 actually force larger families (those with five or more members) out of Chapter 7 more often than smaller families (those with four or fewer members). The means test is pegged to median household income in the population generally, which declines as family size increases above four members. This provision falls hard on everyone raising children, including married couples, but it falls particularly hard on anyone raising a large family on a single income.

Single parents and others receiving support are not identified specifically in these proposed amendments to the Bankruptcy Code, but increasing the access credit card issuers and other consumer creditors have to their ex-husbands' incomes, puts these women into terrible competition for a very limited pool of dollars. Unlike other lenders, they have no opportunity to diversify their collection options, they cannot cumulate their debts at 23% interest or charge late fees and penalties, and they have no access to the sophisticated collection apparatus of a large bank. When women compete with sophisticated consumer lenders, they lose. Proposed HR 3150 and 1301 will set the stage for that competition.

Finally, it is worth emphasizing that the National Bankruptcy Review Commission declined to support any of these proposed changes. While there was no record vote on them, at best, only two Commissioners supported any of the proposals. The three Presidential appointees were outspoken in their opposition to these proposals--largely for the reason noted above.

Mrs. Clinton,

Attached please find a recent letter from Elizabeth Warren re: bankruptcy reform legislation. We've continued to monitor this issue and are working on a hard hitting response to Cong. Gekas' letter to you. — Nicole

Let's send
cc to our P
to Gekas to let
us note how
we strongly believe
the bill
should be
revised

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cc: Nicole



HARVARD LAW SCHOOL

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ELIZABETH WARREN
LEO GOTTLIEB PROFESSOR OF LAW

Direct Phone: (617) 495-3101
Direct Fax: (617) 496-6118

May 19, 1998

Hillary Clinton
Office of the First Lady
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20373

Dear Mrs. Clinton:

It was a pleasure to meet with you in Boston on May 1. I have since read your column on bankruptcy. It was a terrific statement of the issues and illustration of the very real problems facing American families.

I have continued to work on the bankruptcy issues, meeting with Senators Kennedy, Dodd, Feingold and Durbin and doing what I can to support their work. The senators and their staffs have been tireless, but the lobbying from the credit card companies has been intense. I am uncertain about how much they will be able to accomplish in the Senate.

As you know, the House has already passed the bill out of the Judiciary Committee--adding on still more special interest provisions. The Committee rejected fundamental protections for families, such as a provision to make certain that medical expenses the debtor must pay for his own care, for the care of his spouse or dependent, or for an elderly parent are included in necessary expenses when calculating eligibility for chapter 7. The Committee rejected an amendment to the "means test" to make certain that income from social security payments, disability payment or veteran pension payments would not force someone into a seven year repayment plan. The list goes on, but the spirit of the bill is unmistakable. This bill is designed to help large creditors squeeze more money out of families already stressed to the breaking point.

I appreciate the time you have spent on the bankruptcy issues. You have helped give a voice to the million and a half families who will use this system this year to try to stabilize their failing economic circumstances. Please continue to help them.

If I can be helpful in any way, please let me know.

Very truly yours,

Elizabeth Warren
Leo Gottlieb Professor of Law

cc: Nicole



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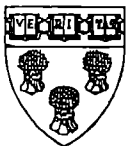
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MEMORANDUM

TO: LAURA ROSEN, NATIONAL ECONOMIC COUNCIL

FROM: ELIZABETH WARREN 

DATE: MAY 19, 1998

I'm sure you have heard that the House claims to have "fixed" the issues that affect single parents in H.R. 3150. They have not. The changes have not ended the post-bankruptcy competition for the ex-spouse's money; instead, they have increased it. The changes have also tangled the Chapter 13 priority for support payments even worse, putting support recipients at much greater risk than they face under current law.

Melissa Jacoby has put together a brief outline on the difficulties with H.R. 3150 as they relate specifically to collection of child support. I'm attaching a copy for you.

Please let me know if I can be helpful in any way.

007/10/98 TEL 10.44 FAX 101/4968118 HARVARD LAW 003

The Effect of H.R. 3150¹ on Single Parent Families

H.R. 3150 has been criticized for its effects on single parents and children, both as debtors and as creditors trying to collect past-due support. The provisions producing these concerns generally do not explicitly mention ex-spouses, children or support obligations; rather, the especially problematic provisions are those that increase dividends and collection rights for nonpriority unsecured creditors (such as credit card lenders) at the expense of priority creditors (such as child support recipients) and secured creditors.

In response, defenders of H.R. 3150 have emphasized that the legislation does not directly lower the priority of support obligations and that allegations of adverse effects have been fabricated for political reasons. At the same time, the proponents have made a set of amendments with the express purpose of protecting support obligations.

Although H.R. 3150 does not explicitly lower the priority of support obligations, provisions throughout the bill would have an adverse impact on the ease of collection for support recipients and other similar types of creditors due to increased competition for resources, heightened administrative costs, and changes to Chapter 13 repayment. While the legislation includes some amendments that may enhance the legal status of support obligations, the amendments are cosmetic at best. Rather than clearing the way for women and children to collect past due and current support obligations, the new provisions would be ineffectual in practice or actually would hinder the ability of women and children to collect support obligations because those provisions also would increase competition for scarce resources by expanding the priority and nondischargeability of additional debts to the states² and of nonsupport debts. Moreover, some of the provisions designed to ensure payment to support recipients conflict with other provisions in the legislation that mandate contrary treatment.

Further expansion of priority and nondischargeable debts that would compete with debts owed to support recipients in and after bankruptcy

Increased competition with credit card companies and retailers

Sections 141, 142, and 145 of H.R. 3150 would make many credit card debts and retail charge card debts survive bankruptcy and would provide some of those debts with priority status. Section 141 would except from discharge any debts incurred to pay debts that would have been nondischargeable had they not been paid upon the filing of the bankruptcy case. Since debts incurred to pay priority debts would be "payable in the higher order of priority (if any) as the

¹As reported out of the Committee on the Judiciary, May 14, 1998.

²While the states and individual support recipients share the same general goal of collecting support obligations, their interests are not co-extensive, particularly in the context of a financially distressed debtor.

respective claims paid by incurring such debts," a credit card debt for a debt in the nature of support would share seventh priority status pro rata with other obligations owed directly to the support recipients. The provision also appears to accord priority status to debts incurred to pay nonpriority nondischargeable debts. This means that if a debtor pays a parking ticket with a credit card prior to bankruptcy, that credit card debt would be a nondischargeable priority debt in Chapter 7. Since all priority debts must be repaid in full in Chapter 13, the credit card debt would get an increased share of the debtor's resources in Chapter 13, to the detriment of other priority and secured. Thus, without a compelling policy justification, section 141 would produce competition among creditors for scarce resources within Chapter 13, within Chapter 7, and after bankruptcy.

