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PANEL DISCUSSION: CONSUMER BANKRUPTCY

PROFESSOR FELSENFELD: Good morning. On behalf of the Fordham Law School Graduate Program, I want to welcome you here for a day-long conference dealing with the subject of consumer bankruptcy.

The subject of consumer bankruptcy has achieved high visibility over the last few years. This stems principally from the dramatic increase in the number of consumers who are now choosing the bankruptcy option. Led by consumer-related bankruptcies, the number of bankruptcy filings reached an all-time high in 1996, when consumer bankruptcy filings exceeded the one-million mark for the first time in history.1 Projections for 1997 are even higher.2 In fact, a new record for filings in the second quarter was established this year, when 367,000 bankruptcy cases were filed.3 This indicates an annual total of close to 1,500,000.4 This means that the total number of bankruptcy filings in 1997 is now expected to exceed those in 1996 by some 23%.5

On the other hand, while 1997 is expected to set an all-time record for the number of bankruptcy filings, it may be that the peak growth rate has been reached and passed. It is significant that the rate of creditor charge-offs showed a decline in June and in July.6

Analyses of the problem—if, indeed, there is a problem—differ. In the second quarter of 1997, commercial banks set an all-time earnings record. The banking system is acknowledged by both the banks themselves and by their regulators to be in excellent financial condition, despite consumer lenders' loss of some $40 billion per year as a result of consumer bankruptcies.7

2. See infra notes 4-5.
4. Professor Felsenfeld's prediction was slightly over the mark. In 1997, 1,350,118 petitions were filed or are pending. See American Bankr. Inst., supra note 3 (collecting data from the Administrative Office of U.S. Courts).
5. In fact, the total number of bankruptcy filings increased by 19% in 1997. See id.
It may be that those who suffer the most from high rates of consumer default and bankruptcy are consumers, both the consumer debtors themselves, who cannot repay all of what they borrow, and the consumers who pay on time but must pay higher prices to cover the cost of those who do not. Creditors have been criticized for lending too much, and perhaps the diminishing rate of charge-offs already mentioned has started to reflect a measure of creditor restraint.

One also has begun to see the imposition by the credit card lenders of tighter credit standards and a reduction in the solicitation of new debt. But these measures can also adversely affect many consumers. For example, when creditors tighten standards, it reduces credit availability, particularly for consumers at the margin.

A significant piece of this mix is the nature of our bankruptcy laws. Perhaps they are part of the problem of consumer debt as well as being part of the solution. In Roman times, bankrupts were frequently killed as a punishment for the non-payment of debt. Today, their unpaid debts are discharged and they are welcomed into a growing fraternity where it is no disgrace to be bankrupt. In the Bankruptcy Code, they are no longer even called bankrupts.

A question now asked is whether the laws are too lenient and whether the startling rise in the number of consumer bankrupts results from their—and their lawyers’—realization that, however much they may earn, they do not have to pay their debts.

It has been proposed that the law be changed so that some part of income earned after a bankruptcy be applied to debt that is discharged. The concept is called “needs-based bankruptcy,” and it is a much-debated proposal.

An overall review of the Bankruptcy Code has been undertaken by the National Bankruptcy Review Commission, established by Congress in 1994. Its final report is due on October 20, but there have been a number of disclosures of what that report will contain. Judge Edith Jones, with us today, is a member of the Commission and may have something to say about its report.

8. See Ausubel, supra note 6, at 264-70.
Our program today will start with some informal, but prepared, remarks by our five speakers. This will be followed by a group discussion.

We are fortunate to have an outstanding panel here today to discuss consumer bankruptcy. They are the Honorable Edith Jones, Jane McNamara, Karen Gross, Henry ("Hank") Hildebrand, and Michael McEneney.

Our first speaker is Judge Jones, who is a member of the National Bankruptcy Review Commission. Judge Jones, it is a pleasure to have you here.

JUDGE JONES: Thank you, Professor Felsenfeld. My claim to fame with regard to being on the Commission is that I did practice bankruptcy law before I went on the court—practiced it very intensively under the new Code, mostly in the Chapter 11 area. I have become much more acquainted with consumer bankruptcy during the course of the Commission.

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14. United States Court of Appeals Judge for the Fifth Circuit. Judge Jones is a graduate of the University of Texas Law School, where she was an Editor of the Law Review. She was an associate with Andrews & Kurth, a law firm in Houston, and became a partner in 1982. She became a judge at the Court of Appeals in 1985 and, among her other honors, Judge Jones was a member of the National Bankruptcy Review Commission.

15. Executive Vice President of Credit Counseling Center, Inc. Ms. McNamara graduated from Michigan State University, earning a Bachelor of Science and a Master of Arts from Michigan State University. She joined the Credit Counseling Center in 1980 as a credit counselor and is currently Executive Vice President. In 1985 she was President of the Society of Consumer Affairs Professionals, one of the ranking positions in her field.

16. Professor of Law at the New York Law School, specializing in bankruptcy law. Professor Gross is a graduate of Smith College. She graduated from Temple University Law School, having spent her third year of law school at the University of Chicago. She was an associate with Weil Gotshal & Manges in New York. She joined New York Law School in 1984, became a full professor in 1989, and remains there today. Professor Gross speaks frequently on the subject of bankruptcy, and has been in regular communication with the Bankruptcy Review Commission on a number of other problems.

Professor Gross has written a fascinating book on bankruptcy, called *Failure and Forgiveness: Rebalancing the Bankruptcy System*, published in 1997 by the Yale University Press.

17. Standing Chapter 13 Trustee. Mr. Hildebrand is also a Standing Chapter 12 Trustee, which he has been since 1986. He is a partner in the Nashville law firm of Lassiter Tidwell & Hildebrand. Mr. Hildebrand attended Vanderbilt University and George Washington Law School and has held a number of prominent positions in the bankruptcy field, including committees of the American Bar Association and the American Bankruptcy Institute.

18. Partner, Morrison & Foerster, Washington, D.C. Mr. McEneney graduated from Manhattan College and the Boston University Law School. He was a senior accountant for Price Waterhouse until 1987, when he joined San Francisco-based Morrison & Foerster, and is a partner in its Washington, D.C. office. Mr. McEneney specializes in creditor-side bankruptcy work.
I think I can best use my time by summarizing the two approaches

to consumer bankruptcy law that will be contained in the Commission

report.19

The Commission was deeply divided on the proper approach to

consumer bankruptcy law. To be quite honest, I think when the Com-

mission started out nobody anticipated there would be such a strong

focus on this area. At that time—November 1994—the economy was

in pretty good shape, and the number of bankruptcies had actually

stabilized at a modest rate of about 850,000 a year.20 Although this

was a much higher rate than when the Code was passed,21 it appeared

that the number had peaked.

Suddenly, in 1996 the number began to skyrocket.22 Perhaps, if you

want to draw a crude cause-and-effect analysis, it was because of fear

that the Commission would change the Bankruptcy Code. We will let

Mr. McEneney speculate on that. Nevertheless, this dramatic in-

crease, followed by another dramatic increase that is ongoing right

now,23 has suddenly put a great deal of pressure on the issues sur-

rounding consumer bankruptcy.24

The Commission report contains two starkly different approaches to

what should be done. Five of the Commissioners will file a majority

report that can be summarized by saying that the number of filings in

bankruptcy is irrelevant to social welfare concerns;25 that the choice

between Chapter 7 and Chapter 13 is irrelevant—or perhaps that

Chapter 7 filings are socially preferable; and that bankruptcy ought to

serve the function of enacting Fair Credit Provisions in addition to and

apart from those that already exist in state and various federal laws.26

First, let me note the areas in which all nine Commissioners agree.

We all subscribe to the need for better education, either before or

after the filings—afterwards only if it is not possible to do sufficient

credit counseling in advance to prevent bankruptcies.27

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   [hereinafter Report].
20. Bureau of the Census, supra note 1, at 555 tbl.881 (stating that in 1994 there
   were 845,257 bankruptcy filings).
21. There were about 440,000 bankruptcies in 1982. See David Shribman, Bank-
    ruptcies Clog Courts and May Slow Economy's Revival, New York Times, Sept. 30,
22. See American Bankr. Inst., supra note 3. Bankruptcy filings increased from
23. See supra note 22 and accompanying text.
24. See Elizabeth Warren, The Bankruptcy Crisis, 73 Ind. L.J. 1079, 1079-80
27. See Report, supra note 19, § 1.1.5, at 1.
We all agree that some sort of random audit system needs to be installed.\textsuperscript{28}

We all agree that debtors who complete Chapter 13 plans ought to get favorable treatment on their credit reports and the law should be accordingly changed.\textsuperscript{29}

And we all agree that there should be a national filing system to identify filers and prevent abusive repeat filings.\textsuperscript{30}

From there, there is little agreement. The significant features of the majority report are, to me, eight in number:

The majority report would considerably limit reaffirmations.\textsuperscript{31}

Under present law, a debtor can reaffirm virtually any debt with or without the guidance of counsel, although counsel is obligated to explain the consequences of reaffirmation. Such reaffirmations occur very frequently under current law. The proposal would limit them to only the secured portion of secured debts, thus eliminating reaffirmations for unsecured debt.\textsuperscript{32}

The proposal also suggests that the Bankruptcy Code treat rent-to-own contracts as installment loans subject to limitation in the amount that needs to be repaid in bankruptcy.\textsuperscript{33}

With regard to housing, a modest incursion is made into the sanctity of home loans by saying that if a loan—typically a debt consolidation or home-repair loan—is entered into for more than the value of the property at the time the loan was taken out—that is to say, a 125% or so loan-to-value loan—the value of the loan will be reduced to the value of the collateral at the time the loan was taken out.\textsuperscript{34}

The proposal would eliminate security interests in bankruptcy for goods with “a value of less than $500.”\textsuperscript{35} Well, I can guarantee that there are very few items of household goods for most of us, to say nothing of most consumer bankrupts, that are “valued at more than $500” at the time of filing. So it basically transforms that entire industry into unsecured lending.

Finally, the Commission takes a position on the \textit{Rash} case,\textsuperscript{36} saying that the value of collateral ought to be wholesale and that the interest rate—which is supposedly to adjust for the risk for the lender in mak-

\begin{itemize}
\item \textsuperscript{28} See id. § 1.1.2, at 1.
\item \textsuperscript{29} See id. §§ 1.5.7–9, at 8-9.
\item \textsuperscript{30} See id. § 1.1.1, at 1.
\item \textsuperscript{31} See id. § 1.3.1, at 3-4.
\item \textsuperscript{32} See Report, supra note 19, § 1.3.1, at 3-4.
\item \textsuperscript{33} See id. § 1.3.5, at 5.
\item \textsuperscript{34} See Report, supra note 19, § 1.5.2, at 7.
\item \textsuperscript{35} See id. § 1.3.4, at 4-5.
\item \textsuperscript{36} Associates Commercial Corp. v. Rash, 117 S. Ct. 1879 (1997).
\end{itemize}
ing a forced re-loan of the money involved in a cram-down—should be the six-month T-bill rate.\textsuperscript{37}

The Commission proposes uniform exemptions.\textsuperscript{38} I think, to one degree or another, each except one of the Commissioners might support an approach to uniform exemptions by making them federally uniform or capping them. Four of us, however, do not support the approach that was voted last week that would give $20,000 per debtor in personal possessions—and, of course, if that is a husband and wife that is $40,000—plus retirement funds, plus a minimum of $30,000 and a maximum of $100,000 on equity in the home.\textsuperscript{39}

The majority suggests that, as to credit cards, anything purchased thirty-one days or more before bankruptcy is dischargeable if it is within the authorized credit limit under the card.\textsuperscript{40} Anything thirty days or less before bankruptcy is non-dischargeable.\textsuperscript{41} Therefore, it does away with any kind of fraud or inability-to-repay criteria for purchases more than thirty days before bankruptcy.\textsuperscript{42}

Finally, on serial filings the majority proposes a sort of “three strikes and you’re out.”\textsuperscript{43} Otherwise you should not file more than once every six years.

I suggest that the bottom-line impact of these proposals will be as follows: First, there will be an increased number of bankruptcies; second, there will be an increased proportion of Chapter 7s; and third, there will be decreased available credit for the poor and the marginally creditworthy, which I would be interested in hearing other people speak about.

Four Commissioners, including myself, have taken a radically different approach.\textsuperscript{44} We do not subscribe to any of what I call “fair credit standards and lien-stripping proposals.”

We believe that there is a considerably greater problem of bankruptcy fraud than the majority do. Their only remedies are either the

\textsuperscript{37.} See Report, supra note 19, § 1.5.3, at 7 (“Payments on secured debts that are subject to modification should be spread over the life of the plan, according to fixed criteria for interest rates.”).

\textsuperscript{38.} See id. §§ 1.2.1–.6, at 2-3.

\textsuperscript{39.} See id. §§ 1.2.2–.3, at 2-3.

\textsuperscript{40.} See id. § 1.4.1, at 5.

\textsuperscript{41.} See id.

\textsuperscript{42.} See id.

\textsuperscript{43.} See id. § 1.5.5, at 7-8.

\textsuperscript{44.} Judge Jones and Commissioner James I. Shepard fully explicated these views in their dissent, Edith H. Jones & James I. Shepard, Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, in Report, supra note 19 [hereinafter, Jones & Shepard, Dissent]. Commissioners John A. Gose and Jeffery J. Hartley concurred with “many of the substantive proposals” in the dissent, see id. at 1 n.****, however, they wrote a concurrence to it, see John A. Gose & Jeffery J. Hartley, Commissioners Gose and Hartley: Concurrence with Consumer Dissenting Opinion, in Report, supra note 19.
“three strikes” provision, an in rem provision that is of some utility around the country, and the threat of random audits. We propose: (1) that the Code require debtors to file their tax returns with their petitions; (2) that the Code require trustees to file a certificate with the court stating that debtors have fully cooperated with the trustee before debtors obtain a discharge; and (3) that if debtors do not file materially accurate schedules and statements of affairs to begin with, then they ought to be penalized, either by the denial of a discharge or the denial of some other benefits of bankruptcy.

