TESTIMONY OF
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SECOND ANNIVERSARY OF THE ENACTMENT OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005:
ARE CONSUMERS REALLY BEING PROTECTED UNDER THE ACT?

BEFORE THE
SUBCOMMITTEE ON ADMINISTRATIVE AND COMMERCIAL LAW
HOUSE OF REPRESENTATIVES JUDICIARY COMMITTEE

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My name is Henry J. Sommer and I am an attorney specializing in bankruptcy and consumer law matters. For over 32 years, I have represented families and individuals in Philadelphia who have sought my help for serious debt problems, often involving mortgage foreclosure. I am the President of the National Association of Consumer Bankruptcy Attorneys (NACBA), an organization of attorneys who represent consumers in bankruptcy. Our over 2700 members represent a large proportion of the individuals who file bankruptcy cases in the United States Bankruptcy Courts, and I am testifying today on behalf of NACBA and its members.

I'd like to address my testimony today to two principal topics: How the 2005 bankruptcy amendments have impacted consumer debtors and how the bankruptcy laws should be amended to give homeowners an effective remedy to deal with the foreclosure crisis our nation is now facing.

I. IMPACT OF THE 2005 AMENDMENTS

In answering the fundamental question posed by this hearing, I would say that the 2005 amendments to the Bankruptcy Code are not protecting consumers. They were premised upon allegations that there was widespread abuse in the consumer

bankruptcy system and that many who filed chapter 7 bankruptcy cases could afford to pay a significant portion of their debts. The reality is that this was never true, and the experience since the effective date of the amendments has borne that out. Very few debtors, only about one half of one percent, have been charged with abuse under the bill's vaunted means test, even though its threshold of abuse is very low – a debtor can be charged with abuse if the debtor is deemed able to pay as little as $100 a month toward her debts, or deemed able to pay only a tiny percentage of what is owed. Not surprisingly, we've seen no trace of the $400 to $550 benefit which the bill's backers promised would redound from its passage to every household in the country. Indeed, abusive credit card practices, including higher and higher late charges, have only increased, at least until some companies agreed to change a few of these practices while testifying at hearings in this Congress.

The biggest impact of the new law has been the enormous increase in the costs and burdens of filing an individual bankruptcy case. I doubt that it was the intention of even those who voted for the bill to increase documentation requirements, bureaucratic paper work, and other costs so much that honest low income and working families, not the "high rollers" at whom the amendments were supposedly aimed, are deterred or prevented from obtaining the bankruptcy relief they need. But that is what has happened. The filing fee has increased by 50%; there are new fees

for credit counseling and education that usually total another $100; and there has been such a great increase in the documentation required to file a case that attorneys have had to increase their fees at least 50%.

This increase in cost and the widespread misperception that bankruptcy is no longer available (aggravated by collection agent misrepresentations to consumers) are the primary reasons that bankruptcy case filings have declined so precipitously. Certainly, the causes of bankruptcy cases – medical problems, job loss, divorce – have not lessened. The misperception about bankruptcy availability will gradually be corrected as word gets out that bankruptcy is still possible, but the problem of costs and burdens is one that Congress must address. Bankruptcy has gone from being a relatively low-priced proceeding that could be handled quickly and efficiently to being an expensive minefield of new requirements, tricks and traps that can catch the innocent and unsuspecting debtor. There is simply no reason, especially in the cases of lower income debtors, that all of the documentation demanded by the 2005 amendments is necessary.

Every consumer bankruptcy attorney has had the experience of explaining these requirements to prospective clients, only to have the clients go away, discouraged, and never return. Debtors must obtain all "payment advices" for the 60 days before the bankruptcy is filed; they must obtain a tax return or transcript for the

most recent year before the petition is filed and sometimes additional years; they must provide an attorney with information detailing every penny of their income for the six months the petition is filed; they must provide bank statements to the trustee and evidence of current income; they must attend a prepetition credit counseling briefing, no matter how hopeless their situation and regardless of whether their problems were cause by imprudent credit decisions of unavoidable medical catastrophes; they must attend a financial management course in order to receive a discharge; attorneys must complete numerous additional forms, including a six page means test form that requires arcane calculations about which there are many different legal interpretations. According to the United States trustee program, attorneys must also provide clients with pages and pages of so-called disclosures, many of which are either irrelevant to the client's case or inaccurate, which then requires much additional time spent explaining why they are irrelevant or inaccurate. Moreover, trustees in some districts demand that debtors provide even more additional documents.