Under section 142, any consumer debt incurred within 90 days prior to filing would be presumed nondischargeable except for "consumer debts owed to a single creditor which are incurred for necessities and aggregate \$250 or less." This expansion of credit card debt nondischargeability would produce additional competition with institutional lenders for debtors' postbankruptcy resources without a policy justification. While proponents of the legislation emphasize that the 90 day provision is a presumption and not an absolute imposition of nondischargeability, this distinction overlooks the reality of consumer bankruptcy law and practice. It is extremely simple for a creditor to file (or to threaten to file) an adversary proceeding alleging nondischargeability, and most consumer debtors cannot afford the litigation necessary to rebut a legal presumption and instead are likely to concede nondischargeability or reaffirm their liability for the debt. Rebutting this presumption would consume financial resources that otherwise should be directed toward important expenses such as support or housing obligations. The \$250 "necessaries" carve-out does not change the practical effect of this provision. Proving that such debts were for "necessaries" imposes the same costs as the presumption. Regardless of the merits, most debtors are unlikely to contest such a nondischargeability claim.

Increasing the benefits for credit card lenders and heightening the debtor's postbankruptcy debt burden, section 145 of H.R. 3150 would amend 11 U.S.C. § 523(a)(2) so that even more credit card debts would be nondischargeable without requiring credit card lenders to prove the elements of fraud. The credit card lender merely would have to allege that the borrower used a credit card "without a reasonable expectation or ability to repay" unless access to such credit was extended without an application and a reasonable evaluation of the debtor's ability to repay. Section 145 also would amend subsection (B) of section 523(a)(2) so that lenders would not have to allege that a debtor intended to deceive the lender with a written representation, replacing the requirement with "without taking reasonable steps to ensure the accuracy of the statement."³ These amendments would widen the scope of nondischargeable debts even further without a sound policy basis and would heighten overreaching by aggressive creditors to obtain reaffirmation agreements. The recently-added carve-out for unsolicited and unwise credit

³ It is unclear why the creditor's burden of proof should be relaxed in section 523(a)(2)(B), which generally has been perceived to work well. Relaxing this requirement will lead to even more concessions of nondischargeability for credit card debt.

extensions would have little, if any, effect on the vast majority of proceedings. Lenders no longer are permitted to send actual credit cards until a debtor completes an application. Moreover, whether the creditor conducted an evaluation of the debtor's ability to pay or increased one's credit limit without a request are questions of fact that generally would require litigation.

Exacerbating the effect of sections 142 and 145, section 143 of H.R. 3150 would make these credit card debts nondischargeable in Chapter 13 even after a Chapter 13 debtor has made plan payments for 3, 5, or even 7 years.⁴ Chapter 13 debtors would have greater economic motivation to litigate the nondischargeability of these debts than Chapter 7 debtors since they essentially would be spending the money of other creditors. Thus, expanding Chapter 13 nondischargeability would increase administrative costs and delay the Chapter 13 process through litigation at the expense of other creditors.

Taken together, sections 141, 142, 143, and 145 could promote extensive and costly litigation and provide a basis for creditor overreaching without a legitimate public policy reason to make these debts survive bankruptcy. Increasing the number of nondischargeable credit card debts is likely to have an adverse impact on the ability of debtors to be able to pay nondischargeable support obligations, not to mention student loans, taxes, car payments, and mortgage payments. This effect is exacerbated by the fact that H.R. 3150 does not do anything to protect support recipient creditors from having to compete with improvidently "reaffirmed" debts. Reaffirmations enable any debt to survive bankruptcy if a creditor can convince the debtor to assent to such treatment. See 11 U.S.C. § 524(d). If anything, H.R. 3150 would provide more leverage for unsecured lenders to request reaffirmations and thus increases the likelihood that a debtor will reaffirm unsecured or nominally secured debts to credit card companies and retailers, producing greater strains on his income after bankruptcy. Such additional strains on the debtor's postbankruptcy budget will not be in the best interest of the debtor, his dependents, or any of his other creditors.

Increased competition with the government

Section 146 of H.R. 3150, one of the provisions that purportedly protects support recipients, would further increase competition for debtors' resources by expanding the size of government claims and enhancing the government's rights to collect on claims in Chapter 7, in Chapter 13, and after bankruptcy. By increasing the size of the state claims and providing priority status, these provisions would, in some cases, reduce the distributions available for children and ex-spouses in the bankruptcy process itself and on a going-forward basis.⁵

⁴Debts falling within the scope of section 141 (debts incurred to pay nondischargeable debts) would not be excepted from the superdischarge under this provision, but this is not relevant since they would have to be paid in full in Chapter 13 on account of their new priority status.

⁵Although section 147 of H.R. 3150 would amend 11 U.S.C. § 523(a)(5) to ensure nondischargeability for property settlements that are not "in the nature of support," which would be helpful in some situations, this amendment does not change the fact that this legislation

While H.R. 3150 would expand the legal rights of support recipients to pursue collection out of otherwise exempt assets, it would restrict the beneficial effects of the expansion by granting even more latitude to government creditors to pursue the same property. Section 146 of H.R. 3150 would amend section 522⁶ to provide that debts to the state that are nondischargeable under 11 U.S.C. § 523(a)(18) could be collected out of otherwise-exempt property, as support debts owed to individuals may be collected under current law. Section 502 of H.R. 3150 would amend that section further to permit nondischargeable support obligations and taxes to be collected from any exempt property, notwithstanding any federal or state law to the contrary.⁷ The broad preemption language of this provision would nullify wage exemptions, federal wage garnishment laws, and exemptions in section 6334 of the Internal Revenue Code and comparable state laws that limit the property that can be seized by taxing agencies to satisfy a tax debt. For example, while the Internal Revenue Code would exempt wearing apparel and school books from levy to satisfy a tax debt, this amendment would allow the IRS to seize school books and sell them. Section 507 of H.R. 3150 would expand the scope of the government's authority to seize the debtor's property even further by excluding 11 U.S.C. § 523(a)(1) nondischargeable tax debts from the Chapter 13 superdischarge, thereby allowing additional government debts to be collected out of exempt property.⁸ Thus, although these changes contain a partial expansion in the legal rights against the debtor's property if the ex-spouses have the resources and legal representation to avail themselves of this remedy (and if the debtor has sufficiently valuable property), any benefit probably is outweighed by the substantial increase in authority provided to government entities, which have far greater resources to pursue this exempt property.

