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ABUSIVE CREDIT CARD PRACTICES AND BANKRUPTCY

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

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TUESDAY, MARCH 24, 2009

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE
OVERSIGHT AND THE COURTS,
Committee on the Judiciary,

WASHINGTON, D.C.

The Subcommittee met, pursuant to notice, at 10:03 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Sheldon Whitehouse, Chairman of the Subcommittee, presiding.

Present: Senators Whitehouse and Sessions.

Also Present: Senators Durbin and Sanders.

OPENING STATEMENT OF HON. SHELDON WHITEHOUSE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Chairman WHITEHOUSE. The hearing will come to order.

I want to welcome the witnesses who have come. Some have traveled some considerable distance, including all the way from North Scituate, Rhode Island, and I am honored to be joined by the Ranking Member of this Subcommittee, Senator Sessions.

What we are going to do is I will make an opening statement, and the Ranking Member will make an opening statement, and if other Senators appear who wish to make an opening statement, they will be invited to do so, and then we will proceed through the testimony of the witnesses. I think that probably the best way to do it is start with Mr. Corey and just go right across, if Your Honor does not mind not going first.

With the economy deep in recession in this country, unemployment rates climbing, and those teaser rates people got on home mortgages expiring and triggering higher mortgage payments for American families, American consumers are relying more than ever on credit cards to just make ends meet from month to month. At the same time, banks who lost their shirts in the mortgage speculation and in other areas of business are attempting to squeeze more and more profit out of those credit card customers.

The standard credit card agreement gives the lender the power to bleed their customers through evolving and ever more crafty tricks and traps. The typical credit card agreement, which 20 years ago was a page in length, is now a formidable 20-page, small-print contract filled with legalese. In substance, it is usually pretty simple. It gives the companies the right to raise interest rates and charge fees and penalties for almost any reason, and in some cases to raise interest rates for no reason at all.

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While interest rates for other types of lending are at historic lows, credit card lenders continue to charge double-digit rates, with average rates around 14 percent, exclusive of fees. At a time when the prime rate is 3.25 percent and the average 30-year fixed mortgage rate is under 5 percent, it is hard to understand why credit card borrowing remains so costly.

Although 14 percent may seem high in comparison with other types of lending, that interest rate may seem like a bargain to a family that has fallen behind on a payment. When families come up short on their credit card payment, they can find a 10-percent or 12-percent annual interest rate morph into a 25-percent or 30- or 40-percent penalty rate. Add to that late payment and other penalty fees, and falling behind on a credit card can mean financial ruin.

When a family struggles to pay its bills, when a parent gets laid off, or unexpected medical expenses arise, that family can enter what Professor Ronald Mann of Columbia Law School has called the "sweat box." The sweat box of credit card debt, like any good trap, has an entrance that is easy to wander into: simply, a high credit limit and pretty soon a high credit balance. If you then get into the position where you cannot pay that credit balance off at once, they have you: a payment delayed, a minimum not met, and now your interest rate doubles, and fees and penalties pile on. You cannot escape because you cannot pay your way out, and they sweat you with those high rates and fees and penalties.

Under this business model, the lender focuses on squeezing out as much revenue as possible in penalty rates and fees, pushing the customer closer and closer to the edge. When that end finally does come, the lender can recover a portion of the outstanding principal under the bankruptcy plan.

I have introduced legislation that would give consumers leverage to negotiate for reasonable rates with their lenders and ban abusive lenders from using the bankruptcy court system to enforce their excessive interest claims. Under the Consumer Credit Fairness Act, claims in bankruptcy stemming from consumer credit agreements carrying interest above a variable threshold—which would currently be 18.5 percent—would be disallowed. With the leverage of a bankruptcy threat, a customer struggling under a 30-percent penalty rate could negotiate for more reasonable terms. In addition, bankruptcy filers with debts carrying effective interest rates above the threshold would be exempt from the so-called means test, a tactic that was enacted in the bank-written 2005 reforms to make it more difficult to enter bankruptcy, and by delaying the date of bankruptcy, add a few months to that sweat box.

In addition to discussing the nexus of abusive credit card terms and bankruptcy in general, I hope that we will take some time today to explore the Consumer Credit Fairness Act. Following Senator Sessions' opening statement, we will hear from our distinguished panel of witnesses, but I see the distinguished Majority Whip here, so after Senator Sessions has made his opening statement, Senator Durbin of Illinois will be invited to make an opening statement.

The witnesses are: Douglas Corey, a constituent of mine from North Scituate, Rhode Island, who will share his experiences with his credit card lender. Mr. Corey has worked in sales and marketing and is a graduate of Rhode Island College.

Judge Rosemary Gambardella has served on the Bankruptcy Court for the District of New Jersey since 1985. A native of Newark, she attended Rutgers University and Rutgers Law School. Judge Gambardella is a member of the National Association of Women Judges, the National Conference of Bankruptcy Judges, the American Bankruptcy Institute, and a former member of the Bankruptcy Judges Advisory Group for the Administrative Office of the United States Courts.

Professor Adam Levitin of the Georgetown University Law Center is a nationally regarded expert in bankruptcy and consumer law. He has served as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel, as an expert witness for the FTC and FDIC on credit card litigation, and as a law clerk for the Honorable Jane Roth of the United States Court of Appeals for the Third Circuit. A graduate of Harvard, Columbia, and Harvard Law School, we are grateful that Professor Levitin will be with us.

Professor Mark Scarberry of Pepperdine University School of Law is an expert in bankruptcy and contract law. A graduate of Occidental College and the UCLA School of Law, he is a member of the American Bankruptcy Institute Law Review Advisory Board and Pro Bono Task Force.

And, last, David John is a Senior Research Fellow at the Heritage Foundation and specializes in pensions, financial institutions, asset building, and Social Security reform. Prior to joining the Heritage Foundation, he served on the staff of Representative Mark Sanford of South Carolina. Mr. John has a bachelor's and three master's degrees from the University of Georgia.

We welcome the witnesses, and I now turn to my Ranking Member, Senator Sessions, for his opening statement.

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator SESSIONS. Thank you, Mr. Chairman. I look forward to the hearing. This is a good panel. I think we will have a good discussion.

I would just recall a few years ago when we passed the bankruptcy bill, the final passage was over 80 votes, and one of the critical issues was the question of means testing in the legislation. We discussed it at great length. A number of Senators raised questions about it, and Senators like Senator Clinton in the end decided that this was good reform, and I certainly believe it is. It simply says that if you make above median income, you do not automatically get the right to wipe out all your debts in bankruptcy, but that the bankruptcy court can then structure a plan for repayment of that part of the debts that you owe that you are able to pay. And if the debtor is not able to pay all of them but can pay 60 percent of them, the judge will set up a proposal to do that. And once, of course, in bankruptcy, one of the great advantages for our debtors is they cannot receive demanding letters or phone calls; they cannot be sued; they cannot be harassed in any way toward paying of those debts.

We also knew at the time that bill passed the overwhelming majority of people, perhaps as high as 80 percent, that filed bankruptcy were below median income. So they would get to file under Chapter 7 if they chose. And many of those above median income, if their debts were high enough, I think they could not have to go under Chapter 13—they could go into Chapter 7 also.

So I thought that was a good reform. I still believe it is a good reform. We discussed at that time the question of credit cards. I know Senator Durbin is very educated on this and very alert to these issues, and we did not always agree. He saw the bad in the credit card sometimes, and I saw the good. The truth is somewhere maybe in between. I do not think it is bad that a poor person who does not have the cash and their transmission falls out of their vehicle that they can pay that on a credit card. In fact, if credit cards were not available for poor people, we would be passing laws demanding that poor people be able to have credit cards and criticizing the big banks for not issuing credit cards. And I am not really offended that they send offers out in the mail offering competitive rates and you can choose between cards that you think best serve your interest. I am not really offended by that.

I do believe that they are a cold-blooded bunch, that they do desire to make maximum profits, and I do think that the Government has a right to examine this. I do not think that the people who issue credit cards are sainted, and that they are out just trying to serve their customers. They are trying to make a profit. And so I think they are entitled to be watched over.

For example, my mother, who recently passed away, had been ill for some time. I failed to get her credit card paid on time, a $25 bill, and it was a $40 penalty. So, you know, they say you can call. Well, she was not able to write her name at the time. You get on the phone and they do not answer, and you have to get 15 different recordings. Also, I do not like it—on her credit card I noticed pretty clearly—that the total debt is buried down there somewhere and the minimum payment is more easy to see. And you could actually miss it in the print.

So I think disclosure of these kinds of issues more clearly, so that a person can know what their real debt is, and what their payment should be, and maybe more, clearer warnings about the danger of these high interest rates is appropriate. But I have learned, though, that that is the Banking Committee's business. And there is a question about the interest rates. I do not know. I am not comfortable capping interest rates, but I do not think that they are free to go without being evaluated and Congress making a decision about that. But that is a Banking Committee issue, and Senator Dodd and Senator Shelby and others on that Committee are supposed to be dealing with that, although we certainly have a right, anybody has a right to offer legislation. So, what we are looking at here is the question of whether or not a lawfully charged rate of interest and debts, how they should be handled in bankruptcy.

I would just say this: In Alabama, we have an unusual situation in which, before the bankruptcy bill passed, half the people chose to file bankruptcy under Chapter 13. That is where you pay back a part of your debts. Now, some people seem to think that forcing people above median income into Chapter 13 is some sort of evil thing and that it is an oppressive thing, but a large number of people voluntarily chose that. In Birmingham, the Northern District of Alabama, 60 percent of the people were filing under Chapter 13. There are a lot of advantages, and lawyers would tell you why they did that, and they think the rest of the country is behind the times in not using Chapter 13 more.

So, under Chapter 13, if an interest rate on a credit card—a person files a debt and they have a high interest rate, the interest rate is dropped by the bankruptcy judge when the filing occurs. So it does not continue at this extraordinarily high rate. It drops down. And we can talk about more of the details about what is happening now in bankruptcy.

I guess I would just say to my colleagues thank you for discussing this. I look forward to the hearing. There are some things I would like to learn about it. But I would say that bankruptcy is one of the greatest things that can happen for poor people in America. It relieves them of debt they are unable to pay. It breaks high interest rate loans that they may be trapped in. It helps them get out from health care bills and other bills. But there are certain things that need to occur in a rational, logical way, consistent with our heritage of law and consistent with what good economic practice is.

Thank you, Mr. Chairman.

Chairman WHITEHOUSE. Thank you, Senator.

Just to make one point clear, the assignment of this bill to this Committee has been through the parliamentarian, so there is no question that——

Senator SESSIONS. It is. What we are talking about is acting in bankruptcy—how to use a bankruptcy mechanism to deal with interest rates we do not like. I am just saying the fundamental question, if we cap an interest rate, that is an issue before the Banking Committee.

Chairman WHITEHOUSE. Correct.

Senator Durbin.

STATEMENT OF RICHARD J. DURBIN, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DURBIN. Thank you, Mr. Chairman, and thanks for this hearing, and your bill as well.

Senator Sessions and I were here for the bankruptcy debate, and it went on for a long time, and I found myself sitting in the Senate Judiciary Committee being, as I looked around the table, the expert on bankruptcy by virtue of the fact that I had taken a bankruptcy course at Georgetown Law School 30 years before, and that I had served as a trustee in bankruptcy in Springfield, Illinois, of a failed gas station. I had had more experience with bankruptcy than any other member of the Judiciary Committee at the table. That is how it works, Judge, around this place.

So I offered an amendment on the floor, and Senator Sessions may remember it, and it said that on your credit card monthly statement, when they say here is your minimum monthly payment, I said the credit card companies have to disclose if you make the minimum payment, it will take X months to pay off the balance and you will pay X dollars in interest. I thought that was in the interest of full disclosure.

The credit card companies came back to me and said, “That is impossible to calculate. We have no way of computing or calculating that.”

That is baloney. They know how to calculate it, and the reason, the real reason came out later. It is like the late Paul Harvey: “The rest of the story.” There was a Nova program, which I recommend to everyone, that went into the credit card industry, and they had this man who was the wizard of credit cards, this guru who was, I guess, concerned about his personal safety, would not disclose the location that he was being broadcast from. And he was the one who discovered that if you could drop the minimum monthly payment to 2 percent, the person could never pay off the balance. It would go on forever. And he was considered one of the shining lights, the person that brought real profitability to the industry.

That I think tells the story. Poor people caught in this predicament do not understand the minimum monthly payment is a sentence, a life sentence, to this debt that they can never get out from under. Now we are talking about what to do about it and whether or not—and I think Mr. John will raise this question—whether or not we should even get involved. Let the market do its thing. Have we been watching the market do its thing lately and what it means to us as individuals, investors, future retirees, savers?

You know, it has not been all that encouraging letting the market do its thing. I think we learned in the AIG boardroom what the market would do if it could do its thing.

I would say to Senator Sessions, we have drawn some lines. We decided as a matter of national policy and national security that we had had it with the people who were gouging the members of the U.S. military. We put a limit, 36 percent interest, and said you cannot loan to members of the U.S. military and charge over 36 percent. And we closed a lot of fly-by-night operations around our military bases who were putting our men and women in uniform and their families on hard times. But we did not apply the same protection to the rest of America.

