Testimony of

Mr. Robert Lawless

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WRITTEN TESTIMONY OF PROFESSOR ROBERT M. LAWLESS
University of Illinois College of Law
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My name is Robert Lawless. Thank you for extending me the privilege of addressing you today. I teach and write about bankruptcy at the University of Illinois College of Law. As a legal scholar, my aim is to examine the empirical reality of how law affects the people it regulates. I have published numerous papers using publicly available government data as well as data collected from bankruptcy court files and from talking to people who file for bankruptcy. What my work teaches me is that the new bankruptcy law helps the credit industry, not consumers, and that the provisions of the law are leading to harsh results in the bankruptcy court.

Although the new law was called the Bankruptcy Abuse Prevention and Consumer Protection Act or BAPCPA, it addressed abuses that did not exist and protected the credit industry instead of consumers. Nevertheless, we were told the law was necessary because bankruptcy had lost its power to shame.1 The decision to file bankruptcy was made to sound as if it were a lifestyle choice. Just before the bill passed, Professor Zywicki, one of today's witnesses, told the full Judiciary Committee that the bankruptcy system was a tax on our society. Changes in the bankruptcy law could lower interest rates and lower prices.2

In the new law, the consumer credit industry got just what it wanted. Industry lobbyists were able to fill BAPCPA with provisions to benefit banks, auto lenders, credit card companies, landlords, and nearly any other business that loaned money to consumers. Congress passed the law, and the president signed it despite the warnings of bankruptcy academics, judges, and lawyers.

Have interest rates gone down? According to the Federal Reserve, interest rates on personal loans and credit cards are the same today as they were just before BAPCPA went into effect.3 What about credit card fees? For the three months ended September 30 of this year, Citigroup reported it made $1.3 billion in fees on credit and bank cards, an 8% increase over the same time period one year previous.4 In October, Wells Fargo increased late fees on its largest credit card accounts 11%, from $35 to $39 for each late payment.5 What about the claim that the old bankruptcy law led to higher prices? The new bankruptcy law certainly has not stopped consumers from paying more for goods and services than they did one year ago.

Where are the benefits of the new law? They are in the pockets of the consumer credit industry. Read the quarterly financial reports of the publicly traded major consumer lenders. Almost every one reports larger revenues and profits in their credit card business since the new law was passed. American Express, for example, reported operating income of $956 million for the third quarter of 2006 alone, an increase of 10% from the previous year.6 Also for the third quarter of 2006,

Wells Fargo reported an 11% rise in total net income, $2.19 billion.7
On its one¬year anniversary, supporters of the new bankruptcy law lauded the dramatic decline in bankruptcy filings as proof that the bill had worked. It is true that bankruptcy filings are currently about half the level they were before the new law took effect. Some critics of the new law predicted that the dip would be short¬lived, and bankruptcy filings would soon return to their previous levels. There is some reason to believe that may occur. Bankruptcy filings are trending upward. Frankly, however, it is too soon to tell whether BAPCPA led to a permanent readjustment of the U.S. bankruptcy filing rate.

In any event, fixating on the number of people who file bankruptcy is a fool's errand. Blaming the bankruptcy system for bankruptcy filings is like blaming hospitals for serious illnesses. That conflates cause (financial distress) and treatment (bankruptcy court). In enacting BAPCPA, Congress did nothing but close the hospital for financial distress, doing nothing to help middle¬class Americans struggling to make ends meet.

Of course, bankruptcy filing rates have gone down. The onerous new requirements on attorneys who represent consumers and the new law's complexity have caused attorneys' fees to rise 50¬100%. In an ongoing research project of mine, a preliminary review of court files under the new law revealed routine requests for chapter 7 attorneys' fees of $1,000 to $1,500, and routine requests for chapter 13 fees from $2,000 to $3,000, precisely the amounts that attorney's fees were predicted to rise. BAPCPA also increased court filing fees, and imposed new credit counseling and paperwork requirements, each of which made bankruptcy a more time¬consuming (and hence expensive) endeavor. Just as Americans drive less when the cost of gasoline rises, they will use bankruptcy less when its costs increase. And, just like increases in the cost of gasoline, a costlier bankruptcy system falls hardest on working, middle-class Americans.

There is reason to believe that consumer financial distress is on the rise. In the third quarter of 2006, credit card delinquency rates are 12% higher than they were just before the law went into effect.8 Home mortgage debt is almost 75% higher today than it was five years ago,9 and over 300,000 properties entered some stage of foreclosure in the third quarter of 2006, an increase of 43% compared to the same time one year ago.10 The Boston Globe and New York Times have run multi-part stories about increasingly harsh tactics by consumer debt collectors.11 With consumers owing more and with a less accessible bankruptcy system, it is not surprising that debt collectors have turned the screws.