Increased competition with secured creditors

To the extent that the legislation is moving toward high valuation of collateral, or the elimination of the Chapter 13 "cramdown" altogether, support recipients would be disadvantaged as well.

produces increased competition for the ex-spouse in collecting her debts from the state and from institutional lenders. In addition, the section 523(a)(5) amendment could have odd unintended consequences in some cases. For example, if a debtor has been married and divorced twice and pursuant to his divorce decrees he owes support obligations to his second ex-wife and child and owes business debts to his first ex-wife who is a successful entrepreneur, this provision would elevate the business debts to the status of his support obligations to his second wife, who would face additional increased competition for the debtor's resources from another ex-spouse who does not need support.

⁶The bill refers to section 522(b), but the proposed language leads to the conclusion that the bill intends to amend section 522(c).

⁷It is unclear how this amendment should be reconciled with the amendment section 146.

⁸Debts that are nondischargeable under 11 U.S.C. § 523(a)(1) can be collected out of exempt property.

Several provisions that inflate the valuation of certain secured claims also would have an adverse impact on distributions for children who are creditors in their non-custodial parents' bankruptcy cases. Secured claims generally are divided into secured and unsecured portions to reflect economic reality and to promote fair and equitable treatment of creditors in the bankruptcy process. See 11 U.S.C. § 506. Under section 128 of H.R. 3150, the usual valuation rules would be inapplicable to purchases made within 180 days prior to bankruptcy, for which the secured claim would include the outstanding balance, interest, and charges at the contract rate, giving the secured creditor better treatment in bankruptcy than under state law. For the valuation of other personal property collateral, section 129 of H.R. 3150 would set the valuation of personal property collateral at "replacement value," to be defined as the price a retail merchant would charge for property of that kind, age, and condition, with no deductions for marketing or sales costs. This is a very high valuation standard that in many instances is the least advantageous for other creditors.⁹ Inflated secured claims, in combination with the proposed mandatory unsecured debt payments, will make it all the more difficult to stretch the debtor's budget to pay other obligations. Rather than penalizing the debtor,¹⁰ in many cases this inflated valuation standard -- or the elimination of the "cramdown" power in consumer cases altogether -- actually would divert resources away from priority claimants, such as child support recipients, and from general unsecured creditors.

Aside from increasing competition, the valuation standards, in combination with other new requirements governing secured claims, may have other effects on the debtor's ex-spouse and children. As the requirements governing secured debt become more onerous and preclude debtors from keeping their cars,¹¹ even a diligent debtor may lose his job if he cannot get to his workplace and thus will fall behind on his support obligations to his ex-wife and children. Alternatively, a Chapter 13 debtor may be trying to cure a default on a car that he is required to maintain for use by his ex-wife as part of her maintenance and support, and in such a case, inflated

⁹The proposed amendment apparently would overrule the United States Supreme Court's determination in *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879 (1997), that debtors should not have to give value for attributes they did not receive (e.g., reconditioning, preparation, sales commissions, warranties, storage, inventory costs, and advertising).

¹⁰While this provision was intended to penalize debtors who purchased property in contemplation of bankruptcy, it actually would benefit more sophisticated debtors who sought to avoid chapter 13, since it will make debtors less likely to be able to pay 20% of his nonpriority unsecured claims.

¹¹Another example of such a provision is section 162 of H.R. 3150. This provision would require a debtor to make cash payments to lessors and creditors with debts secured by personal property until the creditors started receiving plan payments. Since trustees do not immediately disburse distributions to creditors, this section would require debtors to make adequate protection payments concurrently with plan payments in the beginning of a plan, which would be impossible given the calculation of the plan payments.

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valuation may result in the loss of the ex-wife's form of transportation.¹²

Postbankruptcy priority for support obligations does not resolve the problem

In response to concerns raised regarding the effects of many provisions of H.R. 3150 on the support recipients, the House Judiciary Committee added another provision that purports to preserve the priority of support obligations after the debtor has emerged from bankruptcy. This amendment appears to deal with past due, not current, support obligations, and thus does not speak to the essential competition problem for support expenses going forward. Putting aside the very questionable Constitutional foundation for this provision, this amendment is not likely to provide any substantial benefits to support recipients. Collection activities often proceed informally. The fact that one unsecured debt has legal "priority" over another debt is irrelevant if no legal process is ever invoked. Thus, if one creditor has greater resources to exercise more leverage than another, the well-financed aggressive creditor may get paid first without ever having to resort to judicial process and is perfectly entitled to do so in the state law collection system. In addition, unless two creditors actively are seeking to attach, garnish, or execute on the same property, it is unclear how state courts will be able to ensure that a priority debt gets paid ahead of another debt unless a complex noticing system for unsecured claims is developed, which would be ineffective if support recipients did not know that they had to record their claims. In addition, the fact that unpaid support obligations would be given priority does not mean that they support recipients can enforce them. They would have to find the ex-husband and hire an attorney to enforce the order, who would have to determine how to reduce the orders to judgment in the appropriate state, and then find assets to attach. It is unclear whether this amendment would entitle a support recipient to sue the other nondischargeable creditor, such as a credit card company, to collect her payments, but even that remedy is dependent on time, resources, and legal representation.

As a general matter, the postbankruptcy priority of debts becomes irrelevant if debtors leave the bankruptcy system more debt-laden than ever before. To the extent that an individual emerges from bankruptcy with overwhelming debts, the legislation will increase his incentives to go underground, leave his job, move to another jurisdiction, and get paid on a cash basis, rendering postbankruptcy priority utterly useless.

Requirement to pay support obligations

¹²This effect is exacerbated, in part, by section 144 of H.R. 3150, which would cut back substantially on co-debtor stay protection and allow creditors to act unilaterally to possess property that is not within the control of the debtor. A recent adjustment to section 144 is designed to preserve the co-debtor stay if the debtor is obliged to maintain property for his ex-spouse under a divorce decree or separation agreement. This adjustment is well-meaning, but will not prevent creditors from taking actions against the ex-spouse co-debtor if the creditor is unaware of the terms of the divorce decree.