And if a consumer bankruptcy debtor is subject to an audit by the United States trustee, even more is demanded. The consumer is asked to provide six months worth of income documentation, six months worth of bank statements, and an explanation of *each and every deposit and withdrawal* from any account over those

six months. Few consumers keep such records; many consumers in financial trouble operate on a cash basis because their credit cards have been cut off and they must make numerous ATM withdrawals to meet almost all of their expenses. To account for every expense paid with the cash withdrawn is often impossible. But many bankruptcy attorneys are asking for much of this information from every client because they are so afraid of being accused, after an audit, of filing false statements by an aggressive United States trustee program, as discussed below.

As described in the recent GAO report, the credit counseling requirement is not serving its supposed purpose. Even the credit counselors report, as did our members in a survey we conducted last year, that only 2%-3% of the prospective debtors they see could even contemplate a debt management plan. The counseling requirement serves primarily as yet another barrier to bankruptcy, especially in those districts where judges have ruled that debtors, even those facing emergencies, cannot file their bankruptcy cases until the day after they receive the credit counseling briefing.

And most of the required documentation is unnecessary to the ostensible goals of the 2005 amendments. In the vast majority of cases, consumers are nowhere near the thresholds at which the abuse provisions come into play. It should be sufficient for a debtor to provide any one of several documents to show income - a recent

paystub with a year to date figure on it, or a tax return or transcript for the prior year, or a W-2 form. The trustee is free, as has always been the case, to demand additional documents in the small percentage of close cases in which they might actually make a difference. And it should be made clear that if an auditor later finds minor discrepancies in the numbers, discrepancies that would have had no effect on the results of the case, the debtor and the debtor's attorney should not be publicly accused, as they are now, of making "material misstatements." Such a serious accusation should be reserved for cases in which the debtor's misstatement had a significant impact on how the case was handled.

Of course, these are only some of the provisions in the 2005 legislation that are having the greatest impact. Among the dozens of changes made by that law, many cause significant harm to honest debtors in particular cases, including restrictions on the discharge, new requirements for chapter 13 that make it much less attractive and make it more likely that plans will fail, and provisions that make it harder for consumers to save a home from foreclosure or a car from repossession.

Moreover, the problems of consumer debtors are only exacerbated by the aggressive anti-consumer stance of the United States trustee program. We have seen in that part of the Justice Department the same kinds of things we have seen with the United States Attorneys and with other administrative offices. The independent

decisions of career personnel and local offices have been subordinated to central directives from a politicized central office dedicated to serving the political interests of the administration – in this case by effectively becoming an arm of the administration's corporate backers in the financial services industry and trying to make bankruptcy as difficult and unattractive as possible. While spending enormous resources on going after minor document defects in papers filed by consumer debtors, the program has done virtually nothing to address the widespread fraudulent claims and charges of mortgage companies in bankruptcy, the practice of some creditor attorneys who have filed false documents on a regular basis, and other creditor abuses. If a single document filed by a debtor's attorney were as poorly documented as the unsupportable documents filed by creditors by the hundreds every day in the bankruptcy courts, the U.S. trustees would be seeking sanctions against that debtor's attorney. Yet the program devotes no significant resources to investigating creditor wrongdoing. The issues surrounding the United States trustee program deserve a hearing in themselves and I hope that such a hearing will be scheduled soon.

II AMENDMENTS THAT COULD HELP FAMILIES FACING FORECLOSURE

The second topic I'd like to address is how bankruptcy can be used to help solve the enormous foreclosure problems faced by literally millions of American families due to predatory lending, the bursting of the real estate bubble, and the fallout from years of virtually unregulated subprime mortgages. These are problems not just for the families whose homes are being foreclosed, but also for the communities where they live, which face a prospect of vacant properties that cause neighborhood blight and a decline in everyone else's property values.

Chapter 13 has traditionally been an important tool for families facing foreclosure. It has allowed them to save their homes by catching up on delinquent mortgage payments over a three to five year period while resuming their current mortgage payments. This model will not work, however, for people facing the "exploding ARMS", adjustable rate mortgages where the payments will go up by hundreds of dollars even if interest rates do not increase, because they cannot afford the higher regular monthly payments, much less anything toward the arrears.

Our organization, along with the Consumer Federation of America, the Center for Responsible Lending, and the National Consumer Law Center, has proposed changes to the bankruptcy laws that would allow such families struggling with their

mortgages to use chapter 13 to save their homes. These changes are not an attempt to roll back the 2005 bankruptcy legislation. Rather, they primarily amend provisions enacted in 1978. They address changes in the mortgage market that have taken place since then, including the change from market rate fixed interest loans to the subprime and adjustable rate mortgages of today. And our proposal would not require the expenditure of government funds to deal with the foreclosure crisis.