People say, “Well, there is not a lot of fraud in consumer bankruptcy.” I do not disagree with that. I think the majority of debtors are well-intentioned, although, unfortunately, they are not all well-counseled. Even a fraud rate of only 5%, however, is 70,000 fraudulent filings per year. I believe that is more than all of the criminal prosecutions in federal courts each year. So, to me, that bespeaks a significant social problem.

Our other recommendations are mainly geared toward clearing up unclear provisions in the law. We have a slightly different approach on the Rash case—we said the value of collateral should be the midpoint between the wholesale and retail values—and I do not recall whether we took a position on the interest rate.

It is our view that the present bankruptcy law needs to be tightened up considerably, that it is too vague, and that this creates a lot of uncertainty around the country, which is unfair to debtors as well as to creditors and increases the transactional costs of consumer bankruptcy.

45. See Report, supra note 19, § 1.5.5, at 7-8.
46. See id. § 1.5.6, at 8.
47. See id. § 1.1.2, at 1.
48. See Jones & Shepard, Dissent, supra note 44, at 19-20 (Editor’s note: The various dissents and commentaries in chapter five of the Report are each separately paginated.).
49. See id.
50. See id.
51. See American Bankr. Inst., supra note 3. Based on 1997 figures, five percent of annual bankruptcy filings is approximately 70,200. See id.
54. See Report, supra note 19, §§ 1.5.2–3, at 101.
55. See Jones & Shepard, Dissent, supra note 44, at 71-72 (Editor’s note: The various dissents and commentaries in chapter five of the Report are each separately paginated.).
A couple of us, at least, think that the time has come to consider means testing. I do not call it “needs-based”; I call it “means testing” by way of drawing an analogy between bankruptcy relief and that relief which constitutes other portions of society’s social safety net. All of the welfare programs that I know are subject to means testing—whether they are Medicaid, or AFDC, or Food Stamps—and means testing offers the opportunity for an entirely new review of the availability of bankruptcy relief.

I do not consider it involuntary servitude to tell people they ought to pay back some of the money they have borrowed. When you have used other people’s money, most laymen on the street say you ought to pay it back, and I do not see anything particularly extraordinary or penal in asking people to do that to the best of their ability. If you see people like actress Kim Basinger, Governor Symington in Arizona, heart surgeon Dr. Denton Cooley, and former Baseball Commissioner Bowie Kuhn, taking full advantage of the bankruptcy laws when we all know that they have huge earning capacity in the future, of course there is going to be some manipulation and abuse. I think the time has come to stop that.

PROFESSOR FELSENFELD: Thank you.

Our next speaker is Jane McNamara. Thank you for being with us, Jane.

MS. McNAMARA: Thank you.

I am going to talk about alternatives to bankruptcy from the perspective of family financial counseling.

I am sure you are going to hear lots of statistics today. I am going to give you a perspective from comparisons of primarily Chapter 13s to doing credit or debt counseling. It is referred to many different ways. I refer to it as “family financial counseling” because if you do not have the involvement of all the individuals in the family, you are not going to have cooperation.

As Judge Jones mentioned, we have seen an increasing rise in bankruptcies. In 1997, we are projecting 1.3 million. And, of course, the numbers continue to go up.

Well, what are we talking about in terms of the financial health of the consumer?

Income has been flat for about the last twenty years, despite a 56% increase in two-income households.

Debt itself is at or near record levels for individual households, with a debt-to-payment ratio about 20% of take-home pay.

56. See Edith H. Jones and James I. Shepard, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law, in Report, supra note 19, at 15.
57. See supra note 4 and accompanying text.
Bank card delinquencies are currently running at 3.69%, which is much, much higher than what we normally see.  

Savings: only 57% of households save; 27% save for retirement and 56% have pensions.  

Net worth: the average is $52,000.  This is an average of everyone from one extreme to the other—from Bill Gates to ADC mothers.  

Seven percent of everyone out there is considered insolvent or eligible for bankruptcy because they did not pay their debts. 

The individuals that we typically see at Credit Counseling Center have: 

- Gross income of about $26,000. 
- Total debt of about $19,000. 
- A debt-to-income ratio of 71%. 
- Ten creditors only. 
- An insolvency ratio of 86%. 

The amount we are asking individuals to bring to us in order for us to pay their creditors is $348, but the amount we actually receive from them is $286, so the percentage of deposits received is about 82%. 

What are we seeing in terms of a record number of people filing bankruptcy? Well, many consumers are financially illiterate. We do not teach personal finance in the school system. We do not teach consumers how much credit they really can afford. There are too many living on the edge. Wages are down in real dollars. Divorces and uninsured medical bills are causing people to file bankruptcies. Moreover, creditors are going deeper into the risk pool to obtain customers. 

What can be done to help reduce bankruptcy losses? 

- Consumer education and money management. It ought to be a requirement that everyone have a course in personal finance before they get out of high school. 
- Tighter underwriting by creditors.

59. See Ausubel, supra note 6, at 249 (noting that credit card delinquencies exceeded 3.5%, which was the highest rate recorded since such records were created). 
60. See Bureau of the Census, supra note 1, at 482 tbl.767. 
61. See id. 
62. One commentator has posited that as many as 15% of U.S. households may benefit financially by filing for bankruptcy. See Michelle J. White, Why Don’t More Households File for Bankruptcy?, 14 J.L. Econ. & Org. 205, 206 (1998). 
63. The median income of all families in 1996 was $42,300. See Bureau of the Census, supra note 1, at 472 tbl.746. Median income peaked in 1989 at $43,290, in 1996 dollars. See id. 
64. See Warren, supra note 24, at 1084 (observing that some individuals may carry high, manageable debt until a crisis occurs). 
65. See id. at 1083 (“When the [credit] cards are highly profitable, credit card issuers have a strong incentive to distribute them to marginal borrowers and to borrowers already loaded with debts, which increases both the issuer’s profits and its loan defaults.”).
Early referrals to the National Foundation for Consumer Credit member agencies' consumer credit counseling services.

Finally, creditors' making concessions by cutting interest rates and eliminating service fees.

When an individual comes to us for counseling, we do a budget analysis. We assess what their spending is on secured debt, unsecured debt, and household expenses. We then assess whether or not we can help them and explain to them alternatives, including bankruptcy.

If we can help them, we set them up on a "debt repayment program" or a "debt management program." We negotiate terms of repayment with their creditors. The individuals then give us their money, we pay their creditors on their behalf, and we teach them how to manage their money. Unfortunately, some people do not learn that. An awful lot of them, however, do.

When we negotiate with creditors, we need concessions in order for the program to work. We need to them to cut or eliminate interest rates and service fees, because otherwise while we are making a minimal payment on a credit card, for example, the interest rates and fees just increase that balance. So even though an individual may want to pay, it is very difficult for them to make any headway in terms of reducing those balances.

The National Foundation for Consumer Credit ("NFCC") has a large network. What do we do? We teach financial literacy to people. We provide free preventative education to millions of people each year. We provide remedial education to about as many people as those filing bankruptcy. We can also assure the consumers that they will receive a quality service.

The NFCC requires member agencies to become accredited by the Council of Accreditation for Families and Children Services here in New York. They are an independent organization that has a peer review system and certain standards that insure that we provide quality service. It is, as I refer to it, a "Good Housekeeping Seal of Approval," if you will, that can assure the consumer that if they come to an NFCC member agency, then they will receive a certain level of service.

In 1983, there were 207 NFCC offices. In 1997, there will be about 1400. Over the years the number of locations throughout the United States has increased because of the increasing need for the service.

The number of people that we see through educational presentations continues to increase greatly on an annual basis. In 1997, over two million consumers or customers will contact our counseling agencies, hoping to avoid bankruptcy.

An awful lot of people do not know the service exists. I know we have someone here from Visa International. They have very graciously committed dollars to provide a national advertising campaign
in major cities of the United States to help consumers become aware that we are out there and that we are an alternative to bankruptcy.

There are more new debt management programs established on an annual basis than Chapter 13 filings. In 1995, there were more Chapter 13 filings. In 1996, however, there were more debt management programs. That will also be the case in 1997.

What are the results of counseling?

- Thirty-four percent go on a debt management program.
- Seven percent are recommended to a legal advisor.
- Twenty-five percent are on assignment. Debtors on assignment may not have the money to make their regularly scheduled payments, but they make a decision that they do not want to commit to a program.
- Thirty-four percent are given budget counseling. Approximately half of the 972,000 individuals counseled in 1996 closed successfully. The other half closed unsuccessfully, primarily because we could not reduce their debt fast enough.

In 1997, our agencies will return $4 billion to the credit community though these efforts.

Of those people who we do set up on debt management programs:

- Five percent file bankruptcy.
- Forty-eight percent do not pay us. If they do not pay us, we cannot help them. We do not do anything for them they could not do for themselves. We are there to help them help themselves.
- Twenty-five percent complete the program, where all of their debts are paid off to their creditors.
- Twenty-two percent who are on the program for a while decide the crisis has been reduced, they now can handle things more effectively, they have learned how to budget, and they will handle the payment of their creditors themselves.

A debt management program provides some of the benefits of a Chapter 7 or 13 bankruptcy. For example, a debt management program in many cases can stop collection efforts. In most cases, we can eliminate interest because a number of major creditors have committed to stop interest when an individual signs up on a program with us. Of course, if a consumer stops paying us and we drop them from the program, all of these benefits go away.

Can we eliminate principal? No, and that is not why we are there. We have a philosophy that credit is a privilege, not a right, and consumers have a responsibility to repay the credit that they assume. Do we reduce principal? Yes.

On the average, a program lasts for three to five years. In my particular agency, in Michigan, people stay in a debt management program about sixteen months. We have seven offices in Metropolitan New York, and here people stay on the program about eight months.
Many consumers want to pay, but it is really a delicate balance. We need creditor cooperation because without it the balances owed are going to continue to increase on unsecured debt. We need them to reduce or eliminate finance charges and waive late or over-limit fees.

How long does it take consumers to repay? If we do not have creditor concessions, it can be as long as eight years; if we have 50% creditor concessions, 4.9 years; if we have 100% creditor concessions, 3.5 years. This is for an average debt repayment or indebtedness of about $19,000, so this is a long time.

I want to briefly give you some statistics from my organization. We are one of the largest of this type of service in the United States.

- As of December 31, 1996, we had thirty-seven branch locations: thirty in Michigan, one in Illinois, and six at that point in Metropolitan New York. We since have opened another office here in New York.
- We had close to 11,000 client accounts at year-end.
- We disbursed close to $74 million. This year it will be about $100 million.
- Net revenue for our agency was about $284,000. The revenue that we make—we are a not-for-profit—goes back into providing new services and expanding the business, opening more offices.
- We have 144 full-time and seven part-time employees.

The demographics of an average client:

- Average age: 36 in Michigan, slightly less than New York.
- Family members: 2.6 in Michigan, 2.1 in New York.
- We see more married people in Michigan and Illinois than here in New York. Although we have more divorces in Michigan and we have fewer single people, we see many more single people here.
- Number of creditors: fifteen in Michigan, ten in New York.
- Total indebtedness, not including mortgage: about $28,000 in Michigan, $24,000 in New York.

Prior to our panel discussion, I emailed the branch managers and asked them to go through their closed accounts and pull some information for me on individuals that they have seen in the past ninety days who had filed bankruptcy. Sixteen of the thirty-six offices responded. This information I am going to share with you consists of seventy clients, about 6% of our total client base.

- Thirty-eight were single, thirty-two married; forty-three males and twenty-seven females.
- Age ranges: The largest number were 30-39, the next category being 40-49. We do see some retirees and people that are on fixed incomes, many who surprisingly had credit card debt, that come to us for help, and many who use credit cards for cash advances and to pay physicians as well as to pay for medication.
- Forty-two of the seventy people were blue collar, twenty-eight white collar, and two retired people.
The monthly net income of the clients ranged predominantly in the $2000-$2999 range. The next-largest category, below $2000 a household. Although we see expenses considerably higher, 25-30% higher, here in New York versus Michigan, we see salaries at the same level or less. So even though it costs more to live here, salaries are comparable to what we see in Michigan.

The amounts owing by our particular clients who filed a bankruptcy ranged from $6600 to $126,000. The total amount of dollars lost in these seventy client cases was $2.5 million.

JUDGE JONES: Dollars lost to their creditors or to the clients?

MS. McNAMARA: Dollars lost to the creditors. This is the amount that was owed. The average amount of debt owed was about $36,000, but the total amount lost that would not be repaid to the credit community was $2.5 million.

The type of indebtedness that the people had who filed:

- Almost every one had credit cards.
- Auto loans—we do not see as many of those here in New York as we do in Michigan.
- Medical bills.
- Student loans.
- Judgments and taxes that were owed.
- Cash advances that were taken.
- Boat loans.
- Gambling. People take cash advances on credit cards to not only facilitate the gambling but to help cover their losses.

Reasons they originally visited us:

- They were over-extended or it was a money mismanagement problem.
- Divorce.
- Reduced income.
- Medical problems and bills.
- High interest rates.
- Individuals helping children financially. We are seeing people who theoretically should be “empty nesters” who are not because their grown children are moving back home.
- People living beyond their means.
- And again, gambling being a problem.

Why did they file bankruptcy?

- Predominantly it was a reduction in income or job loss.
- Creditor pressure was the number two reason why they filed bankruptcy.
- They were unable to maintain their arrangements with us, the amount of dollars they committed to give to us in order for us to pay their creditors.
- They just gave up. The home budget was too tight and they did not want to live with that for two or three years.
Living beyond their means—there were a few of these, but they were not predominate.

Illness of the clients themselves or a family member that they were supporting.

There was legal action pending and it could be stopped through a bankruptcy.

There was a death in the family.

We see consumers from all walks of life, and it is a misconception that people that use our services are low-income. That is not the case.

There is a responsibility to repay debt, but if people do not know consumer credit counseling services are out there and we are an alternative, many of them end up, obviously, in bankruptcy. That is something that we want to avoid.