As a condition of confirming a repayment plan, section 146 of H.R. 3150 would require a debtor to pay all support obligations that "are due after the date the petition is filed." Postpetition payment of support obligations in a repayment plan would be a condition of receiving a bankruptcy discharge. However, section 102 of H.R. 3150 explicitly excludes "payments for debts" from the IRS budget allowance and 11 U.S.C. 502(b)(5) disallows claims for debts that are unmatured on the date of the bankruptcy petition. Thus, a literal reading of the H.R. 3150 payment plan rules would exclude pending child support payments altogether. In addition, family court orders sometimes address arrearages and pending child support obligations; if such an order was at issue in a case, section 146 would require the debtor to pay arrearages and pending child support before confirming a plan, but section 102 would provide contrary instruction to spread the child support arrearage over 60 months. The explicit conditions for plan payments in section 102 of the bill effectively preclude prompt payment of past due support obligations that normally occurs under current law and would require support recipients (and other priority and secured creditors) to wait 5 years to receive their payments on past due debts. The net income "produced" from requiring deferred payments to priority creditors would be dedicated to credit card debts and other nonpriority unsecured debts.

Rather than re-evaluate and adjust the payment requirements, the House Judiciary Committee instead appended language to the end of section 102 stating that nothing shall prevent the payment of obligations with priority under 11 U.S.C. § 507 and that the plan shall specify how payments to other creditors will be accordingly adjusted. This admonition cannot be reconciled with the other requirements of this subsection dictating the calculation of all plan payments, each of which is dependent partially on the others. Corresponding adjustments to the plan will likely make the plan unconfirmable, or at the very least, infeasible. In addition, this provision does not resolve the exclusion of current support obligations in the Chapter 13 budget, notwithstanding the precatory language in section 146 of the bill.

Additional automatic stay exceptions to permit pursuit of debtor

Section 146 of H.R. 3150 also would amend 11 U.S.C. § 362(b) so that the automatic stay would not enjoin actions to impose or enforce a wage order for domestic support obligations. This provision would obviate the need for parties to seek relief from the stay, and thus could minimize costs. Of course, since wage assignments may be for debts owed to the state rather than to the ex-spouse or child directly, in some cases this automatic stay exception would divert funds away from individual support recipients. In addition, an automatic stay exception for wage orders may have limited efficacy, as many bankruptcy cases with claims for domestic support obligations do not involve wage orders. Wage assignments are not always easy or inexpensive to obtain; the ability to obtain a wage order depends on the laws of a given state and whether the ex-spouse's employment situation makes this possible. Since individuals who file for bankruptcy are likely to have experienced a prebankruptcy period of unemployment or marginal employment for cash payment, the likelihood of having a wage assignment declines. Moreover, a wage order or license revocation may be useless if a financially troubled ex-spouse cannot shed his high interest unsecured debts; restrictions on access to Chapter 7, along with this continuing postbankruptcy

debt burden, will increase a debtor's incentives to leave his job, move to another jurisdiction, and get paid on a cash basis. Thus, while permitting continued wage garnishment for this purpose may be helpful, it falls short of addressing the detrimental impact of this legislation on single parents and children.

This section also would amend 11 U.S.C. § 362(b) so that the automatic stay would not enjoin actions to withhold, suspend, or restrict licenses of the debtor for his delinquency in support obligations. In the case of a Chapter 13 debtor who diligently is attempting to catch up on support payments, license revocation may work against support recipients if the lack of transportation causes the debtor to lose his job, particularly because the debtor would not be allowed to pay the delinquency up front under section 102 of H.R. 3150. For this reason, court discretion may be preferable.

Increased administrative costs and time delays divert resources from support payments

H.R. 3150 is replete with provisions that would make bankruptcy relief more complicated and expensive. For example, two initial hurdles, the means test and the consumer credit counseling prerequisite, would necessitate litigation over eligibility for bankruptcy relief in nearly every consumer bankruptcy case. *See* H.R. 3150 §§ 101, 104. Considerable additional administrative requirements also would increase the costs of bankruptcy. Filing fees and lawyer fees inevitably would consume resources that otherwise could be directed toward creditors and necessary expenses, and excessive litigation would delay payouts to support recipients and other creditors.

Conclusion

Notwithstanding amendments designed to ameliorate concerns about support obligations, H.R. 3150 as reported out of the House Judiciary Committee would adversely affect support recipients and other similar creditors by increasing the number of nondischargeable and priority debts, inflating the valuation of secured claims, providing conflicting authority for the treatment of support obligations in Chapter 13, and generally increasing the amount of resources consumed in administrative costs.¹³ For reasons stated elsewhere, many portions of H.R. 3150 are troublesome for single parent families who use bankruptcy as debtors as well. Divorced women already are disproportionately represented in bankruptcy, to the extent that their financially troubled spouses cannot obtain adequate debt relief, the number of divorced women resorting to bankruptcy is likely to increase.

¹³ The sections discussed are only illustrative of the many provisions of H.R. 3150 that would have an adverse effect on creditors. A more exhaustive list would include, but not be limited to, sections 101, 102, 103, 121, 123, 125, 128, 129, 130, 141, 142, 143, 144, 145, 146, 147, 148, 407, 409, and 507.

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PREPARED BY PROF. ELIZABETH
WARREN, HARVARD BUSINESS
SCHOOL, 617.495.3101

Facts About Consumer Debt

Studies by the Congressional Budget Office, the Federal Deposit Insurance Corporation, and independent economists link the rise in consumer bankruptcies directly to the rise in consumer debt.¹

Deregulation of consumer credit interest rates have not produced a sustained decrease in interest rates. Instead, deregulation has prompted aggressive marketing and a loosening of underwriting standards that have caused a rise in consumer bankruptcies.²

Three-quarters of all households have at least one credit card, and three out of four of them also carry credit card debt from month to month.³

The growth of credit card loans has been faster than any other type of consumer loans since 1993. Credit card debt doubled in just four years: The amount of credit card loans outstanding at the end of 1997 was \$422 billion, twice as much as the amount in 1993.⁴

Credit card usage has grown fastest in recent years among debtors with the lowest incomes. Since the early 1990s, Americans with incomes below the poverty level nearly doubled their credit card usage, and those in the \$10,000-25,000 income bracket come in a close second in the rise in debt. The result is not surprising: 27% of the under-\$10,000 families have consumer debt that is more than 40% of their income. Nearly one in ten has at least one debt that is more than sixty days past due.⁵

There are well over a billion cards in circulation — a dozen credit cards for every household in the country.⁶

From 1994 through 1996, credit card issuers mailed more than two and a half billion card solicitations each year. This means more than 41 mailings went out each year to every American household—not counting telephone solicitations. Based on

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industry estimates, those offers add up to about \$243,000 of credit per household per year. At this rate, in a little over four years, the credit card companies have offered about a million dollars of credit to every household in the United States.⁷

In 1997, mailed credit card solicitations jumped by 20% to three billion.⁸

Direct solicitation of both college and high school students has intensified in the past two years. Cards are available at many colleges to almost any student -- no income, no credit history and no parental signature required.⁹