From bankruptcy courts and practitioners, we are hearing stories about the law's harsh application. A disabled debtor who had not worked in years and not had enough income to file an income tax return since the early 1970s was faced with a trustee's demand he produce those thirty-year old tax returns because the new law requires the debtor to produce the most recently filed return. Two judges have interpreted the law to require dismissal of a bankruptcy case when the debtor receives credit counseling the same day as the bankruptcy filing.12

In contrast to the debtors who received credit counseling on the day of filing bankruptcy, a Texas bankruptcy judge had a case with married debtors who had received credit counseling within 190 days, rather than 180 days, of filing bankruptcy, as the new law requires. They had tried to use the time to negotiate with their creditor. As the judge wrote, "[T]he Court is obliged to dismiss regardless of the fact that Debtors 'almost' met the requirements of the statute, regardless of the fact that Debtors seem to have satisfied Congressional objectives that were enacted as part of the statute, regardless of the fact that no one contends that Debtors were not in good faith, regardless of the fact that no one contends that they did not make a zealous effort to accomplish the Congressional objective, and regardless of the fact that no useful purpose will apparently be served by dismissal."13

Another bankruptcy judge had a case with married debtors who were trying to work with a mortgage lender to repay a debt and avoid foreclosure. The lender would not confirm the precise amount of the debt and at the last minute refused to accept payment. When the creditor initiated foreclosure proceedings, the debtor made an emergency bankruptcy filing. The court had to dismiss the case for failure to obtain credit counseling. The judge's frustration with the new bankruptcy law boiled over in his concluding paragraphs, "Apparently, it is not the individual consumers of this country that make the donations to the members of Congress that allow them to be elected and re¬elected and re¬elected and re¬elected. The Court's hands are tied. The statute is clear and unambiguous. The Debtors violated the provision of the statute outlined above and are ineligible to be Debtors in this case. It must, therefore, be dismissed . . . . Congress must surely be pleased."14

I am not naively going to suggest that BAPCPA be repealed in its entirety. Although repeal would be of enormous benefit to the middle class Americans that make
this country work, such an option appears politically infeasible. Rather than walk away from a system where no change seems possible, Congress could start with one small change that would help the working class Americans who find themselves in financial trouble. That change should be to increase the discretion of the bankruptcy judges to excuse credit counseling when it would serve no useful purpose. The credit counseling lasts only one hour on average and, in six of every seven cases, is delivered over the telephone or over the Internet.15 Given the small amount of actual counseling that occurs, a strong case can be made the credit counseling requirement should be repealed altogether. It would be a small change that would restore the bankruptcy system back on the path to rationality. It would be a small change that would prevent bankruptcy judges from having to apologize to debtors for having to enforce a law that makes no sense. It would be a small change but a meaningful one for middle¬class Americans.

Again, thank you for allowing me to address you today.

1
Edith H. Jones & Todd Zywicki, It's Time for Means¬Testing, 1999 B.Y.U. L. Rev. 177, 180.

2
Testimony of Professor Todd J. Zywicki at the Hearing on Bankruptcy Reform of the Subcommittee on Administrative Oversight and the Courts of the Senate Judiciary Committee (Feb. 10, 2005) (available at http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3997).

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Federal Reserve Statistical Release G.19, "Consumer Credit" (Nov. 7, 2006).

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Citigroup, Inc., Quarterly Report (Form 10¬Q) (Nov. 3, 2006).

5
David Lazarus, Bank's Cloudy Wording, S.F. Chron., Nov. 3, 2006, at D1.

6
Amex Reports Profit, N.Y. Times, Oct. 24, 2006, at C5 ("American Express said yesterday that its third¬quarter profit exceeded Wall Street projections, reflecting robust returns from its credit¬card business.").

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Wells Fargo Profit Up, N.Y. Times, Oct. 18, 2006, at C3.
8
Federal Reserve, "Charge¬Off and Delinquency Rates on Loans and Leases at Commercial Banks," available at http://www.federalreserve.gov/releases/chargeoff/delallsa.htm.

9
Federal Reserve Statistical Release Z.1, "Flow of Fund Accounts of the United States," tbl. L.10 (Sept. 19, 2006).

10
RealtyTrac, "National Foreclosures Increase 17 Percent in Third Quarter" (Nov. 1, 2006) (available at http://www.realtytrac.com/ContentManagement/PressRelease.aspx?ItemID=1362).

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Sewell Chan, An Outcry Rises as Debt Collectors Play Rough, N.Y. Times, July 5, 2006, at A1; Michael Rezendes, et al., No Mercy for Consumers: Firms' Tactics Are One Mark of a System That Penalizes Those Who Owe, Boston Globe, July 30, 2006, at A1.

12
In re Cole, 347 B.R. 70 (Bankr. E.D. Tenn. 2006); In re Mills, 341 B.R. 106 (Bankr. D.D.C. 2006).

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In re Jones, No. 06¬33790 (Bankr. S.D. Tex. Oct. 20, 2006) (available at 2006 WL 3020477).

14
In re Sosa, 336 B.R. 113, 115 (Bankr. W.D. Tex. 2005).

15
National Foundation for Credit Counseling, "Consumer Counseling and Education Under BAPCPA," at 8¬9 (Oct. 16, 2006).