Testimony of

The Honorable Randall Newsome

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Mr. Chairman and distinguished members of this committee, I am honored to appear before you to discuss the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (hereafter referred to as BAPCPA). By way of introduction, I have been a United States Bankruptcy Judge in the Northern District of California since May of 1988, and chief judge of the district since January of 2004. From October, 1982 until May, 1988, I was a bankruptcy judge in the Southern District of Ohio. From October of 1998 until October of 1999, I was the president of the National Conference of Bankruptcy Judges. However, I want to make it clear from the outset that I am appearing before this Subcommittee representing myself only, and not the NCBJ or any of its members.

When I appeared before the full U.S. Senate Committee on the Judiciary on February 8, 2001, I made the following statement concerning S. 220, a bill substantially similar to BAPCPA:

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

I believe this statement is as accurate as to BAPCPA as it was as to S. 220. Given the dearth of filings experienced since BAPCPA became effective on October 17, 2005, and the lack of any empirical data, there is no way to determine whether the new provisions have steered debtors into chapter 13 who otherwise would not have filed a chapter 13. Although some have argued that the reduced number of bankruptcy filings is evidence of the deterrent effect of the new provisions, other explanations are equally plausible. For example, there are reports that some segments of the public believe that after October 15, 2006, bankruptcy simply ceased to exist, and that bankruptcy relief of any kind is now unavailable. This belief might explain the inordinately-large surge of bankruptcy filings on the eve of the effective date of BAPCPA. Although the reasons for the nature and number of filings is certainly debatable, there is no question that bankruptcy relief is now more difficult to obtain. The new statutes and rules have added eight or more additional paperwork requirements for all consumer debtors, regardless of why they are filing or their circumstances. For example, new Official Form 22A, entitled "Statement of Current Monthly Income and Means Test Calculation (Chapter 7)," contains 57 subparts, the first 15 of which must be completed by all chapter 7 filers. By all reports, these new paperwork requirements have substantially increased the time and expense of representing consumer debtors.

Additional observations and conclusions about the impact of BAPCPA cannot be made until more cases are filed. In the meantime, however, I am gratified that this Subcommittee is keeping a close watch on the bankruptcy system, because all of the elements are in place for a perfect financial storm and a resultant avalanche of bankruptcy filings. The financial state of the average consumer in the United States can only be described as dismal. I am not an economist, but anyone with a modicum of common sense can see that the numbers are as bad as they are unsustainable.

According to the U.S. Census Bureau, in 1989 the median total money income for households in 2005-adjusted dollars was $43,946. In 2005 the median total money income for households was $46,326-a mere 5 percent increase over 1989. To add to the picture, a recent report from the Federal Reserve Board indicates that between 2001 and 2004 there was actually a 6.2 percent decline in overall median wage income.

These income numbers stand in stark relief to the debt numbers. The source for these numbers comes from the Federal Reserve Board's G.19 releases, which set forth the total amount of consumer credit outstanding, not including loans secured by real estate. As of December of 1989, total consumer credit outstanding was about $782 billion. As of September of 2005, total consumer credit outstanding was over $2.36 trillion. That is over 300 percent of the 1989 debt level. The revolving credit numbers, which would include credit card debt, are even more impressive. As of December of 1989, the total revolving consumer debt outstanding was about $199 billion. As of September of 2005, that number had increased to over $857 billion, or more than 400 percent of the 1989 number.

The data regarding mortgage indebtedness is even bleaker. According to the Federal Reserve, "[o]verall, the median amount of home-secured debt rose 27.3 percent from 2001 to 2004. . . ." The median balance for those borrowing on home equity loans in 2001 was $16,000. That figure jumped to $22,000 in 2004. In 2004, 15 percent of homeowners who had a mortgage on their house had an adjustable rate mortgage (ARM). One recent report indicates that as of 2006, 22 percent of homeowners had an ARM, and that $1.1 trillion to $1.5 trillion worth of ARMs will re-set in 2007.

Some have suggested that these incredible levels of debt are nothing to worry about, because the value of assets is outpacing the increase in debt. Arguably, that was not the case even when the real estate market was booming, let alone now, when that market is declining. In any event, between 2001 and 2004, the median real value of assets among families rose 10.3 percent, but median net worth rose only 1.5 percent. That is a clear indication that the average American consumer's balance sheet is just as troubled on the asset side as it is on the liability side.

When these numbers are combined with higher energy costs, higher health and education costs, higher minimum credit card payments, and little or no savings, it is no exaggeration to state that a perfect financial storm is in the making. It seems fairly clear that the average American consumer is leveraging his house and other assets to spend more, or to pay off other debts, or simply to make ends meet. When all of the houses have been refinanced up to and beyond their fair market value to pay off all of the credit cards that have reached their limits, and when all of those cards reach their limits again, the debt bubble will burst. It may not happen next week, or even next year, but basic principles of mathematics dictate that it will happen eventually.