Industry analysts estimate that, using a typical minimum monthly payment rate on a credit card, it would take 34 years to pay off a \$2,500 loan, and total payments would exceed 300% of the original principal. Credit card statements, unlike mortgage loans and car loans, do not disclose the amortization rates or the total interest that will be paid if the cardholder makes only the minimum monthly payment.¹⁰

Credit card issuers earn about 75% of their revenues from the interest paid by borrowers who do not pay in full each month. Several companies have instituted charges or even canceled credit cards for customers who pay in full each month, preferring customers with large credit balances who pay minimum monthly payments.¹¹

As bankruptcy levels have risen, total credit card profitability has grown--credit card lending is now twice as profitable as all other lending activities. In the third quarter of 1997, credit card banks showed a 2.59% return on assets, compared to a 1.22% return on assets reported by all commercial banks.¹²

Industry consultants estimate that credit card companies could cut their bankruptcy losses by more than 50% if they would institute minimal credit screening.¹³

Some institutions now invest in bad credit card debt. For example, Commercial Financial Services acquires credit card debt that has been charged off as uncollectible from 25 of the largest credit card issuers, packages the debt into securities which it sells to investors, then pursues new collection activities against the customers. CFS securitized \$1 billion in charged-off credit cards in 1997, and plans to securitize \$1.5 billion this year.¹⁴

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The FDIC observes that by marketing high-risk debt to customers who are at substantial risk for non-payment, credit card issuers have contributed to the rise in consumer bankruptcies.¹⁵

Subprime lending targets borrowers with poor credit records. Such lending has become the fastest growing, most-profitable subset of consumer lending. Although losses are substantial, interest rates of 18 to 40% on credit card debt make this lending profitable. In the subprime automobile finance market, by charging interest rates of 15% to 25% on secured car loans, several lenders have reported profit margins ranging from 23% to 41%.¹⁶

On May 2, 1997, the FDIC issued warnings to banks about the risks posed by increased subprime lending. Some industry analysts predict that overall loan default rates will double by the year 2001 and thus warn that "by lowering their credit standards and saturating the market with loans, many banks will be unable to avoid potentially enormous delinquencies and write-offs."¹⁷

Subprime lending is growing even among reputable lenders. Senator Lauch Faircloth, who notes that he "abhors . . . constraints on the private sector," recently stated about the subprime market: "We have very reputable, very fine institutions, spinning off subsidiaries to get into what I would consider very precarious, reckless, bordering on sleazebag lending."¹⁸

Home mortgage loans with high loan-to-value ratios, particularly so-called 125% loans, are the major component of the recent surge in home equity lending, both in the prime and subprime markets. Recent growth in the volume of 125% loans has been unprecedented: 1995—\$1 billion; 1996—\$4 billion; 1997—\$10 billion; 1998—an estimated \$20 billion. Although such loans are at least partially secured by the debtors' homes and can result in the loss of the home, they carry interest rates much closer to those of credit cards, reportedly in the 13-15% range.¹⁹

Banks actively solicit debtors for new credit after they file for bankruptcy. Industry analysis explain that these debtors are attractive because they have shown they will take on credit and, by law, they cannot seek a bankruptcy discharge for another six years.²⁰

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To Nicole - Pls review and advise ASAP -

Thanks Hrc



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ELIZABETH WARREN
LEO GOTTLIB PROFESSOR OF LAW

Direct Phone: (617) 495-3101
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August 12, 1998

The First Lady
c/o Melanne Verveer
The White House
Washington, D.C. 20001

Dear Mrs. Clinton:

The bankruptcy legislation we've discussed remains a very serious threat. While its momentum has been slowed, thanks in part to your efforts, Senator Lott apparently has agreed that the bill will be brought to the Senate floor on September 4. Senator Kennedy may try to append his minimum wage proposal to the bill and there will be other amendments as well. Whether or not they succeed, the Republicans will push for 60 votes and cloture.

Here is a brief summary of what has happened since you and Brady Williamson last spoke.

Abusive Creditor Practices

While the pending legislation focuses almost exclusively on inadequately substantiated debtor abuses, there is uncontroverted evidence of widespread creditor abuse. Retailers and lenders have violated the federal discharge injunction in hundreds of thousands of cases by seeking payment on charge card debts that have been or can be discharged in bankruptcy.

Sears, Roebuck, and Co. was the first to concede that it engaged in this practice with over 200,000 consumers, resulting in a settlement earlier this year of \$475 million. A federal criminal investigation of Sears' practices is still pending as are state investigations.

In the past few weeks, May Department Stores (Hecht's, Lord & Taylor) and GE Capital settled charges for violations of the consumer bankruptcy laws for over \$100 million.

Other retailers and lenders that have admitted or have been named as participants in these unlawful activities include Circuit City, Montgomery Ward, Federated (Bloomingdale's, Macy's), Ford Motor Credit, Chrysler Motor Credit, AT&T Universal, Beneficial, and Avco.

CLINTON LIBRARY PHOTOCOPY

PHOTOCOPY
PRESERVATION

PHOTOCOPY
HRC HANDWRITING

August 12, 1998

page 2

The current bankruptcy filing rate

The Administrative Office of the United States Courts reports that bankruptcy filings increased 8.5% for the twelve month period ending June 30, 1998. Total filings numbered 1,429,451, up from 1,316,999 for the same period in 1997. Ninety-six percent of these cases were consumer bankruptcies.

At least one researcher, SMR Research Corporation, predicts that the number of personal bankruptcy filings will be flat in 1998 and will decline in 1999. However, SMR warns that the decline merely reflects low long term interest rates and that the causes of bankruptcy are getting worse, which ultimately will lead to a higher filing rate.

Status of the Senate Bill

The Consumer Bankruptcy Reform Act of 1997 was reported favorably out of the Senate Judiciary Committee in May by a vote of 16-2. Senator Lott's staff has announced that the senator is planning to bring S. 1301 to the floor of the Senate on or around September 4th.

This bill, co-sponsored by Senator Grassley (R-IA) and Senator Durbin (D-IL), contains consumer bankruptcy provisions, technical corrections, and an authorization for additional bankruptcy judges. The bill expands the nondischargeability of credit cards and other consumer debts.

S. 1301 differs in significant ways from H.R. 3150, but also has caused substantial concern among those familiar with the bankruptcy system due to its substantive changes and the technical unworkability of many of its provisions.