PROFESSOR FELSENFELD: Thank you, Jane. I am sure we will have a lot to say about those statistics in the course of the day because I think there is a great deal to be learned from them.

Our next speaker is Karen Gross.

PROFESSOR GROSS: Thank you. It is nice to be here, and it is nice to have an opportunity to talk about these issues.

My presentation is of a slightly different nature than the others. It is, perhaps not surprisingly, a little academic in nature. I took Carl at his word, that my job was to chat with you about how one thinks about balancing the interests of debtors and creditors.

While I spent a lot of my law practice years at big firms doing largely Chapter 11 work, I did spend a significant portion of my last sabbatical working with debtors at the New York Legal Aid Society. In terms of my practice experience, the more recent of it has involved real people with real debts.

I wanted to start with a couple of quotes about bankruptcy, the earliest from 1790 and the most recent from 1970, without giving you the dates or the sources, although I have them all. What is remarkable about these quotes, I think, is that you cannot tell when they were written. Let me read them to you without the dates and then we can, if you want, later decipher them, and I can share with you some of my thoughts about what they show.

Despite the stigma of bankruptcy and the evidence it gives of financial failure, debtors find it really no harder to get credit after bankruptcy than they did before. Creditors take the risk of loss on bad debts in order to do business.

Although the debtor is discharged of the debts listed in his bankruptcy, he is sometimes harassed by his creditors about his discharged debts, and sometimes makes binding new agreements to pay them.66

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Next quote:

Misfortune, enterprise, speculation, and a spirit of over-trading have involved thousands into ruin. Widows and orphans, fair merchants, industrious tradesmen, and incredulous friends, rise no more. We should give to creditors a control over property of their debtors so as to stop the fraudulent and we should rescue the honest and unfortunate insolvent from the oppression of a vindictive creditor.\(^{67}\)

Next quote:

Riches carry influence into every society. Wealth is power. But analyze the merit that is found to consist in virtue, in honor, in benevolence. I believe there has never been a criminal code, either in ancient or modern times, which has denounced poverty as a crime. The Gospel inculcates the sentiment of mercy to our debtors. The gates of Heaven were unfolded to receive Lazarus. It is a fact notorious in the history of all nations that the arbitrary and uncontrolled power which has been vested in the creditor has convulsed to its center in almost every community.\(^{68}\)

Let me stop there. The first quote is recent; it is from the 1970s and it is in *The Brookings Report on Bankruptcy*.\(^{69}\) The second one was from the 1790s, by Senator Harrison Wright Otis.\(^{70}\) The last one was from 1823 in a speech by someone named Colonel Richard Johnson.\(^{71}\)

I could keep going. There are similar quotes from others, but what is remarkable, and what these quotes demonstrate to me, is that the debate about debtors and creditors and how to think about them goes back certainly to our earliest history, if not before. This debate is really a very fundamental one about human nature, about how people live in a market-based economy, about freedom, about choice, and about economic and political and social theory. It is no wonder that resolution is very hard to come by.

As Judge Jones points out, there is a very clear split on the Commission between the majority and the minority,\(^{72}\) and it is striking to me that people would be surprised about that. It is not surprising because what is at issue are very fundamental notions about how we believe people act and behave. Indeed, in this area, reasonable people can certainly differ, depending on one’s perspective.

It seems to me, however, that in resolving these disputes, there is no room for rudeness, acrimony, or petty politics. The issues are far too important for that. They involve far too many people to land into

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69. See supra note 66.
70. See supra note 67.
71. See supra note 68.
72. See supra notes 31-44 and accompanying text.
either I call mono-perspectival approaches—i.e., you cannot approach
this either as a debtor representative or a creditor representative. We
have to approach these issues as thoughtful people trying to deal with
a very real and significant social issue.

As an historical matter, the majority and minority are not as far
apart as they could be. If you think of it as a spectrum, one end of the
spectrum would be to put debtors into jail. The other end of the spec-
trum would be to completely discharge all of their debts. Neither the
majority nor the minority is adopting an extremist position. I think
that is important to think about.

I would like to draw your attention to a new law review article by a
Iain Ramsay, a professor in Canada, that talks about three different
models for thinking about consumer bankruptcy. He says that it is
pretty easy to come up with different models. You can think about
consumer bankruptcy laws as a response to deviant behavior, and if
you think about it that way, you can come up with one model; you
can think about consumer bankruptcy as a kind of consumer protec-
tion; and lastly, you can think about bankruptcy as a kind of social
welfare system. While I do not agree with everything he says, what
he is articulating is that there are lots of models and ways to think
about what is happening in the consumer system.

Having said that, how is it that I think we should think about bank-
ruptcy and what do I think we should bring to the table?

I think we know remarkably little about debtors and creditors. In-
deed, I think we know more about the mating habits of fruit flies than
we do about the behavior of debtors and creditors. That is not to say
that understanding fruit flies is insignificant, but it is to say that we
should care about who our debtors are and who our creditors are.

Let me give you a sense of what we do not know. We are develop-
ing a bankruptcy system, but we do not know the general age of our
debtors; we do not know their gender, their marital status, their
ethnicity, or their race. So, we develop a system without a very clear
picture of who the users of the system are.

Similarly, there is a lot we do not know about creditors. We do not
know about a lot of their loss, and we do not know about the amount
they recover at the back end—either through repayment, through
sales of accounts to transferees, or through tax benefits.

In fact, it is quite striking, I think, that despite our effort to homog-
enize debtors and creditors, debtors and creditors within each group

73. See Iain D.C. Ramsay, Models of Consumer Bankruptcy: Implications for Re-
74. See Ramsay, supra note 73, at 270-74.
75. See id. at 274-78.
76. See id. at 278-82.
77. The empirical literature about debtors is growing. See Teresa A. Sullivan et al.,
The Fragile Middle Class (forthcoming 1999).
are remarkably differently each from each other. When we speak about "debtors," we are speaking about everyone from Kim Basinger to the people I saw at Legal Aid. In other words, the range of people is very different. So, to speak about bankruptcy as only involving the high profile players of the world is as anomalous as speaking about bankruptcy as if the only debtors were Legal Aid clients.

Having said that we need more data to inform our thinking about how to achieve a balance, let me raise the second issue: How should we think about the question of abuse? Judge Jones was sort of getting at that in her comments. I think that people are defining “abuse” very differently, and that difference accounts in part for why the camps are in such different places.

Until very recently, everybody was talking about debtor abuse. Whether you find it depends on who is doing the looking and how you define what they are looking at.

Let me give you a question: Is a debtor who could repay creditors in a Chapter 13 but instead elects to file a Chapter 7 abusing the bankruptcy system? Well, there are people who answer that question, “Yes, that is an abuse,” and that leads to the kind of means-based testing approach that Judge Jones talked about. That is because they answered that question, “Yes.”

Another group of people answer that same question, “No.” Their answer, I think, hinges on something like: “The fresh start is at the core of our bankruptcy system. Indeed, it is what distinguishes us in the United States from a host of other nations. It reveals our national humanity.”

In essence, then, the way one answers that question helps one think about why everybody characterizes the issue so differently.

Let me give you an example from a recent meeting at my son’s high school. The high school lets the freshmen off campus. There was a whole debate because there is a sense that about ten of the 110 students could/would/are abusing the privilege by smoking and drinking while they are off campus. So, ten of the 110 students are behaving in ways that we might not want as parents. The question is: How do you think about the problem?

Well, there is a whole group of parents who say, “Oh my God, that is a big problem. That means we’ve got to set up rules so that one-

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78. See Judy Brennan, "Boxing Helena" Judge Won’t Be Presiding Over Retrial, Los Angeles Times, Dec. 15, 1994, at F2 (discussing Kim Basinger’s bankruptcy, which resulted from an adverse court judgment).
79. See supra notes 51-52 and accompanying text.
81. See supra note 56 and accompanying text.
82. See Gross, supra note 16, at 91-103 (discussing some of the values underlying bankruptcy law, such as forgiveness and rehabilitation).
hundred students who are not doing anything will not slide into this terrible thing, and start smoking and drinking off campus. We’ve got to watch out. We’ve got a real problem on our hands."

A whole other group of parents said: “Now, just a minute. I do not see a problem. There are one-hundred students who are not doing anything wrong, who are handling the freedom very well. Let them have their freedom and let’s focus on the ten students who are doing something wrong and put our attention on the ten, as opposed to changing the rules for all 110.”

It is like the “good apple/bad apple” situation. When you look at a bucket of apples, do you see the bad ones or do you see the good ones?

I tell many people that the problem of how you characterize the bankruptcy system reminds me of how you think about the presumption of innocence. Our legal system, the criminal law part, operates off of a presumption of innocence. When you have that presumption it does mean that some guilty people go free; that is an inevitable consequence of that system. Now, you could have a different system. You could have a system that started with a presumption of guilt, and if you had that system some innocent people would be imprisoned.

For me, the question is: with which presumption—given that neither is perfect—are you more comfortable living? I can answer that question for you in terms of what my perspective is, and I would be happy to do that later in the conversation.

I raise it here, however, because it is a choice people are making about how to think about issues. In that sense, I think it is very critical to recognize that the issues at stake in the bankruptcy debate are very fundamental to what we believe in.

Having said that, let me just raise another issue in terms of balance. All the attention, until recently, has been on debtor abuse. There may be lots of reasons for that. But, I have said to people that the best thing that ever happened to debtors was the millionth filing and the Sears debacle, for two reasons. First of all, the millionth filing for calendar year 1996 made people recognize that bankruptcy is not a small problem, and we ought to all be paying attention to it.


84. See In re Latanowich, 207 B.R. 326, 332 (Bankr. D. Mass 1997) (stating that Sears, Roebuck & Co. admitted that, as a matter of policy, it routinely received reaffirmation agreements and did not file the reaffirmation agreements with the bankruptcy courts); see also Karen Gross, As We Fleece Our Debtors, 102 Dickinson L. Rev. 747, 749 (1998) (discussing the need for an examination of reaffirmation agreements); Bruce Mohl, Sears to Pay State, Residents $10.82 Million, Boston Globe, Sept. 4, 1997, at D2 (reporting that Sears coerced hundreds of thousands of debtors to sign invalid reaffirmation agreements). Sears settled these claims for $290 million, see Mohl, supra, and, recently, Sears officials pled guilty to criminal charges, see Ruth Ranalli, Sears Unit Is Fined $60 Million, Boston Globe, Feb. 10, 1999, at 35.
The Sears debacle also made people realize that big-time creditors were abusing—if one wants to use that word—misusing their power in the bankruptcy system and violating the bankruptcy laws. When you see big players—like Sears and Federated Department Stores and General Electric's GE Capital Unit—being referred to in newspapers and in settlements and in class actions, you have to start to believe that the problem is not just debtor abuse. When one looks at big players and big money doing things in the bankruptcy law that should make us worry, one gets a little bit skeptical about everybody focusing on so-called “debtor abuse.” It strikes me as a little bit of the pot calling the kettle black.

So, given that all of this depends on an absence of data and how we think about it depends on one's characterization, is there anything that I think one could achieve without lots of controversy?

I would like to think that one thing that should not be controversial is debtor education. It makes sense to have voluntary, census-based—not federally funded, not bureaucratic—education for the debtors in our bankruptcy system. This suggestion is not intended to diminish pre-bankruptcy debtor education, but it is to say that those in the system deserve more than a legal fresh start; they should get the tools to re-enter the credit marketplace as thoughtful and responsible consumers of credit.

Indeed, we ought to think about Canada. Canada is the only nation in North America with a mandatory debtor education program. I am not suggesting that ours be mandatory. What I am suggesting is that our neighbors from the North have a little bit to give us here in terms of how to think about this. It seems to me that debtor education makes very good sense.

I have a number of comments that I hope to share with the other participants, but why don’t I stop there.

PROFESSOR FESENFELD: Thank you, Karen.

Our next speaker is Henry (“Hank”) Hildebrand.

MR. HILDEBRAND: My perspective a little bit different from those you have heard so far. My perspective is essentially microeconomic, as opposed to macroeconomic. I guess in that context I present to you greetings from the bankruptcy capital of the world, Tennessee—although I have been advised by my friends in Atlanta.

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85. See Mohl, supra note 84. Federated owns Macy's and Bloomingdales, and it settled similar claims for $35 million. See id. GE Capital also recently settled a class-action lawsuit regarding unfiled reaffirmation agreements for $147 million to 100,000 class members. See Final Accord in G.E. Debt Collection Suit, N.Y. Times, Jan. 23, 1999, at C14.

that they now claim to be number one. 87 What I mean by that is that last year one family out of forty in Tennessee filed bankruptcy.

I started as a Chapter 13 Trustee back in the era when nobody wanted to be a Trustee. As a matter of fact, I was appointed when I was out of town. I started as a Chapter 13 Trustee and assumed responsibility for about 1800 cases. We had about sixty new Chapter 13 cases filed every month and we disbursed about $6 million a year to creditors.

Now I am a Trustee supervising about 14,000 active Chapter 13 cases. We get about 500 new Chapter 13 cases every month. This year we will disburse just shy of $80 million to creditors.

In Tennessee, we are a little different than the rest of the world, and certainly different than up here in the Northeast. Most of the people who come to bankruptcy court in Tennessee file for Chapter 13. They file under the repayment bankruptcy system. That tends to be true in districts that are located in the Southeast. Thus, the districts in which the majority of bankruptcy filings are filed under Chapter 13 are in North Carolina, Georgia, Alabama, Tennessee, Texas, and Puerto Rico. With the exception of Puerto Rico, we are talking about one quadrant of the country.

I have frequently been asked why is this and what happens? Well, I grew up right outside of New York. This is a little bit like coming home to me. When I grew up life was a whole lot different than it is now. I grew up in a kind of a traditional suburban life. My Dad caught the train to work and Mom stayed home; Dad earned and Mama took care of the family.

When my father went and got a mortgage on the house, he met with the banker and they had a discussion. He complained—very loudly, I recall—about having to pay 5% interest instead of 4%. That dates me, too, by the way.