So I put a bill in for a 36-percent cap on the APR interest rate. I would say to my colleagues that if you want to start a reptile farm, you should put this bill in and watch what comes in under the door. Folks literally would sit in front of me and say, “Wait a minute. We are the good guys, and you are going to put us out of business.” I said, “Well, what do you charge? What are your interest rates?” And a man—I have had two of them now, one from the payday loan industry, one from the installment loan industry, and they would sit there with a straight face and say, “Oh, we charge between 36 percent and 158 percent.” I said, “If you can get those words out of your mouth, you and I do not have anything to talk about.”

That is what is going on in the real world. Disclosure is not enough anymore. You cannot tell folks enough information to protect them.

One of the things the bill introduced and I recommend to my colleagues is the Financial Service Product Commission, which we put together. We protect consumers. We say when you buy that toy, we will let you know if it had lead paint, we will protect you. But we do not protect them when it comes to credit cards, and we do not protect them when it comes to mortgage instruments. We need to have an agency that is looking out for consumers, saying this is a toxic instrument, you should not be allowed to sell this in America. At least give full disclosure to people involved in it. I do not think there is anything wrong with this.

Credit cards are important, I have a wallet full of them, too. But I think they have gone way too far. They have just abused it because we are not even watching, let alone regulating.

I have to go give a speech, but I am coming back. Thanks, Mr. Chairman.

Chairman WHITEHOUSE. Thank you very much, Senator Durbin.

We will now call on the first witness, Douglas Corey. Thank you, Mr. Corey.

STATEMENT OF DOUGLAS COREY, NORTH SCITUATE, RHODE ISLAND

Mr. COREY. Thank you. Chairman Whitehouse and Ranking Member Sessions, thank you for the opportunity to testify today about my experience with my credit card lender.

I am a victim of the predatory credit card banking practices that punish honest citizens who work hard every day to make an honest income, pay off their debt, and take care of their families.

I have had a Bank of America credit card for 6 years, and I can't remember missing a payment in that time span. During most of this period, I received an interest rate of 12.74 percent, and although it was tough making the payments, I did. I set up an automatic monthly payment of $100 to pay down the principal, and each month when I received my bill, I paid the minimum payment.

In August of 2008, I was on vacation and inadvertently paid less than my minimum payment. The following month, I misread my credit card statement. One line on the bill said "minimum payment"; another said "pay this." I paid the minimum payment, which was about $125 less than the amount on the line that said "pay this."

With my next statement in October 2008 came the devastating news that my interest rate had skyrocketed to an astonishing 28.99 percent. I went from paying $360 in interest to $792 in 1 month, and I was charged a $39 late payment fee. The following month, I was laid off from my sales representative position of 7 years.

Once I realized my rate had increased, I immediately called Bank of America and was repeatedly told that nothing could be done to my rate until I made the minimum payments for 6 consecutive months. In December, I called again and at this time they credited my account $759.23 in interest.

In January, I called again, but the outcome was much different. I was told no discount could be given again but was offered the chance to increase my credit limit for a service fee of over $150 a month. I asked the representative why I would do such a thing. She said to help pay for any expenses I may have.

Several weeks later, I called Bank of America, only this time they sent me to a rate adjuster who asked me several questions, one of which was my current work status. With a great deal of embarrassment, I explained that I was unemployed. He then suggested giving me back $10,000 I had paid in October of 2008, effectively raising my balance by that amount. I explained to him that this would mean I would be paying 28.99 percent on ten thousand more dollars, which would cause my payments to climb well over $1,000 a month and would put me further into debt.

His second option was to create a long-term loan. He explained that he couldn't tell me the rate and terms unless I agreed to the long-term program first. He also explained that my account would be temporarily closed, and once I paid the loan off, my account would be reinstated. I expressed my concern over the effect this would have on my credit rating and he suggested it would be fine over time.

I asked him why Bank of America was still offering me 3.99 percent on debt transfers but was imposing such lethal punishment on those of us who have been keeping them in business for years. He had no answer. I worried that the credit rating I had worked so hard for over the years could be lost.

As of March 13th, I had made six consecutive minimum payments. On March 18th, I enthusiastically called Bank of America and was told that my reward for making my payments was a $13,000 reduction in my line of credit. The rate adjuster explained that he would have to do so because I was unemployed. I told him I was on the brink of starting a new position in the upcoming weeks. He told me that he would call me at that time to see if I had actually started working and what my new compensation was.

He went on to say he could offer me a rate of 24.99 percent, but if he did, it would confuse the computer from "automatically adjusting my rate back from my default rate." He said if he didn't change my rate now, I potentially could get a lower rate in the coming weeks. I asked whether my rate would be 12.74 percent, and he reiterated that he could not tell me what the rate would be. I told him this was frustrating because I had been assured that if I paid for 6 consecutive months, my interest rate would go down.

With pride, I can tell you that for the last 19 years I have never missed a credit card payment or auto payment. In 1994, I became a proud homeowner and was living the American dream. Since becoming a homeowner, I have made every mortgage payment up until this year. That all changed 7 weeks ago. I have to admit that for the first time ever I missed my mortgage payment. But, fortunately, last Tuesday I was able to make up the missed payment and soon will be caught up.

As a responsible single father, I quickly restructured my home budget and spending, and I proactively began contacting my debtors to inform them of my situation and to negotiate an amicable resolution.

Senators, I find myself in the same circumstances that many parents are facing today: few job prospects, a stack of bills, and the challenge of facing off against financial Goliaths. There are many of us in the middle class—the unemployed—who may have overstepped our budgets, but although we struggle to make our payments, we make them.

Bank of America has come before you asking for help, understanding, and, with both hands open, for financial support. Yet when we the consumers go to these institutions looking for the same help, understanding, and financial support, we get roughed up and receive no compassion. Rather than negotiating, banks are preying on those of us who have been weakened by circumstances beyond our control. Banks realize that they are holding all the cards and that the consumer is powerless to negotiate with them.

As a salesperson, I understand the importance of making a profit, and banks are entitled to make a profit. But what is enough? Over the 6 months, I have paid a staggering $1,600 more in interest versus what I would have paid at 12.74 percent. Their policies and actions are having a devastating effect on consumers that are hardest hit by our country's economic hardships.

Last week, I was asked to come here and tell my story. I am not here asking for anything for myself. I am simply asking to stop the greed that is fueling banks' predatory behavior. Consumers are looking to you for leadership and to wage war against this greed that has taken over corporate America. My hope is that you will consider some form of legislation that levels the playing field and empowers consumers to negotiate with these institutions' strongarming tactics.

Thank you for your time.

[The prepared statement of Mr. Corey appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you very much, Mr. Corey, and thank you for coming to Washington to be a part of this hearing. I appreciate it very much.

Our next witness is the Honorable Rosemary Gambardella of the New Jersey Bankruptcy Court.

STATEMENT OF HONORABLE ROSEMARY GAMBARDELLA, JUDGE, U.S. BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY, NEWARK, NEW JERSEY

Judge GAMBARDELLA. Chairman Whitehouse, Ranking Member Sessions, Senator Durbin, other Senators on this Subcommittee, thank you for this opportunity to testify today on the important subject of abusive credit card practices and their relationship to bankruptcy.

I speak today not on behalf of any group of judges or organization, but solely on my own behalf. I have spent the last 23 years serving on the United States Bankruptcy Court in the District of New Jersey. During that time I have seen firsthand the impact of spiraling debt burdens on ordinary citizens—citizens like Mr. Douglas Corey, who has eloquently testified this morning.

Contrary to popular sentiment, persons filing bankruptcy petitions in this country do not do so to escape debt repayment but, rather, as a last resort, driven for the most part by circumstances beyond their control: illness, divorce, job loss, income reduction. Many are on the brink of home foreclosure. On the way, these individuals have accumulated significant unsecured credit, the majority of which often is credit card debt.

The current system of bankruptcy laws that concern individual consumer bankruptcy filers can be assessed in terms of three central concepts: liquidation, as embodied through Chapter 7; rehabilitation or reorganization as symbolized by Chapter 13 and, to a lesser extent for individuals, Chapter 11; and the ultimate discharge or forgiveness of debt. These concepts trace their roots directly to the Bible.

For instance, the Bible makes it clear that people are generally expected to pay their debts. One can look at Leviticus 25:39. However, this moral and legal obligation to pay just debts must be balanced by such considerations as the need for compassion for the poor, preservation of the family unit, and a call to cancel debts at periodic intervals. Again, one can look to Deuteronomy.

The quest to arrive at the perfect balance between compelling persons to repay their debts and society's obligation to forgive debt and to provide debtors with a fresh start has existed since ancient times. In fact, it is this healthy tension that fostered the development of the bankruptcy laws in this country from the early days of bankruptcy referees to the present. It was the pendulum responsible for the 2005 bankruptcy amendments that have been spoken about, as well as the proposed Consumer Credit Fairness Act, which we are discussing this morning.

High-cost consumer credit generally comes in the form of credit cards, payday loans, student loans, refund anticipation loans, and subprime mortgages. Today, I will focus primarily on high-interest credit cards.

At least one study has found that nearly 60 percent of credit card holders do not pay their bills in full every month. It was reported that the average interest rate for standard bank credit cards topped 19 percent in March of 2007. And the Federal Reserve has reported at relevant times that some 46.2 percent of all families held credit card balances with an average credit balance approaching $7,300.

In September of 2006, the Government Accountability Office estimated that in 2005 the number of U.S. credit cards issued to consumers exceeded 691 million. That report stated that "[T]he increased use of credit cards has contributed to an expansion in household debt, which grew from $59 billion in 1980 to roughly $830 billion by the end of 2005." And it is certainly well over $1 trillion today.

That report estimated that "the majority—about 70 percent in recent years—of issuer revenues came from interest charges," and estimated penalty fees to account for an additional 10 percent of total issuer revenues. That report concluded that disclosures used to provide information about the costs and terms of using credit cards generally had serious weaknesses which reduced their usefulness.

Professor Elizabeth Warren of Harvard Law School has conducted extensive research on the causes of bankruptcy. In a 2006 article authored together with Teresa Sullivan and Professor Jay Lawrence Westbrook, the authors argued that "the central characteristic of consumer bankruptcy over two decades has been increasing financial distress marked by rising levels of debt," and that "from the early 1980's to the present, Americans' debt burden compared with their disposable income has risen considerably," while "at the same time, increased layoffs, high divorce rates, lack of medical insurance, income volatility, and rising housing costs have left families even more vulnerable to bankruptcy." Focusing on credit cards which they describe as the dominant form of lending in recent years, the authors indicate that "interest rates are often ruinous for a family with substantial credit card debt, particularly if the family had missed a beat in making on-time payments," as "the combination of late fees, over-limit fees, default rates of interest and other charges means that credit cards for families in trouble may easily be running at 24 percent interest or more."

The authors speculate that changes in the credit industry in making money available to troubled borrowers may have changed the calculus that leads to bankruptcy, as increased lending offers a way for families, in fact, to delay bankruptcy, but the interest payments increased so fast that even a small stumble meant that borrowers would have to declare bankruptcy or literally never get out of debt.

In a 2006 article by Professors Susan Block-Lieb and Edward Janger, they claimed that "the demise of usury laws and the development of national credit reporting and credit score systems and mass marketing techniques permitted lenders to create a national market for credit cards available to even the least creditworthy members of society, but at a price.

Concerning the 2005 reforms, the authors argued that legislation severely limited overleveraged consumer borrowers from obtaining relief in the bankruptcy system and, in effect, rewards consumer lenders for taking advantage of consumer limitations.

Professor Katherine Porter has also argued that the credit industry seeks to profit from financially distressed and vulnerable consumers by encouraging families to continue to borrow even after bankruptcy. And Professor Porter, speaking regarding the BAPCPA amendments states that "the credit card industry's lending decisions were not subjected to the same scrutiny as the scrutiny of debtors' borrowing decisions," and that lenders were not "held to the same moral standard as debtors for evaluating the appropriateness of their financial practices."

As was mentioned in the opening statements, in 2005 the Bankruptcy Code underwent extensive changes with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. That reform act was meant to address a perceived imbalance in the Bankruptcy Code, strengthening creditor provisions, encouraging repayment under Chapter 13 rather than liquidation under Chapter 7 by imposing a means test on debtors to test their ability to repay debt.

The proponents of BAPCPA, among them the banking and credit card industries, car and mortgage loan lenders, advocated that by setting the bar higher for people who could file bankruptcy, the legislation would discourage bankruptcy petitions submitted in an attempt to abuse "the system by deliberately running up credit card debt and running away from repayment obligations through the bankruptcy process." Conversely, consumer advocates strenuously opposed BAPCPA by noting that the vast majority of people filing for relief under the Bankruptcy Code were not abusers, but families in serious financial trouble due to the various factors outlined in this testimony, and that amending the Bankruptcy Code to make it more difficult to resort to bankruptcy, they contended, would create more stress and suffering for middle class families by delaying debt relief."

The implementation of BAPCPA in October of 2005 followed a spike in bankruptcy filings approaching 2 million. After that—and it is in my written testimony—the numbers of bankruptcy filings fell. However, according to the latest statistics issued by the Administrative Office of the United States Courts, during 2008 filings by debtors with predominantly non-business debt, which accounted for some 96 percent of overall filings, was on the rise again to over 1 million filings.

The proposed Consumer Credit Fairness Act would disallow in bankruptcy for purposes of distribution claims arising from a "high-cost consumer credit transaction," which is defined under the act itself. Currently under the standard imposed by the proposed bill, the CCFA would apply to any interest rate higher than 18.5 percent. Additionally, the proposed bill would exclude debtors from any debts arising from high-cost consumer credit transactions from the so-called means test.