In order for the U.S. economy to weather this coming financial storm, it is essential that we have in place a bankruptcy system that is efficient and readily-accessible so that consumers can reorganize their financial affairs and rehabilitate their balance sheets. One way of increasing the efficiency as well as the predictability of the present system would be to clarify some of the language in BAPCPA.

A great source of frustration for both judges and attorneys is the inability to determine the plain meaning of many of BAPCPA's provisions. A prime example is 11 U.S.C. § 109(h), which requires individual debtors to obtain a credit counseling certificate as a condition to qualifying for bankruptcy relief. Although BAPCPA has been in effect for just over a year, this statute alone has generated over 60 published decisions (and many unpublished ones as well). These decisions are in conflict on a wide variety of issues, such as whether a debtor can meet the eligibility requirement by unsuccessfully seeking credit counseling less than five days prior to filing the petition; whether the certificate must be under oath; whether a case can be "stricken" rather than dismissed for failure to meet the requirement; and whether the facts presented constitute exigent circumstance meriting a 30-day, postpetition extension of the time to obtain the counseling. This plethora of decisions and issues indicates that the language of the statute needs clarification.

Another statute in need of clarification is 11 U.S.C. § 362(c)(3), which deals with limitations on the automatic stay for repeat filers. Judge Thomas Small aptly summarized the problem with this statute in In re Paschal, 337 B.R. 274, 277 (Bankr. E.D. N.C. 2006):
In an Act in which head-scratching opportunities abound for both attorneys and judges alike, § 362(c)(3)(A) stands out. It uses the amorphous phrase "with respect to" a total of four times in short order and raises questions about the meaning of the words "action taken" and "to the debtor." The language of the statute is susceptible to conflicting interpretations, and if read literally, would apply to virtually no cases at all. In sum, it's a puzzler.

This and many other "puzzlers" in BAPCPA should be revamped to avoid further inefficient expenditures of time for both the bench and bar.
An additional way to make the bankruptcy system both more efficient and more accessible would be to eliminate credit counseling as an eligibility requirement, and instead make it a condition of receiving a bankruptcy discharge, as is the case with the financial management instruction course mandated by 11 U.S.C. § 111. Most consumer debtors are hopelessly insolvent well before 180 days prior to filing a bankruptcy petition. Requiring credit counseling at one of the most stressful and confused times in debtors' lives significantly reduces its value, and makes it just another hoop to jump through in order to obtain bankruptcy relief. The consequences of failing to comply with this requirement are not only dismissal or striking of the case, but the loss of the filing fee ($299 in chapter 7 cases, and $274 in chapter 13 cases), something this financially-strapped group of people can ill-afford. It may also create adverse consequences under 11 U.S.C. § 362(C)(3), since it may count as a dismissed case and thus limit the stay in a future filing to just 30 days.

The worthy goals of credit counseling can best be pursued after the debtor has filed his petition, when the pressure from bill collectors has stopped and he can clearly focus on reorganizing his finances. There's no reason why both the credit counseling and financial management courses could not be administered by the United States trustee immediately before or after the § 341 meeting, and at no charge to the debtor.
As a means of reducing the cost of bankruptcy for all parties involved, and in the interests of streamlining the process as well, debtors with current monthly income below the state median family income level should be exempted from having to file some of the documents required by the statute and rules. Under 11 U.S.C. § 707(b)(7), a motion to dismiss under the means-testing provisions of § 707(b)(2) may not be brought by any entity if the debtor's current monthly

income is below the applicable state median family income level. Older empirical data indicates that the income of close to 85 percent of all chapter 7 debtors is below the national median household income. Nonetheless, the statute requires debtors to provide the trustee with tax returns, file their pay stubs, and calculate their current monthly income in Official Form 22 , even though that information largely duplicates the information required by Schedule I in Official Form 6. Unless there is some reason to believe that the debtor has not disclosed all income on Schedule C, he should be relieved of these requirements, in keeping with the gist of § 707(b)(7). Finally, it is important for this Subcommittee and Congress as a whole to monitor the needs of the judiciary, and provide the necessary resources for maintaining and improving the administration of justice in both the bankruptcy courts and the U.S. Courts generally. The recent lull in bankruptcy filings should fool no one into thinking that the present calm will endure. If, as the numbers seem to suggest, there is a debt bubble that is steadily growing, it may explode precipitously and with enormous consequences for the bankruptcy system and the entire Judicial Branch. While additional judgeships and staff may not seem necessary now, we must all be prepared to act quickly to add to the judiciary's ranks if a flood of filings arrives.

The suggestions outlined above are just a fraction of what is needed to prepare the bankruptcy system for any future eventuality. Ideally, all of these ideas and much more could be incorporated into a technical corrections bill, a bill which is sorely needed and which should be addressed sooner rather than later. I can safely speak for all of my colleagues in offering our services and assistance on such a bill in any way this Subcommittee sees fit. Thank you for this opportunity to appear and be heard.