In my neighborhood, when somebody's dad got sick, mom went to work. That was perceived as a difficult sacrifice: "Gee, they really have got to pull themselves together. They are really working real hard to do this."

Well, as you saw in the numbers, there are a lot of folks out there who live in a two-income family, and that is kind of the way it goes now. 88 If anything happens to either wage-earning member of this family unit, then disaster happens to the family. It can be divorce, where suddenly you have to pay two rents instead of one; it could be that Mom loses a job, Dad loses a job, Mom gets downsized, or Dad gets downsized; it could be a medical problem where the medical costs

87. Using bankruptcy figures for the twelve months ending in June 1997 and population figures revised as of July 1997, the ratio of citizens to bankruptcy filings in Tennessee was 100:1, and in Alabama it was 124:1. See Bureau of the Census, supra note 1.
88. See McNeil, supra note 58, at 5 tbl.1.
have escalated dramatically; it could even be retirement. Any of these things can wreak financial havoc on a family.

As I said, I see 500 cases a month on a regular basis, and I sit across the table and look into the eyes of the people who are filing the bankruptcy. So I see a lot of things.

I see people who have made credit decisions that make no sense. For example, I see somebody who has financed an automobile and committed to payments of one-half of his family's available disposable income—and GMAC was delighted to do that. This is someone who was actually willing to buy that car and devote half of his available income to it when they were barely making ends meet as it was.

I see people who have truly the capacity to make some repayment on debt using bankruptcy not to repay that debt. They think it is much easier to not pay than to pay using bankruptcy to achieve that goal.

I see people who are playing the system. I see people who are gambling that they will not be caught by a system that handles a lot of paper. Alternatively, they are gambling with the idea that if they do get caught, they can fix it at essentially no charge. I think Judge Jones has mentioned that, too.89

I see something that saddens me as an attorney. I see lawyers who are just too lazy or too untrained to provide full debt repayment assistance and counseling.

I see non-attorney typing services—who are arguably filling some need—misleading truly well-intentioned people to make one of the biggest mistakes they are going to make in their lives.

I also see, however, an elderly couple that is unable to cope with escalating medical costs but is desperate to keep the home that they have had for years.

I see a young couple fresh from an incredible credit frenzy, which you can call the idea of going out and using plastic like there is no tomorrow. They are now ready to face the music, and want to face the music.

I see an entrepreneur—and I see a lot of these, too—whose well-intentioned but totally misguided business plan failed, leaving him with bank debt or SBA debt or farmers' home debt.

I see a self-employed mechanic who is trying to come out from the underground and figure out a way to pay the taxes that he hasn't paid for the past three or four years. He just did not have the money, so he did not file the return.

I see divorcees—people who are now single parents trying to raise two kids. They have a limited income and they only have limited child

89. See supra notes 47-52 and accompanying text.
support. They just are not getting the child support. It is not being collected.

What do we do as a society when we are faced with these two competing elements? Do we as members of the legal profession have a responsibility to deal with this? How do we deal with what Professor Gross has called failure—in one form or another, failure?

I like to use a metaphor on occasion, particularly when I talk to creditors’ groups about the bankruptcy system. I remind them that the bankruptcy system that we have in this country provides the steam valve on a pressure cooker of consumer debt. It is the release valve.

To take this metaphor as far as I possibly can, do we have the level set on this pressure valve too low? Do we have the pressure valve set too high? How can we help those who truly need the help while not giving what is turning out to be a fairly expensive free ride to those who do not?

This discussion we are having here today is an incredibly opportune one because we have met on what some would call the battlefield—although I like to call it the debating field—of where we are going as a society on bankruptcy.

I think that you are going to hear people talk about the creditor bill, McCollum’s bill—maybe I can talk about that—that the credit industry has apparently drafted. You have already heard Judge Jones talk about the majority and the minority views on the Bankruptcy Review Commission as it deals with consumer credit and the bankruptcy consumer system.

It is an opportune time to figure out where we are going from here. It is an interesting point, and it is one that deserves some serious thought. I challenge you that it deserves thought as members of the legal society because I submit to you that, as legal professionals, we have in many ways let down the clients and legal system that we are pledged to serve. This is a good opportunity for us to be able to reexamine those priorities and where we go from here.

PROFESSOR FELSENFELD: Thank you, Mr. Hildebrand. We do hope to return to some of the introductions that you gave and some of the problems that you raised.

Our final speaker is Michael McEneney.

MR. McENENEY: Thank you, Professor.

Given the people that I represent—mainly financial institutions—I am sure that there are no doubts as to what my perspective is. What I thought I would do is just quickly run through some of the debate on the causes of consumer bankruptcy, in particular the popular misconception that credit availability is the central cause, and then talk about

91. See supra notes 25-56 and accompanying text.
some of the things that might be done to address what I think is a fundamental problem with the Bankruptcy Code today.

Hank has run through a number of different causes of consumer bankruptcy that he sees. For at least the last two years, there has been considerable debate on this topic. It has been carried out before the National Bankruptcy Review Commission, it has been carried out in the press, and it has also been a debate that has taken place in academic circles. With two years of debate, you would think that there were some definitive conclusions that one might reach on the subject, but instead what we've got is a lot of different theories as to what causes consumer bankruptcies.

Some say it is caused by too much credit. Others say it is declining income. Still others would point to what is perceived to be a declining stigma associated with bankruptcy that decreases the threshold that people must step over to go ahead and file a bankruptcy case.

There is a recent research paper that suggest that the rise in bankruptcies is closely correlated to a lot of different significant life events, such as divorce, medical problems, being involved in an automobile accident with insufficient insurance, and similar events.

Still others would point to lawyer advertising and suggest that as attorneys have become more aggressive in advertising their services in connection with debt restructuring, that the rate of bankruptcy has gone up.

Probably the only thing that is clear as a result of all this debate is that bankruptcy is a complex problem and there is no single cause of the rise in consumer bankruptcies.

As I indicated, some have suggested that the major cause is too much credit card debt. Proponents of this theory often cite the proliferation of pre-approved credit card solicitations that we all receive in the mail. They claim that these pre-approved credit card offers are sent without regard for a consumer's ability to repay. That is simply not true.

These pre-approved solicitations are sent out based on a process known as pre-screening. Now, pre-screening is a highly sophisticated

92. See Report, supra note 19, at 65-74.
94. See id. at 33.
95. See White, supra note 62, at 211.
96. See Warren, supra note 24, at 1084 (observing that some individuals may carry high, manageable debt until a crisis breaks the metaphorical spine of the camel).
97. See White, supra note 62, at 211.
98. See id.; see also Ausubel, supra note 6, at 250 (noting the "astonishing[ly] high[ ]" correlation between the rise in credit card defaults and consumer bankruptcies).
99. See Snow, supra note 9, at 65-66.
100. See Warren, supra note 24, at 1098-99 (discussing how credit purveyors are soliciting individuals who are low in the U.S. economic strata).
A card issuer, for example, will identify all of the creditworthiness characteristics that the card issuer believes a consumer must meet in order to qualify for a particular credit offer. The issuer will provide that information to a credit bureau, typically one of the “big three” bureaus—Equifax, Experian, or TRW—and ask the credit bureau for a list of all the consumers that meet those criteria. In essence, pre-screening is very much like the underwriting process that would take place if the consumer applied for the credit—in other words, initiated the credit application. The only real difference is that the underwriting process takes place before the solicitation goes out. So pre-approved offers are not offers that are made arbitrarily. They are made on the basis of a sophisticated underwriting process known as pre-screening.

Proponents of the “too much credit” theory would take the argument to the next level and say, “Well okay, even where consumer lenders use underwriting standards, those underwriting standards are too lax.”

I believe that the facts suggest that this also is not true. The credit standards being used today actually are highly successful in identifying creditworthy consumers. Let’s just take a look at the bank card industry, which is comprised of the 6000 or so financial institutions that issue MasterCard and Visa cards. Only 1% of all of those accounts end up in bankruptcy. An additional 2% or 3% of those accounts end up being written off for other reasons; sometimes it approaches 4%. The bottom line is that the industry is successful at least 96% of the time. Ninety-six percent of bank card accounts pay as agreed. It is hard to say that credit standards are too lax when the industry is getting it right 96% of the time.

There are limits, however, on the usefulness of underwriting as a tool to identify consumers who may declare bankruptcy. In fact, stricter credit standards will never fully address the bankruptcy problem, and there are a number of reasons for this.

One is that more and more consumers who end up in bankruptcy look just like a much larger number of consumers who do not. Their financial profiles are virtually identical. This problem is compounded by the fact that there has recently been a phenomenon known as the “surprise bankruptcy.” This is a situation where a consumer is current on his or her account and the first indication that the lender gets that the consumer is in financial difficulty is when the bankruptcy no-
The bottom line is there is really no way to significantly reduce bankruptcies through underwriting without denying credit to even more people who would never go bankrupt. In other words, because the financial profiles of those who end up in bankruptcy look just like the financial profiles of a much larger number of people who are going to continue to pay their debts, you cannot underwrite to resolve the bankruptcy problem unless you are willing to just deny credit to the much larger number of people who are going to pay their bills.

So how do we address the consumer bankruptcy problem? I think that the way to address the problem is to look at the Code itself.

First, let me say that when we take a look at the bankruptcy system today, you have already heard Professor Felsenfeld mention that more than a million consumers used the Consumer Bankruptcy Code in 1996 and even more are expected to use it in 1997. In fact, there are estimates that suggest that consumer bankruptcy in 1997 will cost $40 billion. That is $400 per U.S. household.

It is remarkable that although we are talking about a system that generates those kind of costs, there is no test to determine whether or not an individual gets bankruptcy. It is like a criminal justice system where we have the presumption of innocence, except the only one we ask as to whether they are innocent or guilty is the debtor. There is no adversarial process for purposes of determining whether or not the consumer really needs bankruptcy relief. The consumer simply signifies their desire to have it and, in the overwhelming majority of cases, gets it by filing for bankruptcy.

Let's say that a consumer is in financial difficulty; the consumer finds that he cannot repay 60% of his unsecured debts on a monthly basis but can pay 40%. If the debtor chooses Chapter 7, he will get 100% of those debts wiped out, even though he only needed protection with respect to the 60% payments he could not make. Seventy percent of debtors choose Chapter 7.

There is a provision that is being considered on Capitol Hill on the House side now, as part of a bill that was introduced in the last week and a half or so, that would establish a needs-based test to determine how much relief a consumer gets in bankruptcy. We refer to it as the "needs-based bankruptcy approach."

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103. See supra notes 1-5 and accompanying text.
105. See id.
The purpose, I think, is relatively non-controversial. It is to provide bankruptcy relief based on need—in my example, to make sure that the debtor who cannot repay 60% of his debts gets protection and is able to stave off the creditors with respect to that 60%, but also to make sure that he is required to continue to pay that 40% payments that the debtor can make. In other words, the debtor does not arbitrarily get 100% relief when the debtor simply needs 60% relief.

There has been a lot of debate about how this system ought to work. One of the keys that the proponents of this system have identified is that it has to be simple, it has to be easy to administer, and it cannot place any additional significant burdens on the participants in the bankruptcy system.

In addition, it has been made clear that the system cannot have an impact on people whose incomes are so low that in all likelihood they will never have the ability to repay their debts, and those individuals ought to be able to choose Chapter 7 or Chapter 13 as they see fit.

The way this is addressed in the bill is by establishing an income cut-off.\textsuperscript{107} The income cut-off would be 75% of the national median income for that debtor’s family size.\textsuperscript{108} That threshold would range from about $21,000 up to about $37,000. Debtors with income below that 75% threshold would be free to select Chapter 7 or 13, as the debtor saw fit.\textsuperscript{109}

Debtors that meet the threshold test would have to go through a simple calculation that is part of the bankruptcy filing process. That calculation would be as follows: you take the debtor’s monthly income, back out monthly living expenses—and those would be based on numbers that the IRS uses to determine how much income a debtor has available to repay back taxes—you back out from that 100% of the monthly payments for secured debts, 100% of monthly payments for priority unsecured debts like back taxes and past-due child support, and come up with monthly income available for non-priority unsecured debts.\textsuperscript{110}

The test is a pretty conservative one: if the debtor has monthly income available to pay unsecured debt sufficient to allow the debtor to pay 20% of the balance of unsecured debt over a five-year repayment plan, the debtor cannot file for Chapter 7.\textsuperscript{111} That debtor has sufficient income to enter into a meaningful Chapter 13 repayment plan, and if that debtor then chooses bankruptcy, he would be required to do so.

\textsuperscript{107} See id. § 101.
\textsuperscript{108} See id.
\textsuperscript{109} See id.
\textsuperscript{109} See id. §101(3)(C).
\textsuperscript{111} See id.
That is, in a nutshell, the needs-based test, which is the cornerstone, I think, of, in particular, the credit-granting industry's approach to reforming consumer bankruptcy.

As a number of previous speakers have pointed out, however, there is really a need to make sure that the system is balanced. This approach attempts to balance, not just between debtors in bankruptcy and creditors impacted by bankruptcy, but it also brings into the debate—and I think appropriately—the debtors who pay for bankruptcy. Those are the debtors who do not declare bankruptcy but continue to pay their debts. And again, when we have a bankruptcy system that generates about $40 billion in costs, as is anticipated for 1997, the price that we all pay—everyone that pays their debts pays—is pretty significant.

We view the needs-based bankruptcy approach as not controversial. Again, it simply identifies the debtor's need for bankruptcy relief and makes sure that that debtors get the relief they need and they do not just arbitrarily get more. I think when we get into the debate that we will find that others do find it controversial.

PROFESSOR FELSENFELD: Thank you, Michael.

I would like to get some ideas before the panel about the place of bankruptcy in the system. Bankruptcy has grown, debt has grown, and default has grown; they have all grown. I would like to open this with the question of whether they have grown in proportion. That is, can bankruptcy be justified because of the increase in debt; or can bankruptcy be justified because of the increase in default?