The articulated purpose of the 2005 amendments to the Bankruptcy Code was to inject balance into the adjudication of debtor-creditor rights. In fact, the myriad requirements placed on consumer debtors, including the use of means testing, may have created substantial burdens on consumer debtors without the desired result—increased repayment of debt. It is clear from experience that debtors' use of credit cards as a family lifeline to cover basic living expenses such as food, sustenance, utilities, health care, and tuition is a trend that is seen throughout the cases before our courts. The proverbial "robbing Peter to pay Paul" has resulted in spiraling debt that high interest consumer loans only exacerbate. The disallowance in bankruptcy of a specific category of high-cost loans contemplated by the bill may act as a disincentive to such practices. As well, the specter of disallowance of such claims in bankruptcy may encourage out-of-court settlements. The disallowance of the claims, as opposed to subordination of the claims, may also result in a greater recovery to other unsecured creditors with valid and bona fide claims. In my experience on the bankruptcy court, it must be emphasized that bankruptcy relief is largely utilized by individuals as a last resort for legitimate, non-abusive purposes. And the fresh start afforded by bankruptcy to individuals suffering under enormous debt loads, particularly in the current economic climate, is a laudable goal. So the disallowance of certain high-cost credit claims will, in certain instances, substantially decrease the debt burden on debtors, increasing the prospects for successful reorganization and/or repayments through orderly liquidation to bona fide creditors.

While many debtors and their families' income fall below the applicable respective State median income level and escape the means test, the elimination of means testing for this category of consumer debtors would make the pathway to Chapter 7 relief more available. Again, to the extent that repayment is the goal, such a remedy may be an additional disincentive for predatory lending practices.

It is worth noting that while the remedies in this proposed legislation are limited to bankruptcy filings, this does involve a much broader issue of predatory lending practices that reach far beyond the bankruptcy arena.

In closing, I want to thank this Committee for according me the honor and privilege of testifying today on these important issues, and I stand ready to provide any additional information, Senators, that you may require.

Thank you.

[The prepared statement of Judge Gambardella appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you very much, Your Honor.

The Ranking Member, Senator Sessions, and I have been lawyers long enough that far be it from either of us to interrupt a judge.

Judge GAMBARDELLA. I went over my time limit. I apologize.

Chairman WHITEHOUSE. But I would appreciate it, because Senator Sessions has a commitment at 11 o'clock, if the subsequent witnesses could be more attentive to the time restrictions so that all the testimony can come in while the Ranking Member is present. I thank you.

Senator SESSIONS. You had your chance to stop a judge after having been stopped many times before.

[Laughter.]

Senator SESSIONS. No, that was very valuable. Thank you.

Chairman WHITEHOUSE. Professor Levitin.

STATEMENT OF ADAM J. LEVITIN, ASSOCIATE PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER, WASHINGTON, D.C.

Mr. LEVITIN. Mr. Chairman, Ranking Member Sessions, good morning. My name is Adam Levitin, and I am an associate professor of law at the Georgetown University Law Center, where I teach courses in bankruptcy and commercial law. I am here this morning to testify in favor of S. 257, the Consumer Credit Fairness Act.

I think it is important to start by noting exactly what Senator Sessions said. Credit can be a double-edged sword. It can be both a boon and a curse.

Credit is a wonderful thing that can fuel the economy, but when credit is issued beyond a borrower's ability to repay, it becomes a stone around—it becomes an anchor around their neck, dragging them down.

As Congress tries to figure out how to address the problems caused by excessive consumer leverage, there are a few possible responses. Senator Sessions suggested that disclosure might be a way to go, and I think there is a general sense that disclosure has not worked well for credit cards in particular.

The problem is that there is also no evidence that disclosure can work with credit cards. We have not seen it work yet, and there is no empirical evidence that it will work. There are a lot of reasons to think that, absent really drastic restructuring of credit card price structures, disclosure can work.

First of all, there is simply too much information. Senator Whitehouse described a 20-page, fine-print legalese disclosure. There is no one who reads that, and if you read it, you cannot understand it. And even if you understand it, your understanding might not be the same as that of the card issuer, and it is going to be their interpretation, not yours, that is going to functionally control. So we have lots of disclosure, but we really have obfuscation by disclosure. Stuff gets hidden in the fine print. It is all disclosed, but that does not do the trick. That does not make markets work.

We also have a problem that even if we improve disclosure—and there are definitely moves in that direction. The Federal Reserve has some regulations that are going to go into effect in about 18 months that will improve disclosure, as well as a bill that is pending in, I believe, the Senate Banking Committee, the Card Holder's Bill of Rights. Even if we manage to improve disclosure, card issuers still have every incentive to restructure their pricing to get around disclosure.

So if we say that price points A, B, and C have to be prominently and clearly disclosed, card issuers are just going to restructure their pricing to create new fees, types D, E, and F. So there is a lot of reason to think that disclosure regulation just is not going to do the trick. This makes me think that we need to really look at substantive regulation. Historically, that is how we have regulated credit. Really until the Supreme Court's Marquette decision in 1978, substantive regulation, usury laws, were the primary form of consumer credit regulation. S. 257 is a step toward substantive regulation. It is not, however, a usury bill, and I think that is very important to be clear on, that S. 257 does not say that a lender cannot make a loan at any particular rate. Rather, what S. 257, the Consumer Credit Fairness Act, is is a bankruptcy integrity bill. It is legislation designed to ensure the integrity of the bankruptcy system.

Bankruptcy courts are courts of equity, and a basic principle of equity is that relief will not be granted to a party with unclean hands. Creditors who charge extremely high interest rates do not have clean hands when it comes to consumer financial distress.

High-interest-rate debt is financial quicksand for consumers. With high-interest-rate debt, the interest and the fees accrue faster than a consumer can reasonably be expected to pay off the loan. Not surprisingly, there is a strong correlation between high-interest-rate debt and bankruptcy. Dollar for dollar, credit card debt is the best indicator of a future consumer bankruptcy filing. And even small amounts of high-interest-rate debt can have a significant impact on bankruptcy filings. For example, a single payday loan of $300 increases the chances of a bankruptcy filing by nearly 3 percent.

The interest rates charged to consumer borrowers are a product of the lender's cost of funds, the lender's cost of operations, as well as a risk premium, but also they are a function of whatever extra opportunity pricing that the lender thinks the borrower will pay. The precise mix varies by product, by lender, and by borrower, but it is important to underscore that high interest rates do not necessarily correlate with borrower risk. They often have a lot to do with inefficient markets, things like nontransparent pricing of credit cards which results in consumers borrowing at much higher rates than they realized they will be paying.

It is also important to note that while high interest rates, to the extent that they are a response to increased consumer risk, they also create risk. That is because many consumers are unable to service high-interest-rate debt. Lenders who charge high interest rates are largely shielded from their own self-created default risk by the high rates. But we see this with the so-called sweat box model of consumer lending. And I understand my time is up, so I will simply conclude by saying I urge Congress to give serious consideration to S. 257 as well as also to a true usury law.

Thank you.

[The prepared statement of Mr. Levitin appears as a submission for the record.]

Chairman WHITEHOUSE. I thank you, Professor Levitin, and perhaps if you become a judge someday, you will not be interrupted. But we do have your complete statement, which is very thorough and authoritative, and your complete written statement is a matter of record.

If I could take 1 minute and ask unanimous consent that the statement for this hearing of Chairman Patrick Leahy, the Chairman of the Judiciary Committee, be added to the record, it will be done, without objection.

Professor Scarberry.

STATEMENT OF MARK S. SCARBERRY, PROFESSOR OF LAW, PEPPERDINE UNIVERSITY SCHOOL OF LAW, MALIBU, CALIFORNIA

Mr. SCARBERRY. Thank you, Mr. Chairman, and thank you, Ranking Member Sessions, for inviting me to testify today. You have my full statement. I will not read it. I will try to hit the high points.

I try to look at these issues on their merits, and I am speaking here, of course, just for myself, not for Pepperdine University School of Law, where I teach. My latest article strongly argues that credit card companies and other unsecured and undersecured creditors should not be able to add to their claim in bankruptcy any amount for attorney's fees or other charges that are incurred after the bankruptcy petition is filed. I think the Bankruptcy Code calls for that result, and I think that it is fair. That is, in a sense, an anti-creditor position, you might say.

In this case, I come down on the other side. I think this bill will not accomplish what it seems to intend to accomplish, and that the issues here really, to the extent they need to be addressed, should be addressed more directly.

The bill, because of a single, high-cost consumer debt that may be owed by a debtor who files a bankruptcy petition, would exempt that debtor from what I call the mechanical means test, the Section 707(b)(2) test that looks at income levels and looks at expense levels and decides whether it is appropriate for this debtor to use Chapter 7 liquidation bankruptcy.

Now, we can argue about whether the means test ought to be modified in some way. I do not think it has been terribly successful, and it is very complex, and it raises the cost of bankruptcy in some ways. It could perhaps be modified in some ways.

But if it makes sense to have a means test, it seems to me it does not make sense in a lottery sort of style to exempt people from it just on the basis of a single, perhaps small debt that has a high interest rate. So that, it seems to me, is a problem with the bill.

An additional problem is that I do not think the bill will change credit card company behavior at all. In most consumer bankruptcies, there is no money to be paid to unsecured claim holders like credit card companies. They receive nothing. And so to say to them that—there are no-asset cases or nominal-asset cases. If you say to them, "Your claim will be disallowed so you will receive nothing in bankruptcy," they will say, "Well, we were not going to get anything anyway, thank you very much." And so I think the chance that this will actually influence the behavior of credit card companies is very small.

If there is a serious problem here, address it directly if it needs to be addressed. But the Bankruptcy Code, it seems to me, is not going to be effective in addressing whatever problem needs to be addressed, and the bill will simply make the Bankruptcy Code more complex.

Now, another issue that is actually not in my written testimony is the question of who is going to do the objecting here. Are we going to say to the trustees in every Chapter 7 bankruptcy case, "You must analyze all the credit card debt of every debtor and figure out what their interest rates are for purposes of objecting to the claim" when the credit card company is not likely to receive anything, anyway? It seems to me that that is a question that ought to be asked. Who is going to object? The debtor typically has no incentive to object. The debtor is going to get a discharge from the debt. And the money that goes to pay it, if any does goes to pay it, is going to come from the bankruptcy estate, not from the debtor. Some people say the debtor does not even have standing to object in some cases.

I would also encourage the Committee to consider whether the 18.5-percent rate that you are looking at now is perhaps lower than it should be, especially for someone who gets a rewards card, perhaps with no annual fee, and who typically pays the credit card off without carrying a balance. It makes sense to allow, perhaps, cards with higher rates. But, again, I do not think the bill would keep these from being offered, so maybe that is not such a big deal.

Now, I do have a couple of technical points that I want to make. One is that the applicable interest rate under the Consumer Credit Fairness Act would include fees charged in connection with extension of credit. That could easily be interpreted not to include things like late fees, which are not incurred in connection with extension of the credit. And so, again, it seems to me the bill may not accomplish what it is intended to do.

In addition, the bill says that there will be disallowance for purposes of distribution. If that is intended to be a limitation so that the claim is not completely disallowed, it may allow some liens for credit card debts to continue through, which I think is contrary to the bill's drafter's intent.

Thank you very much.

[The prepared statement of Mr. Scarberry appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you very much, Professor Scarberry.

We will now turn to Mr. John.

STATEMENT OF DAVID C. JOHN, SENIOR RESEARCH FELLOW, THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES, THE HERITAGE FOUNDATION, WASHINGTON, D.C.

Mr. JOHN. Thank you very much for having me to testify. Contrary to expectations, I am not here to defend high-interest lenders in the slightest. As a matter of fact I had an experience somewhat similar to Mr. Corey at a point when I was traveling and my credit card payment arrived one day late, and I saw my credit card interest rate more than double. They have since brought it down, and I have learned to pay electronically and not to trust the Postal service. But, still, I have no fond feelings toward them.

Having said that, I think this bill is going to damage some of the very people that I would hope you would be most interested in helping, because the three groups who most face high-interest-rate loans—and this is not just credit card debt; it is of other types—include low- to middle-income borrowers, and these are borrowers who typically have high rates because even a small amount of credit exceeds the debt-to-income ratios that, say, upper-income borrowers would have; first-time borrowers who have no credit history and, therefore, have no record of payment or repayment; or people with bad credit who are trying to restore their credit balances and their credit histories. This might be people who had filed for bankruptcy or people who had suffered from extended periods of unemployment.

All of these people have much higher than average interest rates simply because it is often harder to collect money from them. I had the misfortune to work for 3 months between undergrad and grad school for a finance company, and I found that while many of the people who were our borrowers were fine, upstanding people who simply were not interested—the banks were not interested in, many others I had to go out and collect a check once a month, which took a little bit of time and money to do.

The effects of this bill are likely to be very damaging. The demand for credit services will not decline. One of the things we have learned the hard way through various and sundry attempts to put on price ceilings and interest rate ceilings and usury laws is that the demand is still there; it is just that the good borrowers tend to withdraw from the market.

So, to the extent that you have added additional risk to various transactions, what is going to happen is that good borrowers will either cease to serve these communities, or what is more likely in this situation, they are going to raise their credit standards so fewer and fewer people in this population are going to qualify for these credit products.

This is going to drive people into much less reputable borrowers—or lenders, excuse me, and what these people will do is to recognize once again that there is a higher risk, so they are going to raise their prices still more so that they can make sure to collect all their fees before there is any sort of a chance of bankruptcy filing or something like this.