Under S. 1301, an individual debtor would be required to make a good faith attempt to create a debt repayment plan through a consumer credit counseling service within 90 days prior to filing for bankruptcy as a condition of eligibility to file. There are no exceptions for people facing imminent foreclosure or other creditor collection actions, and there is no provision for expanding or funding credit counseling services.

S. 1301 would make the ability to pay 20% of one's nonpriority unsecured debts out of disposable income grounds for conversion or dismissal of a Chapter 7 bankruptcy case, thereby imposing a "means test" to remain in Chapter 7 rather than at the point of filing, as the House bill requires.

While Senator Grassley's business bankruptcy bill, S. 1914, has not been marked up by the relevant subcommittee, substantial portions of this bill will probably be introduced on the Senate floor as amendments to the consumer bill. S. 1914 contains some controversial provisions dealing with asset securitization, small business, and employee benefits—all pro bank.

August 12, 1998

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Status of the House Bill

The Bankruptcy Reform Act of 1998 is the omnibus bankruptcy bill introduced by Rep. Gekas (R-PA), Rep. McCollum (R-FL), Rep. Boucher (D-VA), and Rep. Moran (D-VA). On June 10, the House of Representatives passed H.R. 3150 by a vote of 306 to 118. No Republicans voted against passage of H.R. 3150.

The bill would increase the amount of credit card debt surviving bankruptcy and would establish an up-front "means test" to determine Chapter 7 eligibility based on budget guidelines prescribed by the Internal Revenue Service for the purpose of offers in compromise. The bill also would eliminate the ability of self-employed people to reorganize very small businesses in Chapter 13.

When reported out of the Judiciary Committee, the bill would have curbed abuse by high end debtors by capping state homestead exemptions, but the House voted to eliminate this restriction, choosing instead to restrict bankruptcy relief for heavily indebted middle class families.

When debating this bill, the House also defeated a substitute bill introduced by several Democrats on the House Judiciary Committee that would have employed a more workable means test, deleted the new special interest exceptions to discharge for credit card debt, and modified the provisions in H.R. 3150 that discriminate against small businesses.

On the date of passage, the Administration issued a statement that it "strongly opposes" H.R. 3150 in its current form, and reiterated concerns regarding the "formulaic" means test and the nondischargeability provisions. Since then, the Attorney General has publicly said she would recommend a veto of the house bill.

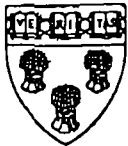
The injury to women and children in this legislation has *not* been resolved. Both the House and the Senate have tinkered with the bill, but the fact remains that substantial credit card debt would be elevated to non-dischargeable status, forcing ex-spouses trying to collect support payments to compete with banks.

Thank you again for the energy you have put into this. Each year more than a million vulnerable families will be affected by whatever changes occur.

Very truly yours,


Elizabeth Warren
Leo Gottlieb Professor of Law

cc: Brady Williamson



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May 22, 1998

2

Hillary Clinton
Office of the First Lady
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20373

Dear Mrs. Clinton:

Judge Lisa Fenning, our mutual friend, called me after your meeting with her on Wednesday. She said she thought you would find helpful some basic information about the consumer credit industry and credit card issuers in particular. I prepared the attached list for your use.

If you have been following the legislation, you have probably observed that the Senate bill (S. 1301) has been amended so that it more closely resembles the House bill (H.R. 3150). The Senate Judiciary Committee approved S. 1301 yesterday. Both bills have become even more pro-creditor, and both are now far more technically jumbled, so that, independently of the policy choices, they are simply bad pieces of legislation.

The people you help most with your interest in this legislation are single parents, the elderly, the unemployed, the uninsured, African American and Hispanic American families--the most vulnerable middle class Americans. Thank you for taking the time to discuss these issues with me in Boston earlier this month. I enjoyed meeting you very much and take great comfort in your interest dedication. If I can be helpful in any additional way, please feel free to call on me at any time.

Very truly yours,

Elizabeth Warren
Leo Gottlieb Professor of Law

Facts About Consumer Debt

Studies by the Congressional Budget Office, the Federal Deposit Insurance Corporation, and independent economists link the rise in consumer bankruptcies directly to the rise in consumer debt.¹

Deregulation of consumer credit interest rates have not produced a sustained decrease in interest rates. Instead, deregulation has prompted aggressive marketing and a loosening of underwriting standards that have caused a rise in consumer bankruptcies.²

Three-quarters of all households have at least one credit card, and three out of four of them also carry credit card debt from month to month.³

The growth of credit card loans has been faster than any other type of consumer loans since 1993. Credit card debt doubled in just four years: The amount of credit card loans outstanding at the end of 1997 was \$422 billion, twice as much as the amount in 1993.⁴

Credit card usage has grown fastest in recent years among debtors with the lowest incomes. Since the early 1990s, Americans with incomes below the poverty level nearly doubled their credit card usage, and those in the \$10,000-25,000 income bracket come in a close second in the rise in debt. The result is not surprising: 27% of the under-\$10,000 families have consumer debt that is more than 40% of their income. Nearly one in ten has at least one debt that is more than sixty days past due.⁵

There are well over a billion cards in circulation — a dozen credit cards for every household in the country.⁶

From 1994 through 1996, credit card issuers mailed more than two and a half billion card solicitations each year. This means more than 41 mailings went out each year to every American household--not counting telephone solicitations. Based on

industry estimates, those offers add up to about \$243,000 of credit per household per year. At this rate, in a little over four years, the credit card companies have offered about a million dollars of credit to every household in the United States.⁷

In 1997, mailed credit card solicitations jumped by 20% to three billion.⁸

Direct solicitation of both college and high school students has intensified in the past two years. Cards are available at many colleges to almost any student -- no income, no credit history and no parental signature required.⁹

Industry analysts estimate that, using a typical minimum monthly payment rate on a credit card, it would take 34 years to pay off a \$2,500 loan, and total payments would exceed 300% of the original principal. Credit card statements, unlike mortgage loans and car loans, do not disclose the amortization rates or the total interest that will be paid if the cardholder makes only the minimum monthly payment.¹⁰

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July 28, 1998

Dear Senator:

The National Partnership for Women and Families, the National Women's Law Center, and the other undersigned women's and children's organizations write to express our deep concerns about S. 1301, the Consumer Bankruptcy Reform Act of 1998. By increasing the rights of credit card companies and other creditors, the bill further jeopardizes the precarious financial position of many women and children.