Alternatively, has bankruptcy increased far beyond those most obvious measures, which says to us that there is something else that must be looked at? Or have I worded the question all wrong? What do you say to that, Jane?

MS. McNAMARA: What we see—and again, it is a limited segment of the market—is that bankruptcies are increasing, but not necessarily because that need is there. Installment debt continues to rise on an annual basis and people are expanding their lifestyle through the use of consumer debt. We are seeing the two-income households who find it more difficult to live; and the women who do not receive child support; the men who have to pay it but then get into a new family and there are new obligations—those kinds of things.

If we really look at how many consumers have an "actual" need, however, to file bankruptcy, I think it is much, much smaller than the numbers we are seeing.

PROFESSOR GROSS: Can I pick up on that? When I went to Legal Aid, a client came in and he owed five creditors in the aggregate $3000, and at that moment, he was unemployed. He was a middle-class person when employed but was then unemployed. I said to him, "Why would you file for bankruptcy? Let's work it out with your creditors."
I went to the head of the Legal Aid office, Mort Dicker, and I said, “There is no reason for this person to file bankruptcy. Why ratchet up a system that costs $175 for someone who owes five people $3000?” I said, “I want to do an out-of-court workout. I used to do it in law practice all the time. I mean, I could call up a bank and we would sit around a table.”

Mort starts laughing—he is practically falling off his chair. He says, “Go ahead, try it.”

So I did, extremely unsuccessfully. I could not do it. I mean, I could not get five creditors to agree that this person should be able to *not* go into bankruptcy. I kept saying, “If he goes into bankruptcy, you will get zero. If we work out a year-long repayment program where you forego interest and penalties, over a year, you will get a third to a half of what you are owed. I mean, it’s a win/win situation for everybody. And, indeed, the $175 that would go to the bankruptcy system would go to all of you also.”

I could not do it. It was astounding to me that I could call up a bank for a corporate client and nobody would ever say to me, “Do you have authority to speak for your client?” I called every bank involved here and, to a one, they all said to me, “I’m sorry, we cannot speak to you.”

I did try getting him credit counseling, but in New York—this may have been prior to your opening all your offices, Jane—there was a two-to-three-month waiting period. So, to be fair, neither consumer credit counseling nor a workout worked, which left one option: bankruptcy. Thus, bankruptcy involves a number of people whom one would think could have their problems resolved in a way other than bankruptcy.

So, when you talk about bankruptcy filing numbers, I think you have to back-end out a number of cases that, were people more flexible and willing, could be resolved in a different way.

Now, the good side of this little story is that a number of major creditors have agreed to start a pilot project here through the Legal Aid office to see if some of these smaller cases could be resolved outside the bankruptcy system.

PROFESSOR FELSENFELD: Let me return to my question, Karen. You have pointed out an unfortunate situation where creditors seem to have acted in an almost irresponsible manner. But my question really was at movement. My question was: Has bankruptcy expanded beyond the expansions in those other fields? Your illustration was directed to a stable situation, and it could just as well have existed last year as this year. So I ask again. Bankruptcy has gotten much worse. Has it gotten worse on a proportionate basis, more than the increase in debt and more than the increase in debt default? Hank is nodding “No.”
MR. HILDEBRAND: One of the benefits of the Review Commission experience has been the amount of very thoughtful and scholarly work that has come to light and has been shared, and I commend the Commission for that.

There were two studies that came out, that found that only one factor correlates with the increase in bankruptcy filings: debt load. That is one of the basic conclusions of the Sullivan, Warren, and Westbrook book after looking at myriad of things in three districts, albeit from 1981 data. They said, "The only thing we can find out is people who file bankruptcy have more debts than anybody else. That is the only correlation that we've got." There was also a University of Maryland study—I guess it was the Congressional Budget Office study—that said, "The only correlation that we can find is debt load."112

JUDGE JONES: I would like to put a few qualifications on that. None of the experts is willing to say that debt causes bankruptcy, except for Professor Ausubel.114

The Federal Reserve Bank of New York published a study, which unfortunately was not presented to our Commission in public session, where they concluded that the rates of defaults and the rates of credit card debt were not correlated with the number of bankruptcies per se for several reasons.

Their best explanation—and this was published earlier this year—was that, in part, the population is borrowing more because, as you saw from Ms. McNamara's statistics, people between the ages of thirty and fifty are in the maximum spending years of their lives. They are buying houses, they are putting kids through school, they are trying to save for retirement, and they are in a position where more of them demographically are filing. In other words, it is us, the "Baby Boom" generation, that are the borrowers in society.

The other thing they said, interestingly, was that filing seemed to correlate with increased wealth and the increased optimism and expectations. So, for whatever that is worth, that is another view.

My own opinion, from having sat through all these sessions, is that it is plain to me that a lot of people are filing bankruptcy. It has to be a middle-class phenomenon now, because you do not go from 800,000 to 50% 60% more filings in two years, supposedly the most prosperous in American history, without including the people who are supposed to be prosperous. I recognize there is the fiat real income,115

112. See Teresa A. Sullivan et al., As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America (1989).
114. See Ausubel, supra note 6.
115. See supra note 58 and accompanying text.
and certainly we are all bearing a higher tax burden and so on, but you just do not explain a 50% bump in two years by saying that there is that much more debt, because those statistics do not correlate.

MR. McENENEY: Right. In fact, the studies that have found a correlation between debt load and write-offs principally focused on debt load and write-offs and whether there was a correlation there, without looking at other possible factors. I think some of the more comprehensive studies clearly show that there are a lot of factors that are correlated with increased bankruptcies. I mentioned a few of them earlier.

There is an SMR study that shows that in states that have no mandatory auto insurance that the filing rate is higher. That makes some sense. People who get involved in automobile accidents without adequate insurance may end up with debts that are much higher than those they can handle. States where the divorce rate is higher seem to be correlated with higher incidence of bankruptcy filing. The list goes on and on.

The other thing I would point out, though, is the one thing we do know is that something has changed out there in terms of the behavior of consumers and when they choose bankruptcy, and that is a lot of consumers with the financial profiles that for years and years indicated they were good credit risks are now declaring bankruptcy. I talked about the surprise bankruptcy, where a consumer has been paying their debts faithfully for years—five, seven years—suddenly goes from a current account to a bankrupt account. That is a change in behavior out there that is recent and that has really intensified in the last couple of years.

PROFESSOR GROSS: Let me pick up on what Mike was saying. Everybody is looking for an answer, a thing, and I do not think there is a thing. I think we ought to stop looking for the answer as to why filing rates are going up. I do not think there is an answer.

Aside from the kinds of factors that you are describing, there is also another factor that has not been quantified: creditor harassment of debtors who are not in default in any meaningful way. I mean, certainly debtor behavior in part accounts for it, but so does creditor behavior.

JUDGE JONES: I have to take issue with that, Karen, because there has always been creditor harassment. If anything, with the ad-


117. See supra note 102 and accompanying text (mentioning the phenomenon of “surprise bankruptcies”).

118. See supra note 102 and accompanying text.
vent of the Fair Debt Collection Practices Act,\textsuperscript{119} various truth in lending acts,\textsuperscript{120} and the Deceptive Trade Practices Act in Texas and many other states,\textsuperscript{121} that problem should be declining. You have all these legal remedies and you ought to be able to ascertain a connection between more of those lawsuits being filed and declining creditor harassment.

PROFESSOR GROSS: Let me try to explain it this way. For me, what is causing bankruptcy is like the kids' game Jenga, where you piece together those wooden blocks, which are all the causes. Lots of things go on in life, including creditor behavior, debtor behavior, loss of job, all of those things. At one point, if you just pull the wrong one out, the thing collapses. That is what causes bankruptcy.

The point is that you do not know which one will get pulled at any given point in time. There are lots of factors existing in people's lives. What pulls down the house—the Jenga structure—in any given case is a different little piece, which is why what is important, it seems to me, is acknowledging that it is all intertwined.

PROFESSOR FELSENFELD: Let's accept that, for the time being anyway. There is always the cop-out of saying that more research needs to be done, and maybe more research does need to be done, but we are only going to be here a matter of minutes now, so we are not going to do it today.

Let me ask Hank: As bankruptcy is being used more and more, do you think part of this mix is the discovery by the bar of things that bankruptcy can do that the bar was largely unaware of as recently as two or three years ago?

MR. HILDEBRAND: Who would have thought that bankruptcy would be used as a financial planning tool? Who would have thought that Texaco would file bankruptcy as a financial planning tool?\textsuperscript{122}

JUDGE JONES: Well, in 1984 a prominent Chapter 11 lawyer in Texas called it a financial planning tool for companies.

MR. HILDEBRAND: Right. Start with the idea that companies are going to go to their law firms and say: "We've got a problem. We have manufactured a product which we no longer make"—and it was asbestos, or it was silicon, or it was a small airplane—

PROFESSOR FELSENFELD: It was a negligence prospect.

MR. HILDEBRAND: —something. "But we do not do it anymore. And we are making money now, but we know that these personal injury actions are going to just kill this company. We owe it to the stockholders to do some kind of planning now to address that."

\textsuperscript{120} See, e.g., id.
At which point the lawyer in the law firm is going to sit and talk a few times with the corporate counsel, and then they will pull in the bankruptcy lawyer. The bankruptcy lawyer says, "You know, there is a scenario that you can use here. It is going to take a little effort, it is going to be painful, it is going to be hard, but we can use this as a tool."

I had a client that was making money with dance clubs, but they had committed to some terrible leases. What did they do? They filed bankruptcy to get out from the leases.

So I suggest that perhaps here it is not so unreasonable to assume that this kind of thought strategy is going to flow downward from the large law firm Chapter 11 lawyers down to the consumer debtor attorneys that are saying, "This is a meaningful financial tool." Is that right? I do not think so, and that is certainly not the way I was raised, but that is what is happening. So is it appropriate? I do not know. But is it happening? Yes, sure.

PROFESSOR FELSENFELD: Karen, what do you think?

PROFESSOR GROSS: For me, there is a difference between phrasing it as a moral question—"this is not how I was raised"—versus "is there something wrong with lawyers counseling their clients as to options that are available under the law?"

One thing is clear to me: if it is right for Texaco, it is right for individuals. I mean, it cannot be that it is right for Texaco but wrong for individuals. We cannot have it such that somehow it is okay for corporations to go out of business but it is not okay for individuals to discharge their debts. Whatever justification we want to make for different treatment of individuals and corporations, it seems to me that our response to their failure cannot be that different.

Do I see something wrong with lawyers advising their clients as to options that are available under existing law? No.

MR. McENENEY: I think that avoids the main point, though. I mean, I think that everyone would agree that someone in financial difficulty ought to take a look at his options, and I would argue that somebody certainly ought to look at consumer credit counseling pretty closely before choosing the bankruptcy option. Once in bankruptcy, however, federal law allows consumers to take 100% relief even if they only need 50% or 40% relief.

I agree that we should not talk about whether it is a moral issue. Instead, let's talk about what is appropriate for a federal law to do, and whether a federal law should be arbitrarily providing billions of dollars of relief without ever asking the people that receive it whether they need it.

JUDGE JONES: I would like to inject the moral issue here because I do think that it is a very important matter of personal integrity and honor not to take on obligations beyond one's means and if one has been caught in a bind to make every effort to pay them back. There is a lot of appeal in the kinds of stories that Hank relates about the people who have fallen on hard times, or that Karen talks about of debtors being harassed, and that sort of thing.

We have to remember, however, that we are dealing with a system that purports to dispense justice throughout society, and there are two components to that. In bankruptcy, not only do you have to look at what is happening to the person who has chosen to break their contracts and default on all of their obligations, something for which we normally have lawsuits as the remedy, but also you have to look at the people who have taken the high road. The latter are people who, as Mike says and a lot of our data before the Commission suggest, are in not that different a position from the ones who defaulted. They, however, are paying back their debts, struggling to make ends meet, putting their children to work to share the expenses or the costs of going to school, and so on.

Every time someone goes bankrupt, those other people are paying more on their debts. If too many people go bankrupt, those people are not going to have access to credit at all anymore. Is that fair? Is that just? Is that moral? I do think, at bottom, you've got to look at it that way.

PROFESSOR GROSS: I think maybe we were talking about different moral issues. I was talking about my moral upbringing.

JUDGE JONES: Well, my moral upbringing suggests to me that what is good for me as a moral person has to be applied to everybody across the board as the standard. You can create deviations, but you've got to remember the moral impact on society as a whole, too.

PROFESSOR GROSS: That is where I differ. It seems to me that the ability to file a Chapter 7, to have a system that recognizes that people fail and forgives them, is essential. Individuals' personal moral codes can dictate behavior as to how people believe they themselves should act, but that is very different than making any particular moral code the law.

JUDGE JONES: Well, I am not going to speed above seventy-five or eighty miles an hour, but I have no problem with there being speed limits in society; and if I get caught, I am going to pay the penalty.

PROFESSOR GROSS: I want to set aside speeding, which seems to me to be something of a different sort of wrong than breaching one's contracts. Go back to contracts. One of the essential features of contract law is that, not only can you breach but there is no penalty for breach. One of the essences of American contract law is there are no punitive damages, except in extraordinarily rare circumstances, for
In fact, that is an interesting segue into bankruptcy because the heart of contract law actually is that you are permitted to breach.

MR. McENENEY: Karen, going back to something you said about the need or desirability for preserving a system that allows someone to take a Chapter 7 bankruptcy and obtain a discharge, do you mean that they ought to be able to obtain a discharge even for debts that they clearly can repay? I mean, is that an essential component of a fair and just bankruptcy system in your view? Because what we have tried to do is to argue: “Look, if consumers want to choose bankruptcy relief, we are not going to preclude them from doing so; but once they choose it, they should be treated in a way that is fair not only to them, by giving them the relief that they can demonstrate they need, but also is fair to everyone else who pays for their relief.”

And so, to go back to my example, if the debtor cannot make 60% of his monthly payments, he gets relief on the 60% but he continues to devote future income to the 40% he can pay.