So the bottom line is price controls do not work. If you want to deal with these lending problems, the proper way to deal with them is to encourage other lenders to enter the market, things like credit unions and banks and that sort of thing.

Now, one of the problems that we have seen with credit card debt over the years are precisely the problems that have been raised by people in this hearing. And as a result, the Federal Reserve Board and various other banking regulators issued regulations in December that, among other things, achieved Senator Durbin's goal of including something on the credit card statement showing how long it will take to repay a credit card if one pays the minimum balance on it. There are certain other changes that have been made, and both the House Financial Services Committee and the Senate Banking Committee are examining these issues in detail. In other words, this is not something that necessarily needs to be resolved in this Committee.

Let me point out one other thing in my last seconds. This bill is drafted far too broadly. Under this bill, a high-cost credit consumer transaction is defined as one where you exceed your cap "at any time while the credit is outstanding." That means that a traditional 30-year mortgage issued in October 1981, when the interest rates peaked at 18.45 percent, would fall and would have fallen under that definition as of December 2008 when the price of the 30-year T-bill declined rather substantially.

Now, we have not seen high interest for some time, but we cannot expect that we are not going to see this again in an era of economic dislocation and trillion-dollar deficits. This bill needs to be substantially corrected, and I would argue that it is going to hurt the very people that you are seeking to help.

Thank you.

[The prepared statement of Mr. John appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you very much, Mr. John.

Out of respect for my colleagues' schedule, I will defer my questioning to the Ranking Member. We will then proceed to Senator Durbin, who was here earlier, and then Senator Sanders of Vermont, whom I am very proud to say has joined us.

Senator SESSIONS. Well, Senator Whitehouse, we are glad that you are in the Senate, and being a new member, a new Chairman, you are very gracious. A good lesson for some of our older Chairmen.

Briefly, Mr. John, summarizing what I understood you to say—and it makes perfect sense to me—if we are going to expose credit card companies to greater and greater possibilities of recovering nothing on their credit card debt when somebody goes into bankruptcy, they will then be more rigorous in denying credit cards to marginal people who would like to get a credit card and may need a credit card.

Mr. JOHN. That is precisely the case, plus this is likely to extend to other types of credit that are offered to the same population.

Senator SESSIONS. Such as?

Mr. JOHN. Such as mortgages, such as installment lending, and a variety of other types of——

Senator SESSIONS. Well, frankly, this thing cuts both ways, as I indicated earlier. You want more people to be able to avail themselves of having short-term credit, which a credit card is. But at the same time, it results in either higher rates for everybody or a reduction in the number of people who would be able to get a card. Would you agree with that, Mr. Scarberry, that fundamental principle?

Mr. SCARBERRY. I think there is a tradeoff between wanting to have credit available but, on the other hand, wanting people to act responsibly. And, of course, we know—I mean, as my testimony points out, the massive increase in household debt has really been on the mortgage side rather than the credit card side over the——

Senator SESSIONS. Well, I would just say it is a big deal—and I am not prepared to accept it—that the responsibility for somebody who utilizes that credit card to run up excessive debt is the person who gave them the credit card. Would you agree with that? I mean, unless we have eliminated the concept of individual responsibility totally.

And, Judge, when you have—in bankruptcy, routinely is it not so that the unsecured credit card people are the ones who get paid last because secured creditors are first?

Judge GAMBARDELLA. Under the priorities of the Bankruptcy Code, they would be unless—if they have no security, that is correct.

Senator SESSIONS. You made some criticisms of the means test, I believe, at least as how it is affected. Do you oppose the concept that persons who make above median income in America and run up big credit card debt ought to at least pay some of that back if they are able to?

Judge GAMBARDELLA. No, I believe that people—I believe in the concept of the honest and good-faith debtor, so that if there is an ability to repay a portion of one's debt, one should attempt to do that. The difficulty with the means test—and I know this is not a Committee hearing on the means test—is what obviously some of the other witness testimonies have indicated. It is very burdensome. It is very costly. In most States, it does not even apply.

I do not know whether it accomplishes what it set out to do, which is to increase repayment.

Senator SESSIONS. Well, I am open to improving that, and I do not want to use up too much of my time. But when an individual files for bankruptcy, they have run up debt, one of the things lawyers tell them is to put everything on their credit card.

Judge GAMBARDELLA. Except the court filing fee.

Senator SESSIONS. And we did back up the—well, they tell them not to pay their rent, to give them their money so they can pay the fee. But, at any rate, they do use credit cards up to the last day, and we backed back a little bit the time that you could do that on some of those debts. So the credit cards are dumped on in many ways once a person decides that they are filing bankruptcy. Is that not correct?

Judge GAMBARDELLA. I am sorry, Senator.

Senator SESSIONS. Well, in effect, what happens is if you talk to a lawyer and they say you are going to file bankruptcy, and the lawyer suggests that you pay your groceries and everything else possible on the credit card and run that up and pay him his fees and pay your family and their debts——

Judge GAMBARDELLA. That would be a scenario——

Senator SESSIONS.—that you owe your brother-in-law, and then sock it to the credit card company and they will lose in bankruptcy.

Judge GAMBARDELLA. Well, I am sure—some of this testimony certainly makes clear that what is happening with American families is that they are utilizing credit cards for all types of purposes that you or I years ago would not have.

Senator SESSIONS. I am trying to figure out how to—what the rate is. Mr. Scarberry, maybe you have looked at this, but at 15 percent plus what the current rate is, 3, about 18 percent, makes this a bit of a risky thing. You think it could constrict the availability of credit for consumers and might increase the interest rates for good creditors?

Mr. SCARBERRY. It is possible, Senator. To the extent that you have people with good credit who are getting specialty cards, where they get double frequent flyer miles and these sorts of things and they have high rates on them and they do not intend to carry a balance, those are people where you might actually have some serious payment if they end up in financial trouble—they have assets—and due to the financial trouble go into bankruptcy. The credit card companies who offer those kinds of cards might, in fact, suffer some serious losses as a result of this bill, and it might restrict some of that credit.

In the usual case, there is not going to be any payment to the credit card company, anyway, so disallowing their claim is not going to hurt them. But in a few cases it would, and it could have some effect.

Senator SESSIONS. Mr. Chairman, I would just like to emphasize, one thing I think Mr. Scarberry mentioned was that if one credit card is over the interest rate allowed under this bill—and it may be a small one—they are exempted entirely from the means test. Is that——

Mr. SCARBERRY. That is correct under this bill which——

Senator SESSIONS. I do not think that is a good policy for sure. Thank you.

Chairman WHITEHOUSE. Senator Durbin.

Senator DURBIN. Thank you, Mr. Chairman.

Back during the debate on the bankruptcy bill, I offered an amendment on the floor which said that if a mortgage lender was guilty of predatory lending practices, they could not recover in a bankruptcy court, similar to what you are doing here, Senator. And I lost that vote on the floor.

During the course of the debate, then-Senator Phil Gramm of Texas got up and said, "If the Durbin amendment passes, it is the end of subprime mortgages." I lost by one vote.

It is true that if the Durbin amendment had passed, we would have restricted credit. But I think most of looking back now would have said, "That might have been a pretty healthy thing to do," because people were doing things, borrowing money under circumstances that made no sense, but there was a willing lender who was willing to take them into a debt arrangement and ultimately into a bankruptcy court.

Judge Gambardella, what is the primary reason people come into bankruptcy court now? What kind of debts push them over the edge?

Judge GAMBARDELLA. Well, generally it would be what I reference in my testimony—a divorce, loss of income, loss of health insurance, some catastrophic event in their lives that creates the need to file for bankruptcy. At least that is what all of the studies that have been done show, and I think it bears out.

But it is shocking when you look at bankruptcy petitions—and I am sure people on this panel can bear me out—at the amount of credit card debt that you see on a family's bankruptcy petition. You do not see just one or two credit cards. You can see upwards of 25 credit cards with over $10,000 on each card. I think that is rather shocking.

Senator DURBIN. Isn't that the last gasp? I mean, when everything is falling apart, they max out the credit cards to try to hang on, hoping that things may turn around if they cannot?

Judge GAMBARDELLA. As I say, that is robbing Peter to pay Paul. You see it. And it is done not, I think, out of bad intentions. I think it is done often out of pure desperation.

Senator DURBIN. And, of course, they are facing interest rates with those credit cards which can be astronomical.

Judge GAMBARDELLA. But I did want to raise one issue because it was raised, I believe, by some of the other witnesses here in terms of the need for these high-cost loans or credit cards in certain instances.

One of the changes that the 2005 amendments instituted was debtor education, so when parties go into bankruptcy, they have to then take a course. That course teaches that——

Senator DURBIN. The author of the amendment just left, but he will be back.

Judge GAMBARDELLA. Okay. Well, maybe he will read this testimony. And so when debtors go into bankruptcy and then come out, they are being told to borrow money responsibly. So I guess there is a dichotomy between the bankruptcy court's telling debtors now they have received discharges, borrow responsibly, and the other argument, which I think is valid, has validity, that if you put too many restrictions on credit, then there may not be available credit even at the most onerous terms.

But we are educating our debtors to go back out in the world and, for better or worse, cut down on their use of credit cards, because I think the end result is what we have seen, these spiraling bankruptcy filings.

Senator DURBIN. Mr. John, did we make a mistake capping the interest rate that could be charged to members of the U.S. military at 36 percent?

Mr. JOHN. I do not know that you have necessarily made a mistake with the military. However, the problem that you face with overall usury ceilings is that if we go back into a period of high inflation, then you are going to have to deal with situations where normal credit exceeds those usury ceilings.

Back during the 1980's, the State of Arkansas——

Senator DURBIN. You used the example of an 18-percent mortgage interest rate?

Mr. JOHN. Yes. Well, there was an 18 percent—and the State of Arkansas has a constitutional requirement to have a 12-percent interest rate. And they came to Congress every 2 years to get a waiver through Congress. Of course, they refused to change their Constitution.

Senator DURBIN. Do you think that the danger of hyperinflation that might call for a change in the law at some point in the future outweighs the benefit of stopping usurious credit practices that are driving people into bankruptcy and the sweat-box situation the Chairman described?

Mr. JOHN. I think there are other ways to do it other than usury ceilings. I think that there are ways to deal with disclosure. There are ways dealing with consumer education, as the judge has just said. And there are many, many different other manners of handling this.

I think that a price ceiling itself, as much as I personally am appalled by the concept of a 36-percent interest rate, is not necessarily the way to deal with it.

Senator DURBIN. Let me ask you this question: Do you think that the credit card contracts that we are given as consumers are easily understood?

Mr. JOHN. Absolutely not. I tried reading one the other day and fell asleep at the end of the third paragraph.

[Laughter.]

Senator DURBIN. I think that is an experience most of us would run into, and the point I am trying to get to is that buried within those credit card agreements are a lot of traps.

Mr. Corey, I read your testimony. You fell into one of those traps, and you paid a heavy price for it.

I think what we are dealing with is not an arm's-length transaction here between the borrowers and the lenders. We have terms that honestly most people cannot follow and occasionally trapped by them, as Mr. Corey was, and find themselves in a miserable situation with their credit rating shot and deeply in debt, maybe ending up in Judge Gambardella's court if they are not careful.

Mr. JOHN. I agree, and I am hopeful——

Senator DURBIN. What do you think Congress should do as a result of that? Anything?

Mr. JOHN. Well, I think actually the Federal Reserve Board and the various banking regulators have already issued regulations addressing some of these more egregious questions, including, as I mentioned, your goal of having something on the credit card statement saying that if you pay the minimum, here is how long it is going to take you, assuming you can.

Now, both the Banking Committee and House Financial Services is looking to see what else needs to be done, and I think that is probably the appropriate venues.

Senator DURBIN. Thank you.

Thanks, Mr. Chairman.

Chairman WHITEHOUSE. Thank you, Senator Durbin. It is a pleasure to have you with us. I appreciate very much that you have attended this and shown such interest.

Senator Sanders.

Senator SANDERS. Mr. Chairman, thank you very much for allowing me to drop into this Committee of which I am not a member, and thank you also very much, Mr. Chairman, for cosponsorship of legislation that I have introduced which would put a cap on credit card interest rates at 15 percent unless there were some dire circumstances, at which point it could be raised. And that piece of legislation is also cosponsored by the Chairman of the Judiciary Committee, Senator Leahy, Senator Durbin, Senator Levin, Senator Harkin as well.

Let me begin by asking Mr. Corey a question. A very simple question, and then I want comments from other of our panelists. You know, the Bible makes a lot of reference to usury, and in our country today, you have financial institutions that are charging Americans 30-percent interest rates, 50-percent, 100-percent interest rates. Mr. Corey, what about the morality of that? Do you think that is a moral thing to be charging people that kind of interest? I know we do not talk about morality too much in the U.S. Senate, but it is an issue that we might want to touch on.

Mr. COREY. No, I don't think it is a moral issue. I mean, folks take on credit cards, and they want to pay off the debt. I think most people do want to pay off their debts. I think people who I grew up with in the middle class all take these responsibilities very seriously. And sometimes they extend themselves a little bit more than they should, and a lot of times in situations of hardship and divorce and things beyond your nature, I think it is a very strong moral issue of what is profit and what is——

Senator SANDERS. Mr. Corey—and anybody else can jump in—we all know what loan sharking is. We know Mafia and gangsters lend people money at outrageous rates, and then they break their kneecaps or beat them up if they do not pay it back.