Women and children are affected by the bankruptcy system in two principal ways: as creditors due child support and as potential users of the bankruptcy system. As creditors, families entitled to support receive protection under the current bankruptcy system. Child support and alimony payments are among the few debts that cannot be discharged in bankruptcy; debtors who can get their finances re-ordered in bankruptcy are left in a better position to pay support. As potential users, the current bankruptcy system provides an avenue of relief for single mothers and children experiencing financial crises, in many cases as a result of nonpayment of child support.

S. 1301 does not directly reduce the priority of child support obligations. But it does increase the rights of other creditors such as credit card lenders, setting up a competition for scarce resources between mothers and children owed support and commercial credit card companies. In such a contest mothers and children, even if they are assisted by state child support enforcement agencies, will lose out.

State child support enforcement programs collect support in only one out of five cases. For cases with support orders in place, collections were made in just over a third of the cases (35 percent); only 52 percent of the current child support due was collected in fiscal year 1996.¹ Child support reforms adopted by Congress in 1988 and 1996 should increase the effectiveness of wage withholding and other enforcement measures. Unfortunately, implementation of these reforms has been slow. Some states have not yet developed the automated child support enforcement systems required by Congress a decade ago. Congress can and should do more to improve the effectiveness of state child support programs -- not set up new barriers to the collection of support, as S. 1301 would do.

Our specific concerns with S. 1301 are described in more detail below.

¹*Child Support Enforcement: FY 1996 Preliminary Data Report* (August 1997).

Under S. 1301, more debts, such as credit card debt, will survive bankruptcy, and compete for payment with child support.

The bill greatly expands the categories of debts, including a substantial portion of credit card debt, that cannot be discharged in a bankruptcy proceeding. Debts incurred within 90 days of filing for bankruptcy, except for necessities that *total* less than \$400, would be nondischargeable. Debts incurred to pay other nondischargeable debts also would be nondischargeable.² Increasing the debts that survive bankruptcy means that more debts will be competing with child support payments after bankruptcy for the limited resources of a bankrupt debtor. For custodial parents forced into bankruptcy, it means that there will be fewer resources available for them to support their children.

S. 1301 creates new barriers that will make it more difficult and expensive to utilize the bankruptcy process.

In addition to expanding non-dischargeable debts, S. 1301 contains several provisions that will make accessing the necessary protections of the bankruptcy system more difficult. S. 1301 provides creditors with standing to challenge a debtor's eligibility for Chapter 7 bankruptcy based on the debtor's income and ability to repay 20 percent of non-priority unsecured debts (ironically rewarding debtors who incur more debt), and requires pre-filing credit counseling. Each of these provisions not only makes accessing the system more difficult but also increases the creditors' opportunities for costly litigation or pressuring consumers into reaffirming otherwise dischargeable debt. This has the potential for making bankruptcy a prohibitively expensive endeavor. Moreover, such costs divert more resources away from the support of children during a financial crisis.

S. 1301 strengthens the ability of credit card lenders and other creditors to take previously protected property, further increasing the competition for scarce resources with child support recipients.

S. 1301 provides credit card companies with new tools to target previously protected personal property. For example, § 317 increases the credit card industry's ability to pressure debtors into reaffirming debt by narrowing the definition of household goods and permitting credit card companies to threaten repossession of items with a minimum resale value but high personal value, such as children's toys or family heirlooms. In addition, § 305 would allow creditors to avoid the necessity of seeking a court order to obtain relief from the co-debtor stay, which

²The Committee amended the latter provision in an effort to provide some protection to families owed support. If the debtor owes child support or alimony, debts incurred to pay nondischargeable debt would not be dischargeable unless they were "intentionally" incurred. However, this may offer little or no relief since it is unclear if any debts can be "unintentionally" incurred.

currently protects spouses from losing property for which they are jointly liable with a debtor. This provision will hurt women and children because it will permit a creditor to repossess, without court permission, valuable items (such as a car or washing machine) from a spouse, even though the debtor was making payments on the items under a Chapter 13 payment plan. Although this section would not apply to property maintained pursuant to a legally binding separation agreement or divorce decree, families who enter into informal agreements for support and maintenance will be vulnerable to the unilateral actions of creditors.

The Amendments to S. 1301 Designed to Protect Child Support Are Inadequate.

In response to the concern over allowing credit card debts to survive bankruptcy and compete with child support, several amendments were made to the bill in committee to strengthen the position of custodial parents who are owed child support by bankrupt debtors. While the majority of these amendments have been adopted in an effort to place a higher priority on the collection of child support during bankruptcy proceedings, they will not affect the anticipated post-bankruptcy competition between custodial parents and credit card companies. Furthermore, amendments intended to increase child support collection during bankruptcy may have unintended adverse consequences in some cases.

For example, § 323 gives child support and alimony "first priority" in Chapter 7 bankruptcy proceedings. This amendment will have limited practical effect; the vast majority of Chapter 7 debtors have no assets to distribute to creditors, making the level of a creditor's priority irrelevant. And while making support debts the "first priority" sounds good, it may not be in the best interests of support recipients to subordinate administrative expenses to support debts. Unless the administrative expenses of liquidation can be paid, it may not be possible to arrange for the sale of assets from which support, and other debts, must be paid. Likewise, § 324 would allow support obligations to be paid before other priority creditors are satisfied in Chapter 13 bankruptcy plans. This amendment is also unlikely to have any effect on the payment of child support during Chapter 13 proceedings because the amendment *permits* but does not *require* paying child support debts first, and, in most Chapter 13 cases, support obligations are already being paid first.

Language was also added to condition confirmation of a Chapter 13 plan and discharge on payment of all alimony, maintenance, and child support owed by the debtor post-petition. Requiring debtors to stay current on support payments during the bankruptcy process will help many families to receive the support they need and are owed. However, if this provision is interpreted to require full payment of arrears, this amendment may result in fewer plan confirmations and Chapter 13 discharges. This could have an adverse effect on support recipients, who may prefer in certain circumstances to receive less than full payment of arrears in order to save a home or other vital property that may be jeopardized if the debtor's Chapter 13 plan or discharge is denied. Under S. 1301, the option to agree to such an arrangement may be eliminated.

S. 1301 will reduce the ability of parents to pay their most important debt -- their debt to their children. Unless it is substantially amended to protect families, not the credit industry, we urge you to withhold your support.