PROFESSOR GROSS: There are lots of reasons why I do not believe in needs-based or means-based testing in terms of access. I guess my simple answer is: yes, I do believe there are debtors who should be permitted to file Chapter 7 even if they could repay their creditors in a Chapter 13. We have obviously a disagreement as to that issue.

But that is not to say that I do not believe in ferreting out abuses. I would just do that differently than you would. In other words, there should be certain debts that are non-dischargeable; I do believe that. I also believe that to the extent that we can—within reason—determine who are the bad actor debtors who are committing fraud, we should also ferret them out. It is not that I am suggesting we have a system plagued by people who are abusers in the fraud sense—we may be talking about different definitions of abusers.

MR. McENENEY: I would not even necessarily call these people abusers. I mean, the Code today allows them to take that 100% relief even if they need something less. So I do not know if that is abuse. I think it is a problem with the law, and I think that if the law stays the way it is that we’ve got to recognize that there is a fairness or equity issue, because creditors, for one, will have to take steps. As more and more people become—aware of the Bankruptcy Code and use it—you know, every indication is that the number of filings in the consumer area is going to continue to go up—the cost will be passed on to other consumers. There is a question as to whether it is fair to do that if the consumer does not need all the relief in bankruptcy that the consumer is taking.

Just as importantly, creditors have been tightening credit standards, and if consumer bankruptcies continue to proliferate, they will only
continue to do that. As I pointed out, that is going to restrict credit to a whole group of people who clearly can repay, and will repay, to try to ferret out those who declare bankruptcy. That impacts most significantly lower and moderate income families who have the fewest alternatives for financing available to them.

So we certainly, I think, understand the need to make sure that people in financial difficulty have a way out, but I think the real question is whether it can be calibrated in a way so they get the relief they need and do not unnecessarily create costs and other problems for people who pay for it.

PROFESSOR GROSS: But, you would also have to agree that even in the best of all systems, we redistribute wealth. There will always be some way that some people use services or partake of benefits of a system that the rest of us pay for.

MR. McENENEY: Absolutely.

PROFESSOR GROSS: And that is sort of a price we pay to live in a civilized society. The question is: How much are we willing to pay to live in this civilized world?

MR. HILDEBRAND: I think you are talking about an issue where Karen is mentioning that there should be an election and Michael is mentioning it should be mandated. I come from a district in which most of the bankruptcy filings are Chapter 13.

To give you just my myopic statistics here, of the cases that reach completion—and we have in excess of 40% completion rate, which is higher than the national average; about 44.5% complete and reach discharge—of the cases that complete in Nashville, they get a discharge; 50% of those cases paid 100% of the debts back. The average distribution in all cases that reached a completion was 69.5% of distribution for unsecured claims.

That may not be typical, but the point is that there was an election made by the folks there, not mandated by the law, to pay as much as possible. They have perceived a reward. I do not know why.

I ask many people sometimes who are seeking to pay their debts back across the table from me why they do not just do a Chapter 7, because clearly all they have is unsecured debt; they are not trying to keep a house, they are not trying to keep a car. The answer is, “This is the election I have made, this is what I want to do. I feel a necessity to do it. I want to do it.” Some of them are misled to believe that I am going to improve their credit rating. I try and improve their credit rating.

PROFESSOR GROSS: And they should have it improved if they do that.

124. See Snow, supra note 9, at 66 (“Not surprisingly, consumer defaults have also risen close to record rates, resulting in well-publicized concern by many high-risk lenders and a tightening of lending standards.”).
MR. HILDEBRAND: They should. I try to do that. We are working on that, and I think everybody at this table right here is working toward that goal, so I do not think there is a disagreement with that.

MR. McENENEY: I would just point out, Hank, there is a corollary to your story about election. All those debtors that paid 100% or 69% could have elected under the Bankruptcy Code to pay zero—

MR. HILDEBRAND: That is correct.

MR. McENENEY: —and file for Chapter 7. I think that there is evidence that many consumers are doing just that. They are filing for Chapter 7, taking 100% relief, when they do not need it all.

PROFESSOR GROSS: Isn’t it possible the problem is not that debtors have a choice—a choice that, I believe, is critical to our system? The question is: Why aren’t there better incentives in place for those who complete a Chapter 13? Maybe that is where we should be putting our attention.

JUDGE JONES: I have two observations about this. One is that nationwide only about a third of Chapter 13 debtors complete their plans. So if you look at the bankruptcy system in terms of “success” and compare it to the “success” in the underwriting of the credit card lenders, I would say the bankruptcy system has a long way to go. I think there is a lot to be drawn from that comparison.

But second, about the benefits of Chapter 13, we have truly struggled to try and figure out how you could confer benefits on Chapter 13 sufficiently to make it attractive. The only things that I think we came up with over the course of the Commission’s discussion were:

Enhance the super discharge—which I think is highly problematic because, to me, the super discharge only protects malefactors and they are a very small proportion of the Chapter 13 users.125

Provide an improved credit rating report, which I think is very important—but it only goes so far, because everybody can get access to post-bankruptcy credit now, and you can get it faster after a Chapter 7 than after a Chapter 13.

That leaves by default the “dog that didn’t bark” in our Commission, which is a requirement of certain debtors to file Chapter 13. We never really took that on as seriously as we should have.

PROFESSOR FELSENFELD: Karen, one sentence in your book that startled me was a suggestion you made that perhaps there were too many Chapter 13s.126 Do you still believe that?

PROFESSOR GROSS: Yes. That is, however, because I believe that there is a problem in how debtors are making their Chapter choices. You see, it is a little unusual that Chapter 13s seem clustered in certain areas of the United States and not in others. It seems un-

125. See Report, supra note 19, § 1.5.7-.9, at 103.
126. See Gross, supra note 16, at 119 (“It may be that too many debtors use Chapter 13, and the success of this chapter is worthy of debate.”).
clear to me that why debtors are making certain choices. There may be some problem in the advice debtors are getting and the quality of that advice, and the quality of that advice may vary across the United States. Now, some debtors are very well represented and very well counseled, but others are not.

It is also important to note that the numbers are a little off when you talk about how many people file Chapter 7 versus Chapter 13, because we only count Chapter 13s as one filing, even when filed by a couple. In fact, it is two people when they are joint. So, there are in fact much more subtle breakdowns that you could do with the numbers that would increase the number of Chapter 13s because a goodly number of those cases are joint.

If what is being suggested is, in essence, a mandatory Chapter 13, there are a whole host of issues that that raises, although that is a different suggestion than means-based choices.

MR. McHENENY: Yes. I just want to make it clear I think the needs-based test in the legislation that I spoke about simply says that if you have the income to fund a meaningful Chapter 13 plan that you are not eligible for Chapter 7. The net result of that is that if you choose bankruptcy, Chapter 13 is probably your only option. Obviously, 11 may be an option for certain people. But it is still the consumer's choice. The only question is what is the appropriate form of relief. And again, if the consumer can fund a meaningful repayment plan, needs-based testing says that Chapter 13 is their only option.

PROFESSOR FELSENFELD: Jane, any comments?

MS. McNAMARA: As the bankruptcy law has changed over the last almost twenty years that I have been in this business, every time it changes we see increases in the number of bankruptcy filings.

PROFESSOR FELSENFELD: Regardless of the change?

MS. McNAMARA: Regardless of the change. In Michigan bankruptcies are increasing on an annual basis 30%, and yet we have the lowest unemployment in the state that we have had in over twenty-five years. It does not add up. It just does not make any sense.

PROFESSOR FELSENFELD: Well, there is one explanation. There is an old story that I heard a long time ago about somebody who wanted to increase worker productivity and said, "Increase the lighting; if you increase the lighting, you will get more output." So they increased the lighting and, sure enough, they got more output. "That worked. Increase the lighting some more." They increased the lighting and got more output. They increased the lighting some more and got more output. And then they said: "Well, wait a minute. This is not a controlled experiment. Let's see what happens if we now reduce the lighting." So they reduced the lighting and they got more output.
Could it be attention to the Bankruptcy Code rather than the nature of the change that is creating some of these events?

MS. McNAMARA: It could very well be. I think the Code needs to be tighter than what it is because I think there are people out there who can pay their debts who elect not to. Yes, there are times when it is a necessity, but that choice needs to be made carefully. For the consumer who goes to a bankruptcy attorney—how do bankruptcy attorneys make money? By filing bankruptcies.

JUDGE JONES: Karen and I were talking about that sub rosa. I think there is a lot to be said about the adequacy of legal advice that people are receiving. Certainly it does appear that the choices between Chapter 7 and Chapter 13 are not always logically driven.

In Texas, for instance, we have more generous exemptions than even the Commission proposals would permit, and you would not think anyone would file Chapter 13. In fact, we have a couple of districts that have large numbers of Chapter 13s and very high success rates with them. That is not rationally explicable.

MR. McENEENY: There is real concern, however, that as the Bankruptcy Code gets a higher and higher profile and more people understand the benefits of bankruptcy—i.e., that you can in a Chapter 7 case wipe out thousands, even tens of thousands, of dollars of unsecured debt—more people who are financially strapped are going to take that route. That is why it is so important that as bankruptcy rates do increase that people get the appropriate relief, and not more.

PROFESSOR GROSS: Why shouldn’t they access the system? That is what it is there for. It is there for people who become overburdened. I think you have a big hurdle, it seems to me, to explain as an initial matter why it would be that a company that could be productive can go out of business but an individual cannot obtain a full discharge.

JUDGE JONES: I am the only consistent member that I know. I would also prevent companies from taking advantage of bankruptcy except under very narrow circumstances.127

PROFESSOR GROSS: I read your article on Chapter 11. At least you are consistent between the individual and the consumer. There are a number of people, however, who are not.

JUDGE JONES: I think that can be partly explained by self-interest. I really do not think, however, that that is the main point here, because if we are talking about consumer bankruptcy the fact is that a lot of people use debt for reasons other than to put bread on the table.

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127. See Edith H. Jones, Chapter 11: A Death Penalty for Debtor and Creditor Interests, 77 Cornell L. Rev. 1088, 1089 (1992) (arguing that because most Chapter 11 filings result in liquidation rather than reorganization, Chapter 11 does not fulfill its goals but merely forestalls liquidation).
One thing that has become very plain to us in these hearings is that a lot of people who file bankruptcy over-indulged.

When we had hearings down in Alabama, the debtors' attorneys surrounded me and said, "Don't do away with reaffirmations," because I have been throwing out proposals like—"well, it is limited to two per household." They said, "But you cannot do that. What about the bass boat and what about the Skidoos?" These were the debtors' attorneys.

In the Fifth Circuit Bankruptcy Judges Conference, I met with our bankruptcy judges who said that they used to get surprised when a person with $25,000 income had $25,000 or $30,000 in debt, and then it became $50,000 in debt, and now there are people with that income who have $100,000 in debt.

PROFESSOR GROSS: The question is: are the people rushing in the people with the Skidoos? You see, Michael makes it sound like everybody is rushing in to bankruptcy going, "Yippee, I get to file bankruptcy today!" That is not what I see.

MR. McENENEY: That is not what I was suggesting. What I was saying, though, is that there are a lot of people out there struggling, and that as more of them become aware of the fact that bankruptcy is a relatively easy way out, that you can eliminate in Chapter 7 tens of thousands of dollars of debt, even if you could repay a good portion of that, that the concern is that more people will choose that option to resolve their financial difficulties. That is why it is so important that as the Bankruptcy Code remains available for people to elect to use at their choice that the relief they get only be the relief they need.

PROFESSOR FELSENFELD: I may be living in a dream world, but I am beginning to think that I hear a consensus among the panel.

MR. HILDEBRAND: We are not dealing with a dream world.

PROFESSOR FELSENFELD: Let me start with Jane and go through the five of you and ask one question to all of you. Would you have any objection to a Code that required somebody with surplus income to pay a portion of the person's obligations, understanding that there are different ways of defining surplus income and there are different ways of determining the obligations that would be paid? What I am suggesting is an approach very different from the Chapter 7 approach today.

Jane?

MS. McNAMARA: I am not opposed to it at all. I could tell you stories all day long of the consumers that come to see us that are not willing to adjust their lifestyle, or who will close out a program with us because the check was not received promptly by the cable TV company and they are not willing to give up their cable TV.

Credit is something that is a privilege, not a right. Michael has said several times that as more and more people file bankruptcy, the costs
of those losses are passed on to the rest of us. That is not going to change. As we see more and more people file, I think ultimately there will be less access to credit for all of us because of the losses the creditors incur. And yes, they build that into the cost of doing business, no question.

Bankruptcy should be available, but it should be a last alternative. I have used the analogy many, many times: the first time you have an argument with your spouse you do not run out and file for divorce. It is the same thing with bankruptcy; it is something that should be a last alternative after you have exhausted all opportunities to repay.

Yes, there will be the need for some consumers to file bankruptcy, there is no question. But as many as are filing? I personally do not believe so. I think the law should be tighter.

PROFESSOR FELSENFELD: Hank?

MR. HILDEBRAND: Do I have an objection to a Bankruptcy Code which would require entities—debtors—who have surplus income to as a condition to getting relief dedicate that income? No, provided it is evenly applied. I am going to agree with Judge Jones—provided it is everybody, business people and consumers.

One of the things that Mike had mentioned is if you are beyond 75% of the median income but you cannot pay 20% of your debt, you can go ahead and do Chapter 7. So people who have greater debts can file Chapter 7, whereas people with smaller debt cannot file a Chapter 7; they’ve got to dedicate their income to a Chapter 13. I find that kind of dichotomy problematic in that scenario.

PROFESSOR FELSENFELD: Karen?

PROFESSOR GROSS: I do not favor a system, either for individuals or businesses, that mandates that income be dedicated—disposable, however you want to characterize the income—be available for repayment to creditors.

I do think, however, that there is something which we may all agree on—that the quality and amount and nature of information and counseling that debtors get pre-bankruptcy is not necessarily optimal across the country. I think you may get consensus on that. While there are some very good debtor lawyers out there, the quality of information that debtors get, because many are pro se, is very questionable. I think you would stand a greater chance of getting agreement on that issue than this one.