How different is somebody in a three-piece suit charging somebody 50-percent interest rate different from a loan shark?

Mr. COREY. I think it is exactly that. I think it is exactly loan sharking. I think that is exactly doing that. Just in my testimony where I say that, you know, if they are there to work with us, why would you offer me the $10,000 I paid down in October to bring down the principal and then say take it back and then to bring me deeper back into—and whereas they would make more money on the interest again and charging the 28.99 percent.

Senator SANDERS. Are we looking at a form of three- piece-suit CEO corporate loan sharking here?

Judge GAMBARDELLA. I don't think that we have to go that far, but what I think, Senator, is it is an issue—one person's morality, you know, may be different from another's. I think it is really a question of personal responsibility or maybe institutional responsibility in a broader sense.

You know, we have spoken a lot about concepts of means testing and concepts of debt repayment and concepts of certainly consumers acting responsibly, and I am all for that. But I think it has to, it goes both ways.

Senator SANDERS. It goes both ways.

Judge GAMBARDELLA. The difficulty is certainly there were perceived—and here I am speaking only in the bankruptcy context strictly. There were perceived imbalances that were addressed by——

Senator SANDERS. I just have a short period of time.

Judge GAMBARDELLA. By legislation, but it has not gone far enough.

Chairman WHITEHOUSE. Senator, it is just the two of us, so I am not going to——

Senator SANDERS. Oh, we can go on for hours. Okay.

Yes, sir?

Mr. SCARBERRY. Senator Sanders, I think it is always good to consider what is right, and I don't have a problem with that. I would suggest one of the differences——

Senator SANDERS. You do not have a problem with considering what is right. All right. That is a good start. We are off——

[Laughter.]

Mr. SCARBERRY. I don't have a problem with the Senate considering that. I think it is very important. It is very important.

One of the differences between a three-piece-suit lender and a loan shark, of course, is the collection method. We do have limitations, for example, on garnishments under Federal law. And we don't have debtor's prisons anymore. And also, very importantly, we do have the availability of bankruptcy to allow people to get a fresh start, and that is very important.

Senator SANDERS. All that is true and important, and I was being a little bit facetious. But, on the other hand, you will not deny, sir, that there are hundreds of thousands of people whose lives have been ruined—whose lives have been ruined with very, very high interest rates and, in fact, going into bankruptcy. I do understand that going into bankruptcy is not getting your kneecap broken. But my point is you——

Mr. SCARBERRY. That is not a very nice thing to have to do either.

Senator SANDERS. Right. All right. Let me ask another question, and that is, I get in my office—and I am sure Senator Whitehouse and every Senator gets—irate calls from taxpayers of this country who have seen—maybe they are losing their jobs. Maybe they are losing their homes. And at the same time, they are forced to bail out the AIGs of the world, the Citibanks of the world, companies where CEOs made hundreds of millions of dollars. And then what they get from these same financial institutions are credit cards which are charging them 25 or 30 percent interest rates.

Professor, what about the taxpayers of this country bailing out institutions which then say, "Thank you very much for bailing us out. We will take the bonuses, and by the way, we are charging you a 30-percent interest rate"? Do you think taxpayers have a right to be a little bit upset about that? Right here.

Mr. LEVITIN. I was not sure which professor you were referring to.

Of course, taxpayers have—should be upset about that. Right now, the Federal Government is effectively funding credit card loans that the Federal Reserve Term Asset-Backs Security Loan Facility, better known as TALF, is purchasing credit card-backed securities in the securitization market. And that is giving credit card lenders the funds to make loans. If the Federal Government is going to be ultimately the financer of credit card loans, it should have a say in what the terms of those loans look like.

I would also note that having the Federal Government's role in financing of credit cards really alleviates some of the concerns that Mr. John has suggested about something like a usury law, that Mr.

John has suggested that if we had something that looked like a usury law, we would have what is known as product substitution and credit rationing. So people would not be able to get loans from legitimate lenders, and they would turn to loan sharks.

Having essentially a Federal subsidization—which is what we have now—of credit card lending mitigates that significantly. It is going to depend on the scope of our subsidization of credit card lending. But now that we are in that game, I think that the concerns about usury laws are definitely mitigated.

Senator SANDERS. Let me throw out my last question, if I can, Mr. Chairman.

Chairman WHITEHOUSE. Please.

Senator SANDERS. Senator Durbin mentioned that the Department of Defense has imposed a 36-percent cap on interest rates charged to people in the military. What is not widely known is that for, I believe, three decades now, credit unions in this country have been mandated not to charge more than 15 percent, with some exceptions, and, in fact, some credit unions now charge up to 18 percent.

There was an article a couple of weeks ago in the L.A. Times where a fellow active in the Credit Union Association in California said their credit union was doing pretty well. They have survived under this legislation, this regulation for 30 years. Is there any reason we think why other financial institutions could not survive equally well if we had the same type of cap? Professor?

Mr. LEVITIN. I would suggest that if you are thinking about a cap, like a 15-percent cap, it should really be a floating cap, that it should float above some sort of index rate, like the Federal funds rate. That would alleviate any of the inflation problems that Mr. John raises.

Senator SANDERS. Well, in fact, that is, I believe, what is the case in the credit union situation.

All right. Let me just conclude. Thank you very much, Mr. Chairman. I think obviously the American people have had it up to here with financial institutions in general. I think in the last year the incredible greed, recklessness, illegal behavior on the part of Wall Street has enraged the American people because our economy is tanking and they are having to bail out the people who caused the problem. And I think one way that we can move forward, Mr. Chairman, is to, in fact, put a cap on interest rates. We are proposing something similar to what goes on with credit unions in this country, and we look forward to support for that.

Thank you very much.

Chairman WHITEHOUSE. Thank you, Senator Sanders. And as a member with you on the Budget Committee also, I have had the opportunity to see the vigor, passion, and relentlessness of your advocacy on this, and it is, if you do not mind me using a loaded phrase, "creditworthy."

[Laughter.]

Chairman WHITEHOUSE. Just for the record, the legislation that I have proposed is a 15-percent limitation riding on top of a 30-year T-bill rate, so that if the circumstance Mr. John was talking about were to arise of a dramatic rise in underlying interest costs, this would rise naturally with it with that T-bill rate.

Mr. JOHN. Forgive me, Senator, but your bill says that this would happen at any time when the credit is outstanding, which means that while it is very true that in October 1981 when this hypothetical mortgage that I mentioned was taken out, this was the case. Over the intervening years, the 30-year T-bill rate has declined.

Chairman WHITEHOUSE. I see your point.

Mr. Corey, let me ask you just a little bit about—you seem to be in many respects kind of an ideal customer. You are college educated, you are solidly middle class. Your testimony reflects that for 19 years you never missed a credit card payment or an auto payment. Until 7 weeks ago, you had never missed a mortgage payment.

Mr. COREY. True.

Chairman WHITEHOUSE. Your testimony here shows how seriously you take these responsibilities. The only thing that went wrong initially was that you inadvertently paid less than your minimum payment 1 month.

Mr. COREY. Right.

Chairman WHITEHOUSE. And then in the following month, they had two things: one said "minimum payment" and one said "pay this." You paid the minimum payment. That was a trap, they caught you, so those two things then pitched you into this circumstance, which required you to deal with your credit card company, and the upshot of your dealings with your credit card company is the sentiment that you have expressed here that you are facing off against financial Goliaths, that they are out there preying on those of us who have been weakened by circumstances, and that you need something to level the playing field to empower you to negotiate with these institutions' strong-arming tactics.

If they are treating you that way, you have had a pretty rough experience.

Mr. COREY. It is basically a tightrope walk, and now someone is poking sticks at you at the tightrope. And at every turn, that one-half step in the wrong direction, you are basically ending up in the judge's court. And it is not someplace, like I said, in the middle class where we want to be. But, again, we are forced down into this sweat box, and they are relentless. And they are trying to get us deeper into debt so then we really do not get into this.

To Mr. John's point as far as——

Chairman WHITEHOUSE. The response to your predicament was to offer to lend you more money so you could pay off their exorbitant rates and then be in a deeper hole later on.

Mr. COREY. They did not like the fact that I was paying the principal down, clearly, and they did reduce my credit limit down from what it was by over $13,000. So now they are taking credit away from me. I have asked many friends about their own situations, and people who have not missed payments are losing credit just for no reason whatsoever. Someone who may have made a minimum payment or less than a minimum payment on another card, not even with that particular company, their rate went up. And when they said, "Why did my rate go up?", "Well, you were kind of late on this payment."

They then said, "Well, if you want to get it back to that lower rate, close the account." Close the account, they really don't care about losing your business any longer.

Chairman WHITEHOUSE. Your description of this is walking a tightrope while being prodded with sticks is a memorable description.

I think a lot of the—around here we often disagree on things because we disagree on the underlying facts. But it seems to me I am seeing quite a significant degree of agreement among all four, if you do not mind my saying so, Mr. Corey, the professional witnesses here about what the credit card industry's business strategy is.

Judge Gambardella refers to, first of all, that the vast majority of people filing for relief under the Bankruptcy Code are not abusers or out to take unfair advantage, that bankruptcy relief is largely utilized by individuals as a last resort for legitimate, non-abusive purposes. And the sort of counter to that is the practice of the industry where they increase interest payments so fast that even a small stumble meant either having to declare bankruptcy or be in a situation where you "literally never get out of debt"; and that in this circumstance, ultimate repayment may not be necessary for the credit card to have a highly profitable transaction; and that in some circumstances repayment is not even the goal. You used the phrase "to the extent repayment is the goal," which all raises the prospect that there is something different going on than what we ordinarily think of as extending a loan and getting it paid back over time with a reasonable interest rate to reflect the risk.

Professor Levitin, you talk about companies turning people into a perpetual earning asset and distinguishing that from the lender who lends with an eye to getting its principal repaid and making a profit from the interest.

Professor Scarberry, you refer to the damage that is done by high-cost consumer credit and that this is a significant problem.

And, Mr. John, you talk about a "debt trap," which you define as "where customers of high-interest lenders find themselves deeper and deeper in debt to the lender as interest rates and fees combine to make it impossible for them to repay their loans." And you say that, "Such a trap may well exist in both specific cases and in general."

So it appears to me that across the board and among all of the witnesses for really both sides, the ones who were invited by the majority and the ones who were invited by the minority, there is at least a fair degree of consensus that there is a business strategy to some degree extant in the credit card industry to move people into what I referred to in my opening remarks as a "sweat box," to put them into a place where they can never pay it down because it is too high, where they have been kicked up into these interest rates and they cannot escape from those. And now by making bankruptcy more difficult, pursuant to the so-called bankruptcy reform, they extend that time, and then they calculate that minimum payment so it is just enough to keep you in there essentially forever, you know, 40 years or whatever.

It strikes me that we might have more agreement in the Senate on this if we had more agreement that this was, in fact, a business strategy that in some circumstances took place in the industry.

Do any of you contest that at some level and to some degree that is a business strategy that exists in this industry? Judge Gambardella?

Judge GAMBARDELLA. I cannot comment as to whether or not it is a business strategy, but I think certainly that is the result of these practices. So whether it is intended to be the result or not, I think that the conclusions of these studies pretty much speak for themselves.

Chairman WHITEHOUSE. It would be a little hard to imagine that a $1 trillion industry with all these computers and marketing strategists at their disposal would be doing this accidentally. At least that is my perspective.

Professor Levitin.

Mr. LEVITIN. The card industry is one of the most sophisticated industries in the world, and there is no chance that this is accidental.

Chairman WHITEHOUSE. Mr. Scarberry? Professor Scarberry. I apologize.

Mr. SCARBERRY. My expertise is in bankruptcy. I have not studied the credit card industry directly. It would not surprise me. I would like——

Chairman WHITEHOUSE. Describe for a minute what you meant by your use of the word "damage." You said the "damage caused by high-cost consumer credit." What do you mean by "damage"?

Mr. SCARBERRY. What I meant by the damage is that when people miss payments and their interest rates go way up—and as other people have mentioned, you have universal default clauses and other sorts of things. When the interest rate goes up and the bills pile up and people cannot pay them, there has been damage that has been done.

Now, the difficulty is that this bankruptcy bill is not going to do anything, I think, to prevent that damage or to remedy it. I would note that I think it was fairly——

Chairman WHITEHOUSE. Would you agree that the damage is to some degree systematic?

Mr. SCARBERRY. I have not seen the studies that would let me say that as an academic matter. Anecdotally, certainly there are a lot of people who are in over their heads with credit.

Now, I suppose one issue might be this: that if you were to place fairly Draconian limits on interest rates, you might have more credit card companies cutting credit limits very substantially. When people cannot pay them off, now they are going to be charged over-limit fees, and they are not going to be able to borrow the extra money that they may need in these hard economic times.

So I don't know what the right economic approach to it is. Clearly, there are people who are being harmed substantially. What we should do to deal with it, I don't know.

Chairman WHITEHOUSE. A credit card company can unilaterally lower a credit limit below what somebody's balance is and then charge them over-limit fees?

Mr. SCARBERRY. I don't know that, but with the high interest charges, if you lower the limit so that it is still above what is owed, it might be that in a few months what is owed would go over the limit. And, in any case, the person would not have the additional credit available.

Let me just say this: I believe recently there was a requirement that minimum payments on credit cards be increased, in part to deal with this problem. And that could be something Congress could look at as well.