Very truly yours,

American Association of University Women
American Medical Women's Association
Association for Children for Enforcement of Support, Inc. (ACES)
Black Women's Agenda, Inc.
Catholics for a Free Choice
Center for Law and Social Policy
Children's Defense Fund
Church Women United-Washington Office
Coalition of Labor Union Women
Feminist Majority
General Board of Church and Society, The United Methodist Church
Hadassah
MANA, A National Latina Organization
National Association for Female Executives
National Black Women's Health Project, Inc.
National Organization for Women
National Partnership for Women & Families
National Women's Conference
National Women's Law Center
NAWE Advancing Women in Higher Education
NOW Legal Defense and Education Fund
Older Women's League (OWL)
Wider Opportunities for Women
The Woman Activist Fund, Inc.
Women Employed
Women of Reform Judaism, The Federation of Temple Sisterhoods
Women Work!
Women's Institute for Freedom of the Press
YWCA of the U.S.A.



National Partnership for Women & Families

June 9, 1998

Dear Representative:

The National Partnership for Women and Families, the National Women's Law Center, and the other undersigned women's and children's organizations write to express our deep concerns about H.R. 3150, the Bankruptcy Reform Act of 1998. By increasing the rights of credit card companies and other creditors, the bill further jeopardizes the precarious financial position of many women and children.

Women and children are affected by the bankruptcy system in two principal ways: as creditors due child support and as potential users of the bankruptcy system. As creditors, families entitled to support receive protection under the current bankruptcy system. Child support and alimony payments are among the few debts that cannot be discharged in bankruptcy; debtors who can get their finances re-ordered in bankruptcy are left in a better position to pay support. As potential users, the current bankruptcy system provides an avenue of relief for single mothers and children experiencing financial crises, in many cases as a result of nonpayment of child support.

H.R. 3150 does not directly reduce the priority of child support obligations. But it does increase the rights of other creditors such as credit card lenders, setting up a competition for scarce resources between mothers and children owed support and commercial credit card companies. In such a contest mothers and children, even if they are assisted by state child support enforcement agencies, will lose out.

State child support enforcement programs collect support in only one out of five cases. For cases with support orders in place, collections were made in just over a third of the cases (35 percent); only 52 percent of the current child support due was collected in fiscal year 1996.¹ Child support reforms adopted by Congress in 1988 and 1996 should increase the effectiveness of wage withholding and other enforcement measures. Unfortunately, implementation of these reforms has been slow. Some states have not yet developed the automated child support enforcement systems required by Congress a decade ago. Congress can and should do more to improve the effectiveness of state child support programs -- not set up new barriers to the collection of support, as H.R. 3150 would do.

Our specific concerns with H.R. 3150 are described in more detail below.

¹*Child Support Enforcement: FY 1996 Preliminary Data Report* (August 1997).

Under H.R. 3150, more debts, such as credit card debts, will survive bankruptcy, and compete for payment with child support.

The bill greatly expands the categories of debts that cannot be discharged in a bankruptcy proceeding, including a substantial portion of credit card debt (for example, debts incurred within 90 days of filing for bankruptcy, except for debts for necessities that total less than \$250, and debts which the creditor alleges were incurred without a reasonable expectation or ability to repay). Increasing the debts that survive bankruptcy means that more debts will be competing with child support payments for the limited resources of a bankrupt debtor. For custodial parents forced into bankruptcy, it means that there will be fewer resources available for them to support their children.

H.R. 3150 creates an arbitrary means test and other barriers that will make it more difficult and expensive to utilize the bankruptcy process.

In addition to expanding nondischargeable debts, H.R. 3150 contains several provisions that will make accessing the necessary protections of the bankruptcy system more difficult. H.R. 3150 imposes a strict means test for Chapter 7 relief, requires pre-filing credit counseling, and provides standing to creditors to challenge bankruptcy eligibility. Each of these provisions not only makes accessing the system more difficult but increases the creditors' opportunities for costly litigation. This has the potential for making bankruptcy a prohibitively expensive endeavor. Moreover, such costs divert more resources away from the support of children during a financial crisis.

H.R. 3150 generally strengthens the rights of credit card lenders and other creditors, further increasing the competition with child support.

In addition to making more credit card debt nondischargeable, H.R. 3150 strengthens the protections provided to credit card companies in other ways. Several provisions increase the credit card industry's ability to pressure debtors into reaffirming credit card debt by threatening the debtor with repossession or litigation. Through reaffirmation, even more credit card debts become nondischargeable in bankruptcy. Meanwhile, H.R. 3150 does nothing to control the aggressive marketing of high interest credit cards to vulnerable consumers.

The Amendments to H.R. 3150 Designed to Protect Child Support Are Insufficient.

In response to the concern over allowing credit card debts to survive bankruptcy and compete with child support, several amendments were made to the bill. For example, §150 purports to give priority to past child support debts after bankruptcy. Unfortunately, this provision will be virtually impossible to enforce. In Chapter 7 bankruptcies, the most common form of personal bankruptcy, the bankruptcy courts are involved for only a brief period of time. After the debtor's assets (if any) are liquidated, the bankruptcy court does not continue to supervise the debtor's affairs, and there is no other system for coordinating debt collection and child support

enforcement. All creditors holding nondischargeable debts (including women owed child support and, under H.R. 3150, credit card companies) will be competing for payment, and there will be no referee to enforce the priority of child support. Collection agents or other creditor representatives have no incentive to advise the debtor that he should pay his child support first, and are unlikely to do so; even if they did, it would remain within the debtor's discretion whether to honor child support's priority. Even if the credit card companies use the judicial process to collect, the various courts to which they might take their claims will have no way of knowing that a priority child support order exists.

Language also was added that purports to protect the payment of child support in Chapter 13 bankruptcy plans. However, other provisions of H.R. 3150 require that "adequate income," and no less than \$50 per month, be committed to repaying non-priority, unsecured debt -- such as credit card debt -- in Chapter 13 plans. If a debtor in Chapter 13 bankruptcy also must make regular payments on credit card debts, payments on child support debt will have to be smaller, and spread out over a longer period of time. H.R. 3150 says that child support must be paid in full; but in the real world of limited resources, the bill makes it less likely that this will occur.

This Bankruptcy Reform Act will reduce the ability of parents to pay their most important debt -- their debt to their children. It is for these reasons that we strongly oppose H.R. 3150 and urge you to oppose it as well.

Very truly yours,

American Association of University Women
Association for Children for Enforcement of Support, Inc.
Black Women's Agenda, Inc.
Business and Professional Women/USA
Center for Advancement of Public Policy
Children's Defense Fund
Church Women United
Coalition of Labor Union Women
Federally Employed Women, Inc.
Feminist Majority
MANA, A National Latina Organization
National Association of Commissions For Women
National Association for Female Executives
National Organization for Women
National Women's Conference
NAWE Advancing Women in Higher Education
NOW Legal Defense and Education Fund
Older Women's League
The Woman Activist Fund, Inc.
Women Work!
YWCA of the U.S.A.