The detailed proposals are attached to my testimony, but probably the most important part is the removal of the current limitation on modifying mortgages on a debtor's principal residence. Unlike any other secured debts, most home mortgages are protected from changes in their interest rates, payments, and other terms in chapter 13 cases. Allowing chapter 13 debtors to change these terms, within fair parameters that we have proposed, would permit reamortization of the mortgages at a fixed rate of interest with payments those debtors can afford.

This proposal would give all homeowners the right to the type of loan modification that is available to farmers and fishermen in chapter 12 bankruptcy and that some lenders are saying they now give to some borrowers. However, under our suggested amendments, the availability of this relief would not be limited, as it now is in many cases, by the terms of securitization trusts that prohibit such modifications. It would also not be subject to whims and bureaucracy of mortgage

servicers. The experience of those who have sought loan modifications is that, at best, it requires hours and hours of negotiation and paperwork. Typically, while this is going on, the foreclosure is proceeding at full speed. All too often, we see homeowners coming to us at the last minute before a foreclosure sale because they thought they were going to be able to obtain forbearance or modification from their lenders and had therefore not consulted an attorney earlier.

It is in such cases that the prebankruptcy credit counseling is often a particular problem, and that is why we are proposing that families facing foreclosure be exempted from the counseling requirement. The supposed purposes of the counseling simply do not apply: The alternative of a debt management plan will do nothing to stop a foreclosure; indeed chapter 13 itself is a payment plan. To the extent the counseling might serve an educational function, that purpose is also served by the postbankruptcy financial education course, which will probably be much more effective when the recipient of the education is not absolutely frantic about the possible loss of the family home.

We have proposed several other statutory changes that would complement the basic proposal, including a provision to give the court control over the outrageous, often secret, fees and charges regularly added to a chapter 13 debtor's mortgage balance, and a special homestead exemption floor for elderly homeowners who, with

years of accumulated equity, are among the most frequent victims of predatory lenders. Again, the details are in the attached documents.

In closing, let me say that is a pleasure to testify before this committee once again. I would be very happy to work with you and your staff on bankruptcy legislation that could provide meaningful relief for the financial problems faced today by American working families.

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Henry J. Sommer is Supervising Attorney at the pro bono Consumer Bankruptcy Assistance Project in Philadelphia. He has litigated many major cases involving bankruptcy, consumer law, civil rights and other issues. Previously, he was the head of the Consumer Law Project at Community Legal Services in Philadelphia, where he worked for over 21 years. Mr. Sommer has also served as a Lecturer-in-Law at the University of Pennsylvania Law School. He received his A.B. degree from Harvard College, magna cum laude and his J.D. degree from Harvard Law School, cum laude.

Mr. Sommer is Editor in Chief of Collier on Bankruptcy and the entire Collier line of bankruptcy publications. He is the author of Collier Consumer Bankruptcy Practice Guide (Matthew Bender); Consumer Bankruptcy Law and Practice, (8th Ed. 2006) published by the National Consumer Law Center, Boston, Ma., and Consumer Bankruptcy: The Complete Guide to Chapter 7 and Chapter 13 Personal Bankruptcy (John Wiley & Sons 1994) as well as numerous articles on bankruptcy law. He is the co-author of Collier Family Law and the Bankruptcy Code (Matthew Bender).

Mr. Sommer is President of the National Association of Consumer Bankruptcy Attorneys (NACBA), a former member of the Federal Judicial

Conference Advisory Committee on Bankruptcy Rules (appointed by the Chief Justice of the Supreme Court) and a member of the National Bankruptcy Conference. He is a Fellow of the American College of Bankruptcy, a member of the American Law Institute, and a former member of the Federal Reserve Board Consumer Advisory Council. He is also a former Chair of the Eastern District of Pennsylvania Bankruptcy Conference, and Vice President of the Coalition for Consumer Bankruptcy Debtor Education.

He has been asked to testify many times before the House and Senate Judiciary Committees, as well as the National Bankruptcy Review Commission, on bankruptcy and consumer law issues. He has served on the faculty of numerous continuing legal education programs including those presented by the Federal Judicial Center, the National Conference of Bankruptcy Judges, the Southeastern Bankruptcy Law Institute, the Executive Office of U.S. Trustees, numerous law schools, the ABA Family Law Section, NACBA, ALI-ABA, and the Pennsylvania Bar Institute. Mr. Sommer was the first recipient of the National Consumer Law Center's Vern Countryman Consumer Law Award.