Chairman WHITEHOUSE. Mr. John, what of your testimony about the debt trap and the danger that a consumer gets into a situation where they are—I remember visiting a dairy farm when I was a kid, and they walked the cattle into the pens, and they put their heads through a railing, and then the gates closed to keep their heads locked in, and then the folks come and hook them up and milk them. It is probably not as good an analogy as Mr. Corey's about walking the tightrope prodded with sticks, but one does get the sense that consumers are being lured into these things, that the size of their credit and the tiny measure of the suggested minimum payment and the ease of the trap all combine to put them into a situation not unlike that poor dairy cow where their head is trapped by their inability to get out, because they cannot pay out, and then they just get milked and milked and milked.

Mr. JOHN. Oh, I think that to a large extent that is true. I think one of the things we would agree across this panel is on the problem. I think we might disagree on the proposed solutions.

Now, one quick factual check. Under the credit card regulations, if the credit card company makes a significant change in your credit card, you have the ability to essentially refuse that change, whether it is interest rate or whatever, by simply not using the credit card again and paying off your balance according to the previous terms of the credit card, which means that if they lowered your credit limit to below a certain level, you would have the ability to say, well, sorry, I am not going to use my credit card anymore, I am just going to pay it off under the existing contract.

Chairman WHITEHOUSE. And is that the result of the recent Federal Reserve——

Mr. JOHN. No. This has actually been the case for many, many years.

Chairman WHITEHOUSE. Okay. Mr. Levitin? Professor Levitin. Sorry.

Mr. LEVITIN. I think it is important just to spell out a few other pieces of the credit card business model that fit with the sweat box. And I think when you see those, the business model is even more disturbing.

Credit cards attract consumers. They compete not on the basis really of interest rates. If you look at credit card advertisements, it is not "We have the lowest rate." It is "We have such-and-such frequent flyer miles," or some sort of rewards program, and it is teaser rates. It is not the actual cost of the card. So consumers get lured into using cards based on these flashy teasers and promotional items.

Once they are using the cards, then we have the sweat box model, but card issuers can be very aggressive with the sweat box because, because of securitization, card issuers hold all of the upside. So if you pay off—if they squeeze more money out of you at the sweat box, they get 100 percent of the upside. But if it turns out that they miscalculated and you default, they only have a small percentage of the downside. This gives them every incentive to squeeze harder, and they are able to do that because they are able to change terms retroactively, after the fact. They can lower your credit limit. They can increase the interest rate. They can lard on various late fees, over-limit fees, and so forth. They can invent whatever fee they want.

And because they have 100 percent of the upside but only a limited percentage of the downside—and the percentage is going to depend on the particulars of their securitization deal—this really encourages them to squeeze consumers harder. This is like a water balloon, and if they squeeze it too hard and it pops, it is not so bad for them. Most of the water gets on someone else. But if they can squeeze it really hard and it does not pop—well, I am not sure what you get with a water balloon with that. But I think you see my point, that they get all the benefit.

Chairman WHITEHOUSE. Let me go to Mr. Corey first and then Professor Scarberry.

Mr. COREY. The situation is—again, I have talked to a lot of friends about this since it is a very hot topic amongst people in the middle class. But a friend of mine had a 2.9 rate, and they got a notice saying that their rate was going up to 14.99 for no reason whatsoever, just because we can. And literally she said that the conversation that she had with this person was, she said, "Well, I am just going to close my account." She has very little on that particular account. "I'll close it and pay it off." And the woman on the other line said specifically that we really—"If you want to close it, that is fine, because we are going to get someone who has a lower credit rating and get them at a higher interest rate. So if you want to leave, go right ahead." And that is really what is going on. They don't care for people with good—they don't want people who are responsible and whatnot. If you want to leave and go to another business, that is fine. You can take your card and go somewhere else, we don't care.

Then they are eliminating—again, they are already eliminating credit levels for everyone already. So I am kind of having a hard time understanding what folks are saying about banks are—this would eliminate banks from giving out credit. They already are—when people need it.

Chairman WHITEHOUSE. Professor Scarberry.

Mr. SCARBERRY. Senator, one of the points that has been made is that this bill would allow consumers to call up the credit card company and negotiate. You know, "You have raised my rate because of a default, and I may have to go into bankruptcy, so why don't you lower the rate? Because if I go into bankruptcy, your claim is not going to be allowed."

Well, one of the problems with the definition of the high-cost consumer debt here is that after the rate goes above the limit for 1 day, that debt is forever tainted. So in a negotiation with the creditor, if you say, "Would you please lower the rate?" well, they do not have a lot to gain, because they cannot redeem that debt from now being tainted. It was at some point during its life over the limit. So that is a difficulty.

The other difficulty with the negotiation issue——

Chairman WHITEHOUSE. Although, just to be clear, if the customer as a result does not go into bankruptcy, then that so-called taint has no effect.

Mr. SCARBERRY. That is correct. That is correct.

The other difficulty with negotiating is that if you have multiple credit cards, which people seem to have, it is difficult to do multi-party negotiations. If the point is, "well, I can stay out of bankruptcy if you will lower it, people can negotiate that already, because already the credit card companies are not going to get much in a bankruptcy. So I don't know that this bill adds to that leverage. It does taint the debt forever.

But when you have multiple credit cards, it is difficult to coordinate a negotiation, and people who do law and economics will talk about difficulties of these multi-party negotations—the transaction costs are high. So that is an issue.

Now, there is one other technical issue. Suppose the rate goes up above the limit on a credit card balance for a few months. Then the debtor makes a lot of payments and the credit card company reduces the rate. How do we decide when the taint is gone? Is it after all of the principal balance is paid?—after principal payments have been made equal to the principal balance at that time? Ten years later, is that credit card account still tainted because at one time for some of the credit that was issued on that credit card the rate was over the limit? How are we going to figure what is the debt on which the credit was over the limit? That is a practical question that bankruptcy judges and trustees might have to deal with.

I also wonder if bankruptcy trustees will appreciate having the burden of going through all the credit cards to figure this out. They might have time to, but those are concerns I have about that.

Judge GAMBARDELLA. Well, I want to take up that last point because it was raised who would have standing to move to disallow these claims, who would have the incentive to review these claims. Certainly there are many no-asset Chapter 7 cases that just go through the system, and there probably is very little incentive there. But there are certainly, in certain district, asset 7s where there is substantial debt and substantial assets. And I think a vigorous trustee would have an interest in going after a certain category of claims that could be disallowed to increase payment to the bona fide unsecured debt in a given case.

In a Chapter 13, which is the repayment plan, I would think that a Chapter 13 trustee who oversees plans and the debtor's counsel would have equal incentive to review these claims.

So I think there are parties with standing and incentive to investigate and to make hopefully rational decisions about when a motion for disallowance should be brought before a judge and when it should not. That is the one point I wanted to bring up from the testimony prior.

Chairman WHITEHOUSE. Let me ask one last question, and then if anybody has anything final they would like to add, we will do that and then conclude the hearing.

There has been the repeated suggestion in the hearing that by any substantive regulation of interest rates, we risk denying people credit and that there is almost a tone as if this would be sort of a novelty or anomaly.

My understanding is that back to, you know, biblical days, interest rates have been substantively regulated and that from biblical times until, I guess, 1978 when the *Marquette* decision came out, and then a tail after that as the banking industry became aware of the opportunity that the *Marquette* decision provided and began to move its operations to no-protection States and operate out of those so that they could get out from under local usury laws, which I think almost every State had. Indeed, if I recall correctly, some of the States actually got rid of their usury laws as a means of attracting the business of the credit card companies to come to their State. So from there they could launch unrestricted marketing efforts and unrestricted interest rates around the rest of the country, notwithstanding, for instance, the Rhode Island Legislature's desire to protect Rhode Islanders. "Nothing we can do about it," said this decision.

So it strikes me as if the baseline on this is a multi-thousand-year baseline of generally consistent, substantive interest rate regulation, and that if there is an anomaly, the anomaly has been the last 30 years—actually, probably less than 30 because it took a while for the banking industry to catch on to the door that the *Marquette* decision had opened, and that actually we are in the period of anomaly right now. And so to move toward more substantive regulation would be consistent with the entire sort of legal common law and regulatory history of our culture dating back to its very earliest days.

Mr. JOHN. May I bite on that one?

Chairman WHITEHOUSE. Please.

Mr. JOHN. There are two other factors that come into play here, however, which is that prior to *Marquette*, credit was not regularly available to certain groups of consumers. It is one of the reasons, for instance, in Rhode Island they had such a heavy retail presence of credit unions and such a small consumer presence of banks up until relatively recently. So there has been a result, which is that the three groups that I talked about—the lower-and middle-income workers, the first-time borrowers, and those with poor credit histories—now have much more credit available to them than they would have otherwise.

The other factor which comes into play with Senator Sanders' legislation is that he does talk about what the credit unions do. And I have great respect for credit unions. I am a member of a credit union. I once lobbied for credit unions. However, they are tax-exempt, so it seems only fair, if he is going to put a 15-percent ceiling on there, he should also take away the taxes on bank credit activities.

Chairman WHITEHOUSE. I am sure he will take that recommendation into consideration.

Well, if there is nothing further, I just want to express my appreciation to all of the witnesses who have shared from their personal experiences and from their judicial experiences, from their academic experiences, and have been, I think, both thoughtful and helpful. I express my appreciation also to the Ranking Member—unfortunately, he was called away, but clearly this is a matter of interest to him—and to the Chairman of the Judiciary Committee, Chairman Leahy, for his interest in this and his statement, and for our Majority Whip, Senator Durbin, and Senator Sanders for their attendance.

The record of this proceeding will be open 7 days if anybody seeks to add anything further, and with that, the hearing is now adjourned.

[Whereupon, at 11:45 a.m., the Subcommittee was adjourned.]

[Questions and answers and submissions follow.]

QUESTIONS AND ANSWERS

QUESTIONS FOR THE RECORD FOR JUDGE ROSEMARY GAMBARDELLA
SUBMITTED BY SENATOR JEFF SESSIONS

1. In your testimony, you stated there are problems with the way the means test is implemented and how it operates. I believe the means test, conceptually, is good policy. Rather than disregarding the test, as this bill will do in practice, we should first examine what steps can be taken to strengthen the means test and make it more effective. What suggestions do you have for tightening up the means test in order to address the concerns and objections that have been raised?

SUPPLEMENT TO
TESTIMONY OF HONORABLE ROSEMARY GAMBARDELLA
United States Bankruptcy Court for the District of New Jersey
"Abusive Credit Card Practices and Bankruptcy"
Hearing of the Senate Judiciary Committee's Subcommittee
on Administrative Oversight and the Courts
Hearing Date: March 24, 2009

Senator Sessions, thank you for the opportunity to supplement the record of this hearing and your question regarding suggestions to "tighten up" or "strengthen" the effectiveness of BAPCPA's means test. Your question raises the following issues:

Despite the high cost of administering the means test by way of collecting, analyzing and reporting this additional information, most debtors have income below the applicable state median income levels and are within the "safe harbor" such that the presumption of abuse will not arise. As well, these median income thresholds greatly vary from state to state. A study of 1995 bankruptcy filings found that more than 75 percent of the debtors had income less than the national median, and that this percentage would likely increase if, as in BAPCPA, state medians were used. A later study using 1998 and 1999 case filings concluded that more than 84 percent of debtors had incomes below the applicable state median. As well, for debtors whose income is above the median, pre-bankruptcy planning can produce significant deductions from income, particularly in the area of secured debt and charitable contributions, to remove otherwise disposable income. See Hon. Eugene R. Wedoff, U.S.B.J. N.D. Ill., Means Testing in the New § 707(b); Am. Bankr. L. J., Vol. 79, Issue 2, 231, 277-279 (2005).

U.S. Senator Dianne Feinstein

Question for the Record for Professor Adam Levitin
Hearing on "Abusive Credit Card Practices and Bankruptcy"
Administrative Oversight and the Courts Subcommittee
Senate Judiciary Committee, March 24, 2009

In December of last year, the Federal Reserve Board issued new regulations for credit cards. These regulations take an important step toward giving consumers the information they need to stay on top of their finances. For example, the regulations prohibit double-cycle billing practices that can be confusing for consumers, and they require credit card statements to prominently display changes to accounts.

In at least one area, however, I do not think the regulations go far enough. The regulations state that companies must issue general warnings about the effects of making minimum payments, but they allow companies to show only examples, and they do not include examples of how the total amount a consumer pays can increase over time. I have introduced the "Minimum Payment Notification Act" (S. 131) because I think these warnings need to be specific and need to show consumers both the length of time and the amounts they will pay if they make only the minimum payment each month.

- Do you think the Federal Reserve Board's December 2008 go far enough in giving consumers the information they need to manage their credit card debt responsibly? If not, what additional changes do you think are needed?

Adam J. Levitin's Response:

I do not. The new unfair and deceptive acts and practices regulations (the "UDAP regulations") for credit card issued by the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration under Section 5 of the Federal Trade Commission Act are a positive first step in helping consumers manage their credit card debt more responsibly, but they are a very incomplete step. I believe there are two problems with the regulations. First, there are many other abusive credit card practices that are left untouched. And second, the regulatory approach of federal banking regulators is futile in ensuring long-term fairness in the card market.