PROFESSOR FELSENFELD: Before proceeding with the rest of the panel, what is your reason, Karen, for saying that somebody with surplus income should not use a portion of that income to pay some part of the creditor obligations? I am not sure that I follow.

PROFESSOR GROSS: I wrote four chapters in a book explaining why the "fresh start" principle and the discharge in Chapter 7 is so
significant. The bottom line, to condense these four chapters very quickly, is that I believe that people fail and should be forgiven. We live in a world in which we encourage risk-taking, and we live in a world in which when you take risks, whether they are good risks or bad risks, sometimes things do not work out as you want.

One of the benefits that our law provides—not every year, but every six years, and not for those who are fraudulent—is that you can begin again. For me, that is central to our notion of bankruptcy, it is central to our vision of ourselves as a people, as a nation, and it is what distinguishes us from lots of other nations across the world. It is not something I am embarrassed about, by the way. I am very proud of the fact that our bankruptcy system prizes its ability to recognize failure and to deal with it.

PROFESSOR FELSENFELD: Do we want to continue with this question?

JUDGE JONES: You know my answer.

PROFESSOR FELSENFELD: Yes, and I know your answer, Mike.

PROFESSOR GROSS: How about the other one? Would you agree on the other one, though, about better counseling?

MR. McENENEY: Pre-bankruptcy counseling.

JUDGE JONES: I think the Commission agreed on that. I do not, however, discount personal responsibility to the extent that some people do here.

MR. McENENEY: Obviously I support a system that would devote surplus income to repayment of debts.

On the "fresh start" point, obviously there has historically been a lot of value placed on the fresh start. I think the way the bankruptcy system works today, however, it fails everyone. It fails the debtor, who files for Chapter 7, gets a discharge, and everybody seems to agree that those debtors largely are unsophisticated financially, and it sets them free to engage in exactly the same behavior that got them into financial difficulty in the first place.

If you want to look at one of the significant benefits of needs-based bankruptcy, it takes at least some of those people and, under a plan administered by a trustee, helps them understand how they need to change their lifestyles to manage their money.

JUDGE JONES: Is this a "Twelve Step" process for financial repair?

MR. HILDEBRAND: It is true. Some of the more successful programs in Chapter 13, and in bankruptcy in general, have dealt with the San Antonio process, where there is a great deal of education and counseling that is available. Other programs are in Columbus, Ohio

129. See Report, supra note 19, § 1.1.5, at 96.
MR. McENENEY: So a fresh start that would really be meaningful to a debtor, I think, would be one that would involve something like a Chapter 13, where the debtor is supervised in terms of managing his or her finances, at the same time being given the protection with respect to the obligations the debtor cannot meet.

MR. HILDEBRAND: If we took and made that in some way applicable to a Chapter 7 debtor, wouldn't that be an appropriate response? You get your discharge, you can walk away with a fresh start, but you get some kind of an educational requirement as well?

PROFESSOR GROSS: Absolutely.

MR. McENENEY: I think education is important in either case. I have serious reservations about the efficacy of education in a Chapter 7 context, where it is over in a relative heartbeat. I think that the opportunities for education are much more significant in a Chapter 13.

MR. HILDEBRAND: Under the existing scenario that would be true. But let's assume—we are sitting here creating a new Bankruptcy Code—that until you complete your educational program in a Chapter 7 you do not receive that Chapter 7 discharge—but there is no a requirement to repay any debt.

MR. McENENEY: No. I understand that, Hank. All I am saying is there is nothing like having someone like yourself spend three-to-five years helping the debtor understand how the debtor needs to budget in order to make these payments under a plan. I mean, that is very effective education, and you cannot find that in a Chapter 7 case.

JUDGE JONES: Let me ask a historical question of our professors about the fresh start. We did not have a bankruptcy law for a hundred years, did we?

PROFESSOR GROSS: Our first bankruptcy law was in 1800.130

JUDGE JONES: I understand, but they only lasted two to three years.131

PROFESSOR GROSS: Yes. We have had whole periods, until 1898, in which we did not have a bankruptcy law, although the history that has been told is not a completely accurate one.132 For example, many people say that our first bankruptcy law had no discharge when in point of fact it did.

JUDGE JONES: Well, I am not making that point. I am just saying the fresh start is sort of like the "wall of separation" between

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church and state. It is a metaphor, and you've got to add content to it and understand it very carefully in context.

MR. HILDEBRAND: Our need for a discharge has changed a little bit. I can throw in your home state and my home state as an example. In the early nineteenth century the equivalent of a bankruptcy discharge was writing the word "GTT" on your door in Tennessee. The "GTT" meant "Gone To Texas," and no one was going to follow anybody down and go fight in the Alamo down there to go and collect a debt. In addition, until the Second World War really, almost all of the lending decisions were asset-based lending decisions. If you had property, you could borrow money. If you had assets, you could borrow money. Then, the phenomenon that developed is the reliance on an income stream. Now, with some of the pre-screening stuff, we may not be relying even on your income stream or debt load; we are requiring some other criteria. We are relying on something else.

Our bankruptcy law, however, is founded upon asset-based lending, and that may be why we are in the throes of this conflict. It is an asset-based lending solution to an income-based lending environment.

PROFESSOR GROSS: I would be happy at some point to chat about the history of the fresh start, which I think antedates even our bankruptcy law. I mean, we are a nation founded by debtors.

I want to talk about personal responsibility, to respond to Judge Jones. I do not abdicate personal responsibility at all. You and I may differ as to how to develop personal responsibility, and you and I may have very different notions about how to develop it. It is not that I do not believe in personal responsibility, by any stretch. I think that is very important to make very clear. In fact, my book makes it very clear that I am not saying people have no responsibility. The question is: How do you get responsible people?

JUDGE JONES: You know, this is an argument that cuts across every social debate in society today. How do you foster responsible conduct in teen-agers with regard to sex? Do you tell them, "No, don't do it"; or do you "educate" them in the hopes that they will not get tempted by all the trash that they hear and see on TV and in the media? Similarly, how do you teach people not to use drugs? Do you put them in jail when they start to deal in drugs; or do you "counsel" and treat them?

What disturbs me about this bankruptcy debate that has gone on over the last couple of years is that many people in the bankruptcy community are unwilling to look at it in those terms and recognize that there are two different views of society here that we are talking about. To be honest, I felt as if my view, which has to do with personal responsibility, was just ignored.

133. See text accompanying supra note 129.
PROFESSOR GROSS: I do not think that is true for my debate with you.

JUDGE JONES: I am not saying that. I would be interested in your comments. That is just something I have found. Hank Hildebrand is an obvious exception to that. I think he has one of the more refreshingly open-minded views on the whole subject.

PROFESSOR GROSS: Actually, I think the basis of my initial remarks here was to acknowledge that it is a world-view issue. It is a perspectival issue that has to do with fundamental beliefs about human nature, choice, social, economic, and political theory.

Can I just go to a point you made that education is best served in a Chapter 13? I really disagree with that, because one of the remarkable things to me is that Chapter 13, even in those areas of the country without a formal education program, does by its nature provide some education. You have to budget, you have to live within an agreement for a three-to-five-year period. I mean, it does have some financial management skills in it.

MR. McENENEY: Sure.

PROFESSOR GROSS: We have a bunch of Chapter 7 debtors who go into the system and out of the system no better off—other than being discharged from their debt. If you were to think about where debtor education belongs, if you only had $X dollars and only one place to put it, give it to the Chapter 7 debtors. I do not care that they are in the system for a short time. Do short-term intensive education, but don’t leave them out.

MR. McENENEY: I think we agree, Karen. I think, though, that the way I would deal with the problem with Chapter 7 debtors and the fact that they do not get educated is to shift more of them into Chapter 13. That way they would get those opportunities that we both agree are stronger and more effective than they would be in Chapter 7. At the same time I would educate those debtors that remain in Chapter 7, but most would benefit by shifting them out of Chapter 7 into Chapter 13 at the start.

JUDGE JONES: Do the people who sponsored Representative McCollum’s bill have any estimate of the number of cases that this would shift from Chapter 7 into Chapter 13? They must have done something.

MR. McENENEY: Estimates vary. The one piece of research that is out there, which is based on a slightly different model, is the research that was done by Professor Jack Barron at Purdue and Mike Staten at Georgetown.134 The two of them looked at a sample of

134. See John M. Barron & Michael E. Staten, Personal Bankruptcy: A Report on Petitioners’ Ability—To—Pay (Oct. 6, 1997) (unpublished manuscript, on file with author), cited in Warren, supra note 24, at 1088 n.35. This study has been harshly criticized by commentators and vehemently supported by its authors. See Warren, supra note 24, at 1091-92.
Chapter 7 bankruptcy petitions and found that a quarter of those petitions, based on the debtors' own information, showed enough income to repay a third of their debts.\(^{135}\) In other words, just based on taking a look at income, backing out the living expenses—not the conservative living expenses that would be set forth in the needs-based test I discussed, which are based on IRS numbers; but taking the debtor's actual information where the debtor says "income is \(X\), living expenses are \(Y\)"—the remainder, according to the two professors, would be sufficient in 25% of the cases to pay off the debtor.\(^{136}\)

MR. HILDEBRAND: Before you get to that level, how many people in Chapter 7 are beyond the 75% of the median national income?

MR. McENENEY: The answer to that is I don't know. The research was not based on that model. The 75% threshold is something that Representative McCollum first floated a few days before he introduced the legislation.

MR. HILDEBRAND: I am talking pure self-interest here, which is the fact that when this bill passes, as you hope it will next year, I suppose, then I now have to administer a group of cases for people who are in Chapter 13 who do not want to be there, for one thing. I cannot use the incentive reason anymore; I've got to use some kind of electric prod.

MR. McENENEY: Well, actually, the incentives will be pretty strong, because if they do not perform—if under the needs-based test Chapter 13 is their only option—then they better pay that Chapter 13 or they are back out of bankruptcy and the stay is lifted and they have to deal with creditors again.

PROFESSOR GROSS: Let me just say that it is interesting to me that you make a threshold without having the data to support how many people are impacted by it. It would seem to me that data would have pushed you one way or the other as to how to address the problem you perceive.

MR. McENENEY: Well, I think, based on the study that I just mentioned and the tighter standards that are in the legislation that has been introduced, the number is below that 30% number I mentioned.

JUDGE JONES: This business about data to me is totally a red herring. How did Congress reach the amounts of debt for the threshold in Chapter 13 to begin with? They pulled them out of the air. Why did they raise them in 1994? Well, they raised them because debtors in California had mortgages to pay, so they raised them effectively in Texas, where the mortgages are lower, bringing small businesses into Chapter 13.

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135. See Barron & Staten, supra note 171, cited in Warren, supra note 24, at 1088 n.35.
136. See Barron & Staten, supra note 171, cited in Warren, supra note 24, at 1088 n.35.
PROFESSOR GROSS: The fact that we did not do it wisely before does not mean that we should do it equally unwisely again.

JUDGE JONES: I do not think that data are the sole criterion of what is wise. I think that there is a principle here, and the principle is that if you are making 75% of the American median income, you can cover your expenses and have a little left over. That is the principle, and I do not see anything wrong with that principle. Some people might have the lower principle—for example, they may feel that even the most frugal immigrant who has come over and lives hand-to-mouth and puts money away in a shoe box should pay something back. I do not share that view, but to me that is a logical view.

I do not see how anyone can go to the further extreme and say that these doctors who made bad real estate deals and are earning $250,000-$500,000 a year ought to walk away from their debts in Chapter 7. Just picking something like that is not unfair.

PROFESSOR FELSENFELD: Let me make an abrupt change and try something new, which I think will lead to a very, very brief discussion. There has been so much written and spoken about lenders lending too much money, lenders lending carelessly, there being an excessive amount of credit out there, etc. Does anybody on the panel think that there should be some form of restriction on the lenders as to what they could lend?

MR. HILDEBRAND: A lot of this would go away if we had a national usury law. I am convinced of that.

MR. McENENEY: So would a lot of the credit availability, Hank.

MR. HILDEBRAND: I am not necessarily advocating that, but I think far fewer debtors would file for bankruptcy.

MR. McENENEY: That is just another side of the underwriting issue. The bottom line is if you set up a national usury law, a lot of people who handled credit responsibly all their lives would not have it available to them.

PROFESSOR GROSS: Actually—people may be surprised—I do not have a problem with the extension of credit. In fact, I think that what is remarkable is that the credit scoring system has enabled people who previously could not access the credit market to get credit, and what is even more remarkable is that they are paying. So, to me, it is not access to the credit market that is the problem. That is not to say there aren’t some frivolous lenders out there, but that, for me, is like there are some bad actor debtors out there.

The root of the problem is not that credit card companies are extending credit extraordinarily improvidently. In fact, the flip side is that people are getting credit who could not get it before. There are other problems, though, like lack of monitoring. I have problems with the credit industry, but access is not my major beef.

PROFESSOR FELSENFELD: And your major beef is?
PROFESSOR GROSS: I have problems with the credit card industry in two places. One is pre-bankruptcy. There is a lack of monitoring of credit, and I have problems with their mechanisms and means of dealing with debtors who cannot pay. I think are far too stringent and do not recognize the availability of more flexible approaches to debt repayment outside of bankruptcy. That is my pre-bankruptcy piece.

I also have a problem on the post-bankruptcy piece. There are a whole group of credit collection mechanisms that are now being tried on debtors who have gotten a discharge that I think are problematic.

JUDGE JONES: With regard to the lack of monitoring, we have gotten a lot of letters from lenders, credit unions and other lenders as well, and there have been lots of articles now, that the number of bankruptcies filed by people who were not in default has increased. That leads us to a serious question in my mind about how one complains about lack of monitoring. I know there is a realm in which one can, but that is a portentous problem.

PROFESSOR GROSS: I would agree for the ones that are the surprise bankruptcies.

JUDGE JONES: That is a very fast-growing number.

PROFESSOR GROSS: It is not as big a number as one might believe.