The December 2008 UDAP regulations fail to address several unfair and deceptive credit card acts and practices that are addressed by pending legislation, particularly Senator Dodd's Credit Card Accountability, Responsibility and Disclosure Act (the C.A.R.D. Act), S. 414, and Representative Maloney's Credit Cardholders' Bill of Rights, H.R. 627. Among the abusive practices left untouched by the UDAP regulations are:

1. The ability to change contract terms, including:
    a. Universal cross-default.
    b. Unilateral term changes other than retroactive application of increased APRs to existing balances.

2. Manipulation of the finance charge, including:
    a. Application of finance charges to fees incurred in the same billing cycle ("junk interest").
    b. Residual or trailing interest (a practice similar to double-cycle billing).
    c. Application of finance charges from the transaction date, rather than the posting date.

3. Unfair and abusive fees, including:
    a. Failure to provide an ability to opt-out or opt-in to overlimit spending.
    b. Multiple overlimit fees in a single billing cycle.
    c. Penalty interest rates that bear no relation to actual or anticipated damages from late payment.
    d. Fees or cancellation of cards for on-time payment or payment in full, or fees for non-use of a card.
    e. Card cancellation fees.
    f. Pay to pay fees.
    g. Currency conversion fees unrelated to actual costs.

4. Inadequate disclosure, including:
    a. Use of non-standard definitions for terms like "Prime Rate" and "Fixed Rate."
    b. Failure to disclose the time and cost to payoff by making minimum payment (a problem that your Minimum Payment Notification Act, S.131, addresses).

5. Predatory lending practices, including:
   a. Lending without suitable investigation of the borrower's reasonable ability to repay in full in reasonable time period.
   b. Aggressive solicitation and issuance of cards to financially vulnerable populations, including college students.

The failure of the December 2008 UDAP regulations to address many problematic practices in the card industry means that the regulations will not help consumers manage their credit card debt responsibly, and that the card industry will still be given broad latitude to engage in abusive lending practices.

My larger concern about the new card regulations is that they will do little good in the long run. While a number of specific egregious practices are prohibited, this prohibition only comes years after these practices became widespread; federal banking regulators have historically shown no interest in regulating card practices. The December 2008 UDAP regulations are the first in nearly a quarter century. Since 1985, there have been no new UDAP regulations for credit cards, even as the market has changed and developed.

The card industry has every incentive to develop new ingenious tricks and traps to wire around the new UDAP regulations. The card industry has shown that it is capable of doing this before—when interest rates were subject to usury laws, card issuers simply shifted the cost of cards to annual fees and interchange fees. The card issuers realized that they could do better shifting from annual fees to back-end fees and cranking up interchange fees on merchants, who just pass the fees on to consumers. I have little faith that federal banking regulators will manage to keep pace with industry innovation in the future. Therefore, I fear that any regulatory initiative that focuses on banning specific practices *A, B,* and *C* will at best result in a Pyrrhic victory for consumer protection. The card industry will simply invent new practices *D, E,* and *F* that accomplish the same or worse.

To address this problem the regulatory paradigm of "disclose, disclose, disclose, and do whatever you want except for *A, B,* and *C*" needs to be flipped on its head. The better regulatory solution is to prohibit all card fees and billing practices except for *X, Y,* and *Z.* A simplified price structure would help consumers comparison shop between cards and use credit more responsibly, and it would prevent against negative innovation to end run regulations.

While this method of regulation would potentially stifle positive innovation, it is important to recognize that little innovation in the card industry has been entirely positive for consumers. In any case, concerns about innovation can be dealt with by vesting a new federal financial product safety commission with the power to grant regulatory exceptions to account for product innovations that help consumers.

The December 2008 regulations do not go far enough in dealing with current unfair and abusive practices, and, more importantly, they do not represent a long-term solution to unfair and abusive credit card acts and practices. They only way to help consumers manage their card debt more responsibly is to move away from a regulatory system based on disclosure and UDAP regulations to one that permits card issuers to charge whatever they want, but within a simplified, transparent, and standardized product price structure.

ANSWERS SUBMITTED FOR THE RECORD BY PROFESSOR MARK SCARBERRY IN RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY SENATOR JEFF SESSIONS

1. Question: *Some criticize the means test as "subject to being gamed" by "strategic debtors." For example, there are arguments that debtors "game the system" by reducing their current monthly income or increasing their household size in order to have the ability to file under Chapter 7. Rather than disregarding the means test completely, which is what this bill will essentially do, what suggestions do you have for how we can tighten up the means test to prevent this kind of opportunistic bankruptcy planning by debtors?*

Response: One reasonable approach to manipulation of income levels would be to give the bankruptcy judge discretion to find that "current monthly income" as defined in 11 U.S.C. § 101(10A) does not appropriately measure the income reasonably available to the debtor. In such a case, the judge could be permitted to determine the amount of monthly income reasonably available to the debtor at the time of, or shortly after the time of, the bankruptcy filing. Thus, if a debtor who had been out of work for a year obtained a good job shortly before filing a bankruptcy petition, the court could find that "current monthly income"—the average of the six months' income prior to the filing—was not representative of the income reasonably available to the debtor and could instead require that the debtor's monthly income from the new job be used in the means test. By the same token, however, a debtor who lost his or her job shortly before filing for bankruptcy, and who at the time of the filing had poor prospects for obtaining similar employment, probably should be able to ask the court to find that current monthly income as defined in the Bankruptcy Code would substantially overstate the income reasonably available to the debtor.

Here are examples to illustrate this approach. Debtor A had been without work for a year but obtained a job paying $10,000 a month, and then one month later filed a bankruptcy petition. The section 101(10A) "current monthly income" for Debtor A would be $10,000 divided by six, or $1,667, which substantially understates his ability to pay debts. By contrast, Debtor B lost her $6,000 per month job two months before filing a bankruptcy petition and had been unable to find work despite strenuous efforts. The section 101(10A) current monthly income for Debtor B would be $24,000 divided by six, or $4,000, which substantially overstates her ability to pay debts.

With regard to household size, courts could be given explicit authority to require that additional household members be disregarded for purposes of the means test on a finding that the debtor caused his or her household size to be increased with the intent of affecting the application of the means test.

My preference, however, would be for the means test to be substantially simplified, with debtors whose likely future income exceeded a particular amount, or the value of whose exempt assets exceeded a particular amount, being required to make some payments on debts. For example, a debtor whose reasonably available

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income, as determined by the court, exceeded 150% of median income for the debtor's state, or the value of whose exempt assets exceeded $200,000, could be required to make such payments.

2. Question: *There are some arguments that S. 257 will create a new gaming of the system if it becomes law. For example, imagine the scenario of a prospective filer taking out a small, high-interest-rate loan for the express purpose of getting into Chapter 7, rather than Chapter 13, and thus avoiding any obligation to repay from future income. Is not this a loophole that would provide hundreds of new customers for the very lenders the bill claims to target, harming the people this bill seeks to help?*

Response: I would agree that there could indeed be gaming of the system in this way. Some debtors with substantial ability to repay debts may, for example, have credit cards on which the interest rate for cash advances would exceed the limit set by S. 257. Such a debtor could take a small cash advance and thus obtain an exemption from application of the means test. (I have good credit and pay credit card balances in full each month; nevertheless the interest rate for cash advances on my airline miles Visa card exceeds the limits set by S. 257.)

3. Question: *Regardless of one's overall view of the means test, you raise an interesting point that the Consumer Credit Fairness Act "creates a lottery in which some debtors receive an exemption from the . . . means test but others do not." Is it appropriate that some creditors will be harmed by exempting a consumer with one high interest loan from the means test?*

Response: I do not believe it is appropriate. The existence of one small debt with an interest rate higher than the limit set by S. 257 would allow the debtor to escape application of the means test even if the vast bulk of debt owed by the debtor did not carry such a high interest rate. Another debtor with the same income, expense, and debt levels would be subject to the means test, simply because that debtor did not owe such a small high-interest rate debt. Creditors of the two debtors would then be treated very differently in their debtor's bankruptcy, simply because of the happenstance of the existence of such a small high-interest debt. Note that almost all of the creditors who would thus be denied whatever benefit they might obtain from application of the means test would have had nothing to do with charging interest rates above the limits set by S. 257.

4. Question: *In your written testimony you stated that "[u]nfortunately, S. 257's approach is unlikely to have any substantial effect on the conduct of credit card companies." I would also assume that this applies to all similar lenders too.*

    - *Can you elaborate on this statement?*

- *Why will lenders not lose much by charging high interest rates that will ultimately trigger a disallowance of their claims?*

Response: The typical consumer bankruptcy case is a "no asset" or "nominal asset" case in which no assets are available to pay any value on unsecured credit card debt or other unsecured debt. Most or all assets of most consumer debtors are fully encumbered in favor of secured creditors, are exempt, or are excluded from the bankruptcy estate, and thus are not subject to being used to pay unsecured creditors. In such a case the unsecured creditor loses nothing if the creditor's claim is disallowed, as would be the case under S. 257 for certain high interest rate debts. In fact, creditors are told by the court not to even bother filing proofs of claims in such cases.

These cases make up about 95% of chapter 7 cases and even a higher percentage of consumer chapter 7 cases (as opposed to business cases). See, e.g., Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill*, 44 SANTA CLARA L. REV. 1065, 1089 n. 128 (2004) (citing the 1997 Report of the National Bankruptcy Review Commission); Benjamin F. Davis, IV, *Before the Law Sits a Gatekeeper: Finding Brilliance in the Attorney Liability Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act*, 23 EMORY BANKR. DEV. J. 285, 303 (2006); Kathleen Farrell-Willoughby & Laura Brundage, *Pro Bono Representation Helps Meet Needs of Pro Se Filers*, 25 AM. BANKR. INST. J. 44, 76 (September 2006) (citing statistics showing that 98% of chapter 7 cases filed by individuals in the Southern District of New York from July 1, 2003 to June 30, 2004 "were deemed no-asset cases"); Teresa Sullivan, Elizabeth Warren & Jay L. Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STANFORD L. REV. 213, 227 n. 46 (2006) ("Almost all consumer bankruptcies are 'no asset' cases, with nothing available to be sold to pay creditors, primarily because of security interests, taxes, and exemptions."); Elizabeth Warren, *What is a Women's Issue? Bankruptcy, Commercial Law, and other Gender-Neutral Topics*, 25 HARV. WOMEN'S L.J. 19, 41 (2002) ("Yet, 96.4% of all Chapter 7 cases are no-asset cases, which means there are no assets to liquidate, no money in the estate, and nothing to distribute.").

As Professor Jason Kilborn has noted, "For as long as any living person can remember, the overwhelming majority of bankruptcy cases initiated by individual debtors have produced no assets for equal distribution among creditors. Particularly in 'consumer' cases, involving no potential small business assets, the goals of asset collection and equality of distribution among creditors are all but irrelevant." Jason J. Kilborn, *Mercy, Rehabilitation, and Quid Pro Quo: A Radical Reassessment of Individual Bankruptcy*, 64 OHIO ST. L.J. 855, 865-66 (2003). "Note that debtors in both 'no asset' and 'nominal asset' cases are not penniless—exemptions allow them to shield from their creditors and retain a certain amount of property (perhaps a substantial amount) even after bankruptcy." Id. at 865 n. 59.

Since credit card companies and other unsecured consumer lenders receive little or nothing anyway in consumer chapter 7 bankruptcy cases, disallowance of their claims will cost them little or nothing. As a result, the prospect of disallowance in the event the interest rates they charge exceed the limits set by S. 257 is unlikely to influence them to lower their rates.

It might be thought that the prospect of disallowance could have more bite with respect to chapter 13 cases, in which it is sometimes thought that unsecured creditors whose claims are allowed may receive substantial distributions. However, available statistics indicate that little is paid to holders of unsecured claims in the typical chapter 13 case. In fact, the median amount paid to holders of unsecured claims in chapter 13 cases seems to be zero dollars. See Scott F. Norberg, *Chapter 13 Project: Little Paid to Unsecureds*, 26 AM. BANKR. INST. J. 1, 54 (March 2007).

The arguments made by proponents of S. 257 seem self-defeating. They argue that credit card companies do not expect to collect much in bankruptcy or in state collection actions; rather, they make their money by keeping debtors in the sweat box making payments even as the debtors fall into hopeless insolvency. The creditors who are thus targeted by the proponents of S. 257 are precisely the creditors who expect to collect little in an eventual bankruptcy and are thus precisely the wrong creditors to target with a sanction of disallowance of claims.

By contrast, a few debtors with substantial assets and incomes may have incurred debt that creditors hope with some reason will be repaid, but yet the interest rate on some of their debt may exceed the limits set by S. 257. Those debtors would then be exempted from the means test, and their creditors might be harmed by S. 257. Thus to the extent that S. 257 helps any debtors or harms any creditors, it seems to miss its intended targets.

5. Question: *I foresee a problem arising with a lender, say a credit union, which follows the rules and makes loans that are reasonable, with low interest rates, being harmed due to an unintended consequence of the Consumer Credit Fairness Act. Specifically, since a debtor with the defined high-interest-rate can avoid the means test and file Chapter 7, there is a real likelihood that the good lender may not get anything at all in bankruptcy.*

    - *Is this a fair and accurate concern?*
    - *Do you think that all creditors will play by the rules and there will be no innocent bystanders who will be harmed by this bill?*

Response: Yes, I believe this is a fair concern and that it accurately pinpoints a problem with S. 257. There are indeed likely to be innocent bystander creditors who are harmed.