MR. HILDEBRAND: It is a surprising number, that almost one out of ten, one out of twelve, would do that. I am saying that.

MR. McENENEY: The bottom line is there is a lot of monitoring that does take place. Transaction patterns are looked at and systems are becoming even more and more sophisticated to try and identify consumers that look like they are on a bankruptcy track earlier and earlier. The problem is that, for the reasons I mentioned earlier, including surprise bankruptcies, it is really impossible with any certainty to identify consumers and say consumer A is going to go bankrupt, consumer B is just going to be in default for a while and come back, and consumer C is just slow paying. There is just not a good way to do that. I think that the lenders are trying, but there is just no perfect system.

PROFESSOR GROSS: I do not know enough about the mechanics of the credit scoring system to know how much more one could tell. One thing, however, is true: If the problem is not access, then individuals who get credit are not counseled as to how to use it well. There is a problem there.

JUDGE JONES: The access is not the issue. It is the responsibility with it and determining how much of it you can afford. Because if you are bombarded with pre-approved credit applications and you send

137. See supra notes 101-102 and accompanying text (discussing "surprise bankruptcies").
them all in and you get credit, that is not the creditors' problem. It is up to the consumer. Unfortunately, we do not teach consumers, generally speaking, how to manage money, and so they learn the hard way, by getting into trouble.

MR. McENENEY: Although the overwhelming majority of consumers that get that credit use it wisely and do not get themselves in trouble.

MR. HILDEBRAND: Should a credit grantor have a responsibility for saying "you've gotten the credit; we want you to use it responsibly?"

MR. McENENEY: Let's go back to the bank card industry statistics: 1% of accounts end up in bankruptcy; an additional 2% or 3% get written off for other reasons; 96% of the accounts are paying as agreed.

PROFESSOR GROSS: That does not mean they know what they are doing. That just means they are paying. That does not mean they know how much they are paying for their washing machine. They are paying for it, but instead of it costing $300, it costs them $700.

MR. McENENEY: It also does not mean they do not know what they are doing. Educating 100% of consumers in fine print on disclosures—or however you would accomplish that—the bottom line is it would be costly to do if it is going to be effective. How do you justify imposing that cost on 96% of the accounts that do not need the education to cover the 3% or 4% that do?

PROFESSOR GROSS: In fact, your industry is doing a fair amount of education for just the reasons that I am explaining, which is that educated consumers who learn how to use credit well, even non-defaulting debtors, are better customers for creditors.

MR. McENENEY: Absolutely, and I think the industry has recognized that. I think you have probably seen programs that bank card industry associations have developed for high school students and for adults to help them manage credit wisely. I think there is a difference, however, between that and imposing some sort of federal obligation that makes those programs mandatory and imposes a cost on them.

PROFESSOR FELSENFELD: Unfortunately, our time is up. I think what I would like to do is go through the panel one last time and give each member a chance to sum up and give any final observations he or she may have. Let's go through in the order that they began a long, long time ago.

JUDGE JONES: I think I will use this portion of my time to go over what our dissenting report said because I really did not do that to begin with. I think you have seen the general theme of what I learned

138. Professor Gross was unable to attend the afternoon session and, accordingly, she was unable to make concluding remarks.
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being on the Commission, which was that the bankruptcy system that we presently have—leave aside any question of means testing—does not seem to me to be satisfactory. The reason it is not satisfactory is that it lacks controls; it lacks clarity. Whenever it lacks clarity, that causes more litigation, which drives up the transactional costs, which ultimately means less money for debtors as well as less money for creditors, and costs society at large because of the unwieldiness of the system.

Given that background, our proposals were mostly in the vein of—this is speaking for four of us—aside from the matters that we agreed to, we had restrictions on the filing to try to clean up the problem of inaccurate and inadequate schedules, including:

The National Registry; 139
Making discharge contingent on a trustee certificate; 140
Requiring debtors to submit copies of their tax returns; 141
Putting the lawyer on the line with Rule 11-type responsibility for the debtor's schedules; 142
Revoking a discharge if a debtor has made material false statements in connection with his schedules and documents filed with the bankruptcy court. 143

Then, to try to clarify some particular problems in the law that people had identified before the Commission:

We suggested, as I have already said, a response to the Rash 144 case that would have been a mid-point between wholesale and retail value of collateral. 145

We would solve the circuit split about the so-called "installment redemption" option by saying that a debtor does not have that option. 146
The debtor retains three options: to reaffirm, redeem, or surrender collateral subject to security interests only. 147

In Chapter 13 we would require payments to be made simultaneously to secured and unsecured creditors for the life of the plan. 148
That is also a provision in the majority recommendations. 149

139. See Jones & Shepard, Dissent, supra note 44, at 8 (Editor's note: The various dissents and commentaries in chapter five of the Report are each separately paginated.).
140. See id. at 9.
141. See id.
142. See id. at 8.
143. See id. at 9.
145. See supra notes 36-36.
146. See Jones & Shepard, Dissent, supra note 44, at 10 (Editor's Note: The various dissents and commentaries contained in chapter five of the Report are each separately paginated.).
147. See id.
148. See id. at 11.
149. See Report, supra note 19, §§ 1.5.2-.4, at 7.
there is to make sure that the debtors have an incentive to actually complete the plan and make the payments to the unsecured creditors.

We would allow five-year plans specifically. We would have the Chapter 13 plans be reviewed annually and payments modified either up or down according to the debtor's income.

We would define "default" in Chapter 13 to include a debtor missing two consecutive payments and not being able to catch up. Furthermore, we would make it clear that if a debtor defaults in a Chapter 13 plan all the benefits of Chapter 13 would have to be revoked.

Now, this series of recommendations is open to the obvious criticism that nobody would file Chapter 13 under these restrictions. There is some truth to that. To me, that leads naturally into further discussion of means testing; but the Commission, unfortunately, did not reach that in any detail.

I would also, in response to the recommendations of a number of judges, as well as lawyers, allow an affidavit practice on motions for relief from the stay in the ordinary consumer case. That would speed things up considerably.

We would exempt from the automatic stay residential leases. We received 375 letters, I believe, from landlords pointing out what an abuse occurs in regard to residential tenancies when the tenant has gone through a foreclosure or eviction proceeding and then files bankruptcy. It costs the landlord, who is often him or herself not a person of means, additional expense and delay in payment of rent.

We would clarify § 1322(b) to say that no lien for a debt secured principally by a debtor's homestead can be stripped down, although we took no specific position on Congressman Butler's proposal. But that explanation of § 1322(b) would reinforce the Nobelman decision, as opposed to doing away with it, as some advocated.

I have an extensive critique of the proposals the Commission's majority. I believe there will also be four votes to take a different approach to reaffirmations, which is to say that reaffirmations ought to

150. See Jones & Shepard, Dissent, supra note 44, at 11 (Editor's Note: The various dissents and commentaries contained in chapter five of the Report are each separately paginated.).
151. See id.
152. See id.
153. See id.
155. See Jones & Shepard, Dissent, supra note 44, at 11 (Editor's Note: The various dissents and commentaries contained in chapter five of the Report are each separately paginated.).
go back before the courts for approval again, and that the real problem in reaffirmations has not been creditor abuse—although Sears is an obvious counterexample—but that so many reaffirmations go through without adequate advice or counsel by the debtor's attorney, or by the judge. We had enormous amounts of testimony about how the debtors' attorneys really ought to counsel their clients better on this subject. If they did, the law as it stands is adequate to protect them.

We also had an alternative proposal, which I think will garner four votes, on serial filings. It basically restricts filings to one every six years, unless there is some administrative problem or particularly exceptional circumstances. The idea there is that the Commission's majority proposal, as it now stands, has a totally toothless ban on refilings. If you take bankruptcy seriously, that it is a special matter of dispensation by society from what is your ordinary obligation to pay debt, then it should not be something that people can resort to with impunity again and again and again, whenever they suffer setbacks.

This is appealing to the Congress, which has passed a five-year lifetime limit on welfare payments. It seems to me that the people who are in need of welfare are at least as deserving—or more so—than many of the people who end up filing bankruptcy. So I do not regard that as a serious stretch.

I will just conclude by reiterating a few little nostrums that have sort of guided me during the consumer process.

I disagree very much with people's using the Bankruptcy Code solely for the purpose of installing what they believe to be debtor-friendly provisions, because if you take each one of them—the ones that I mentioned in the framework to begin with—they turn out in the aggregate and on the whole, and viewed in the context of the society at large, not to be consumer-friendly. So every time you strip a lien in bankruptcy or treat something as unsecured which was formerly secured, it has consequences on the rest of society at large.

My other guiding principle has been that I do not think bankruptcy law ought to substitute for state law unless it is absolutely necessary. Butner v. United States is one of the great under-appreciated decisions that we have. I view bankruptcy as a mechanism to enforce state law, not to add a bunch of remedies on top of what already appear in state law.

Finally, I have the feeling that Congress is going to have to look at all this very seriously now because, given this large a number of bank-

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157. See Jones & Shepard, Dissent, supra note 44, at 10 (Editor's Note: The various dissents and commentaries contained in chapter five of the Report are each separately paginated.).
158. See id. at 12.
ruptcies in a time of prosperity, somebody is going to be called to account if the number triples or quadruples as soon as we have a downturn, and they will be looking around for scapegoats. I will not be there anymore; I will be back on the bench. I do not know who the scapegoats will be.

There is no doubt in my mind that this reflects a social problem that it would be better for us to nip in the bud than to wait until we actually see the fruits of it in the destruction of many people's household finances. By analogy again to other social problems, we took a different approach to crime in the 1960s and 1970s and rates of crime skyrocketed. You see here that in New York rates have been ratcheting downward once you took a more stringent approach to panhandling and minor offenses. So I think the same thing can be done if we will do it in bankruptcy, rather than have to wait until a crisis erupts.

PROFESSOR FELSENFELD: Thank you, Judge Jones.

Jane McNamara, any concluding words?

MS. McNAMARA: Thank you.

We talked about the moral issue of bankruptcy being available for consumers, and the need for it and how should it be structured.

Bankruptcy has long-term social ramifications. Many times when people file for divorce, the first reason they cite is that they had financial problems. Typically, the way people handle money is indicative of how they communicate within the family. So as we see the rise in bankruptcies, we see other social issues occurring—not only the losses to creditors, but the disruption to families.

I already mentioned today, and I will say again, I think the Code needs to be tightened and strengthened so it is not so easy to file bankruptcy as it currently is, that there is a responsibility to pay back the money that has been borrowed, in whatever capacity.

If the Code is changed, there is going to be a greater need for alternatives, because we will not see people seeking those remedies as they currently are, and it is going to be even more important to have a greater awareness of what those alternatives are to make early referrals, to have cooperation from those people that are involved.

And education is going to become even more important because right now there is not a great emphasis on that. Certainly, the consumer credit counseling services can provide that role, but it is also going to take cooperation and support, as well as education from creditor groups.

PROFESSOR FELSENFELD: Thank you very much.

Hank Hildebrand?

MR. HILDEBRAND: I think that everybody here is aware that the landscape is going to wind up changing, and it is going to change maybe in the next eighteen months. It may be that in about a year, or a year and a half, from now you will be attending a CLE talking about
what Congress has just done in connection with the Bankruptcy Code. The people here probably will not be surprised, no matter what happens out of this, because you would have heard it here, in one form or another, first.

Let me do a little prognostication on this. Clearly the landscape has changed. There will be a fundamental shift in how this country deals with bankruptcy and consumer insolvency. That means that, as members of the legal profession, we have an obligation to know what has happened and how the law will change. I do not think it is any more acceptable, nor will it be acceptable, for people to be able to know just a little bit of that process.

I know that in many places in the country people just do not know Chapter 13 because Chapter 7 is easier and it is accepted and you just do not have to know it. I do not think that is going to be an acceptable response anymore. I think, as you have heard all across the board today—I think everybody is telling you that—that you will need to know all aspects of consumer bankruptcy if you are going to practice any aspect of consumer bankruptcy.

I think you have also heard today, and I think you are going to see this in eighteen months, that education is going to be a critical element of this process. Now, whether that education is done at the high school level or whether the education is done at the pre-bankruptcy level—which I call “Chapter selection”—or the post-bankruptcy level, where we are trying to get people so that they go forth and sin no more in this process, I think you are going to see education as being an element of this, and you can look back in two years and say, “Yes, that’s right.”

Finally, we are going to be talking for the next year, year and a half, about this rub, where the judicial system and our consumer economic system and our social welfare system rub together. We are going to have to make some really serious decisions as to where these are differentiated and where they blend together.

I think you are going to see that some of the assumptions that you and I will make today will not be true in a year and a half from now. We may be saying, “Gee, what happened? I don’t remember how that could happen.” Or we may be saying, “Thank the Lord something has happened to change that.”

So I guess I leave here not knowing what is going to happen myself, but with the thought that I know something will happen. So I encourage everybody to at least follow the process, because I think the process itself is going to dictate the outcome.

PROFESSOR FELSENFELD: Thank you, Hank.

Finally, Mike McEneney.

MR. McENENEY: Well, first, I hope that Hank is right and something does take place of a dramatic nature.
I think, in closing, I would just say that I think you have heard today—and it is probably something you have already known—that consumer bankruptcy is extremely costly; the cost is not only borne by creditors, but it is borne by all consumers that continue to pay their debts. They bear that cost in the form of higher prices. The system, by all accounts, in all likelihood is only going to become more costly.

I think in order to have a bankruptcy system that is fair and continues to work there has to be fundamental change in the Bankruptcy Code. People have to be measured to determine how much bankruptcy relief they need, and they’ve got to get just that relief that they need—no more, no less. I think if that does not happen that the ramifications will be much more significant than perhaps some changes that impact bankrupt debtors. I think we will see a dramatic increase in the cost of credit and a decrease in credit availability, which, as I said earlier, is going to impact most greatly on those that can least afford it, and those are the lower and moderate income families that do not have a lot of alternatives available to them.

PROFESSOR FELSENFELD: Will you join me, please, in thanking the panel for coming here and giving us an extraordinarily worthwhile day?