A creditor, such as a credit union, may make a low interest rate loan to a debtor who the creditor believes is likely to repay the loan. This creditor is not the kind of creditor the proponents of S. 257 seek to target, but the creditor may well be harmed by S. 257. Many debtors of this sort may seek at least one cash advance—perhaps in perfectly good faith—before deciding to file a bankruptcy petition. Such cash advances, as noted above, are likely to carry interest rates exceeding the limits set by S. 257. Thus the debtor would be exempt from the means test, under S. 257, and the credit union would lose whatever benefit the means test might have provided.

The only way for the creditors as a group to preserve the benefit that the means test might provide would be for all of them to avoid charging an interest rate exceeding the limits set by S. 257. If the proponents of S. 257 are right, there are a lot of credit card companies that will try to give the debtor high cost credit and to milk the debtor for whatever can be gotten prior to bankruptcy. It only takes one bad apple to ruin the entire barrel for all the creditors.

It is not clear that the means test in fact provides much assistance to creditors. I will not rehash the argument over that issue. But to the extent it makes sense to have a means test, it makes little sense to deny creditors the benefit of it just because one of them charged a high interest rate.

6. Question: *There was testimony at the hearing that the Consumer Credit Fairness Act is neither a usury law nor a "de facto usury cap." I agree that this is not an actual usury law, but I do think that its practical effect is very similar to a national usury law. The argument was made that the Act would create a disincentive for making high-interest-rate loans, while not regulating consumer credit. However, this bill will regulate consumer credit.*

    - *Do you not think that a basic economic principle will emerge that there is a risk some reputable banks will choose not to lend to some borrowers because of this bill?*

    - *Do you agree that Congress has the power to prohibit high cost consumer credit, without making changes to the bankruptcy code that will have undesirable economic consequences?*

Response: Yes, I believe there is a risk that reputable banks may choose to restrict lending, where a debtor with eyes wide open is willing to pay a rate which may be reasonable in light of the risks but that exceeds the limits set by S. 257. For example, if I ran into a short term cash crunch, I would be happy to that cash advances are available to me under the Visa card noted above, even though the interest rate exceeds the limits set under S. 257. If I then had unexpected trouble repaying the cash advance and ended up in bankruptcy (perhaps due to illness), the card issuer would have its claim disallowed under S. 257, and it would not receive the substantial dividend in my bankruptcy that it might otherwise expect. I suppose that prospect might lead reputable banks and other credit card

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issuers to restrict the availability of cash advance lines of credit to creditworthy customers. That would seem to be an unintended side-effect of S. 257.

In addition, Congress might wish to consider the history of the regulation of high cost mortgages under the Home Ownership and Equity Protection Act of 1994 (HOEPA). The labeling of some mortgages as high cost as a matter of federal law, and the onerous regulation of such mortgages, has caused reputable lenders to avoid issuing such mortgages, perhaps partly to avoid being seen as the kind of lenders who make such disreputable kinds of loans. It is possible that a similar reputational effect might cause reputable lenders to avoid granting credit with rates higher than the limits set by S. 257, even where the availability of such credit might be beneficial to borrowers with good credit ratings and substantial assets.

And yes, I do agree that Congress has the power under the Commerce Clause to prohibit high cost consumer credit. To the extent that Congress wishes to do so, it makes more sense to do it directly, rather than to amend the Bankruptcy Code in a way that is not likely to have the desired effect and is likely to have unintended and perhaps undesirable consequences.

QUESTIONS FOR THE RECORD FOR DAVID C. JOHN
SUBMITTED BY SENATOR JEFF SESSIONS

1. There is an argument by some that the Consumer Credit Fairness Act will not reduce the availability of credit for any class of borrowers. Do you agree?

    - In this economy, do you think it would be wise to make credit even harder for borrowers to obtain?

    - Wouldn't that likely prolong our recession?

2. There are some lenders who, allegedly, charge high interest rates with complete disregard as to whether the borrower will ever pay back the loan. Thus, the institutions that will likely continue to loan to high risk or low income borrowers will probably not be the good actors in the industry. The good actors will lower their rates to avoid losing money in bankruptcy court, but they will also deny a lot of credit applications. One unintended consequence of this bill could be that some lenders will take full advantage of the fact that the market is now exclusively theirs – the reputable banks have left the field – and they will charge even higher rates.

    - Is this a fair and accurate concern? Do you agree?

3. In your written testimony you cited a recent article that studied payday lenders and found that some consumers may be better off with the presence of high interest lenders than they are without them. Specifically, the authors concluded that when payday lending in Georgia was banned in May 2004, as compared with households in states where payday lending is permitted, households in Georgia had bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at a higher rate.

    - If we take the results of that study and apply them to this bill, recognizing there is a real likelihood that some borrowers will not be able to obtain credit, is it accurate to state that the borrowers the bill is trying to help will in fact be harmed?

4. At the hearing, an argument was made that some creditors choose to lend at exorbitant rates, making "a gamble that for every few consumers who are crushed under the burden of the high-interest-rate debt another will somehow manage to pay it off, making the overall venture profitable." One of the goals of the Consumer Credit Fairness Act is to create a disincentive for lenders to make these kinds of loans. If there is a business model in existence as I just described, what in this bill will prevent these lenders from taking advantage of the system and further squeezing borrowers, perhaps now cut off from reputable lenders? How will this bill provide a disincentive these kinds of loans?

SUBMISSIONS FOR THE RECORD

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March 23, 2009

The Honorable Sheldon Whitehouse
Chair, Senate Judiciary Subcommittee on
Administrative Oversight and the Courts
Washington, D.C. 20510

The Honorable Jeff Sessions
Ranking Member, Senate Judiciary Subcommittee on
Administrative Oversight and the Courts
Washington, D.C. 20510

Dear Chairman Whitehouse and Senator Sessions:

On behalf of the members of the American Bankers Association, we respectfully request that this letter be made part of the record for the Senate Committee on the Judiciary, Subcommittee on Administrative Oversight and the Court's March 24 hearing on S. 257, the "Abusive Credit Card Practices and Bankruptcy".

Our nation is facing its greatest financial crisis in years, perhaps since the great depression. The credit markets are tight due to increased lending risks, and it is absolutely the worst time to exacerbate our financial problems by enacting changes to the bankruptcy laws that would further contract credit. Should the bankruptcy laws be amended to make it easier to wipe out credit card debt, as has been proposed by this bill, the market response would simply be to restrict credit, raise interest rates and fees or both. This would significantly hurt tens of millions of Americans at the very time they can least afford it. We would strongly urge the Senate to reject such an initiative.

A 2006 study by the General Accountability Office (GAO) found that about 20% of credit card accounts from the top six issuers had interest rates of more than 20 percent[1], reflecting the higher risk posed by such borrowers. This means that out of about 390 million credit card accounts, 4/5ths have lower rates but 1/5th – approximately 78 million accounts – have rates of more than 20 percent. S. 257, by undermining the ability to collect on a credit card or other loan in bankruptcy with an APR (including transaction costs and fees) that is a little over 18% at today's rates, would cause most of these loans – more than 78 million – to not be made. Credit would be denied to millions of Americans when they need it the most.

Credit card debt is not a major cause of bankruptcy. A 2006 study conducted by the Federal Reserve Board at the direction of Congress found that the reasons for filing bankruptcy are complex and tend to be driven by unforeseen events

[1] Follow this link for the GAO report: http://www.gao.gov/new.items/d06929.pdf

such as job loss, divorce and uninsured illness, and that there is **no direct link** between increased use of credit cards and the rise in consumer bankruptcy filings.

There is no doubt that bankruptcy filings have increased recently. But, this is the result of problems in the mortgage market and deteriorating economic conditions rather than credit card debt. In fact, credit card debt loads have always been a small portion of consumer debt (3.5%, according to the 2007 Federal Reserve Survey of Consumer Finances), and increases in credit card debt are reflective of consumer financial needs and not a primary cause of bankruptcy. In these tough economic times, credit cards are a ready source of credit that can act as a bridge for millions of families and paid back over time, and are thus a benefit to consumers rather than a liability. We believe that embracing a policy that unintentionally eliminates such a benefit should not be pursued.

We recognize that our nation faces serious economic challenges and want to work with you to assist consumers. However, enacting changes to the bankruptcy laws that would inject more risk and uncertainty into the credit markers by undermining consumer debt is exactly the wrong thing to do at this time.

Sincerely,

Kenneth J. Clayton

Testimony of Douglas Corey
Hearing on "Credit Cards and Bankruptcy"
Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
March 24, 2009

Chairman Whitehouse and Ranking Member Sessions, thank you for the opportunity to testify today about my experience with my credit card lender.

I am a victim of the predatory credit card banking practices that punish honest citizens who work hard every day to make an honest income, pay off their debt, and take care of their families.

I have had a Bank of America credit card for 6 years and I can't remember missing a payment in that time span. During most of this period I received an interest rate of 12.74 percent, and although it was tough making the payments, I did. I set up an automatic monthly payment of $100 to pay down the principal, and each month when I received my bill, I paid the minimum payment.

In August of 2008 I was on vacation and inadvertently paid less than my minimum payment. The following month, I misread my credit card statement. One line on the bill said "minimum payment;" another said "pay this." I paid the minimum payment, which was about $125 less than the amount on the line that said "pay this."

With my next statement in October 2008 came the devastating news that my interest rate had skyrocketed to an astonishing 28.99 percent. I went from paying $360 in interest to $792 in one month and I was charged a $39 late payment fee. The following month, I was laid off from my sales representative position of seven years.

Once I realized my rate had increased I immediately called Bank of America and was repeatedly told that nothing could be done to my rate until I made the minimum payments for 6 consecutive months. In December I called again and at this time they credited my account $759.23 in interest.

In January I called again, but the outcome was much different. I was told no discount could be given again but was offered the chance to increase my credit limit for a service fee of over $150 a month. I asked the representative why would I do such a thing? She said to "help pay for any expenses I may have."

Several weeks later I called Bank of America, only this time they sent me to a rate adjuster who asked me several questions, one of which was my current work status. With a great deal of embarrassment I explained that I was "unemployed." He then suggested giving me back $10,000 I had paid in October of 2008, effectively raising my balance by that amount. I explained to him that this would mean I would be paying 28.99 percent on ten thousand more dollars, which would cause my payments to climb well over $1,000 a month and would put me further into debt.

His second option was to create a long-term loan. He explained that he couldn't tell me the rate and terms unless I agreed to the long-term program first. He also explained that my account would be temporarily closed, and once I paid the loan off my account would be reinstated. I expressed my concern over the effect this would have on my credit rating and he suggested it would be fine over time.

I asked him why Bank of America was still offering me 3.99 percent on debt transfers but was imposing such lethal punishment on those of us who have been keeping them in business for years? He had no answer. I worried that the credit rating I had worked so hard for over the years could be lost.

As of March 13th I had made 6 consecutive minimum payments. On March 18th I enthusiastically called Bank of America, and was told that my reward for making my payments was a $13,000 reduction in my line of credit. The rate adjuster explained that he would have to do so because I was unemployed. I told him I was on the brink of starting a new position in the upcoming weeks. He told me that he would call me at that time to see if I had actually started working and what my new compensation was.

He went on to say he could offer me a rate of 24.99 percent, but if he did, it would confuse the computer from "automatically adjusting my rate back from my default rate." He said if he didn't change my rate now, I potentially could get a lower rate in the coming weeks. I asked whether my rate would be 12.74 percent, and he reiterated that he could not tell me what the rate would be. I told him this was frustrating because I had been assured that if I paid for six consecutive months, my interest rate would go down.

With pride I can tell you that for the last 19 years I have never missed a credit card payment or auto payment. In 1994 I became a proud homeowner and was living the American dream. Since becoming a homeowner I have made every mortgage payment up until this year. That all changed 7 weeks ago. I have to admit that for the first time ever I missed my mortgage payment. Fortunately last Tuesday I was able to make up the missed payment, but I am still catching up. As a responsible single father I quickly restructured my home budget and my spending, and I proactively began contacting my debtors to inform them of my situation and to negotiate an amiable resolution.

Senators, I find myself in the same circumstances that many parents are facing today: few job prospects, a stack of bills and the challenge of facing off against financial goliaths. There are many of us in the middle class (the unemployed) who may have overstepped our budgets but although we struggle to make our payments, we make them.

Bank of America has come before you asking for help, understanding, and, with both hands open, for financial support. Yet when we the consumers go to these institutions looking for the same help, understanding and financial support, we get roughed up and receive no compassion. Rather then negotiating, banks are preying on those of us who have been weakened by circumstances beyond our control. Banks realize that they are holding all the cards and that the consumer is powerless to negotiate with them.

As a salesperson I understand the importance of making a profit, and banks are entitled to make a profit, but what is enough? Over the last six months I have paid a staggering $1600 dollars more in interest versus what I would have paid at 12.74 percent. Their policies and actions are having a devastating effect on consumers that are hardest hit by our country's economic hardships.

Last week I was asked to come here and tell my story. I'm not here asking for anything for myself, I'm simply asking to stop the greed that is fueling banks' predatory behavior. Consumers are looking to you for leadership and to wage war against this greed that has taken over corporate America. My hope is that you will consider some form of legislation that levels the playing field and empowers consumers to negotiate with these institutions' strong arming tactics.

Thank you for your time.

WRITTEN TESTIMONY OF HONORABLE ROSEMARY GAMBARDELLA
United States Bankruptcy Court for the District of New Jersey

"Abusive Credit Card Practices and Bankruptcy"
Hearing of the Senate Judiciary Committee's Subcommittee on Administrative Oversight and the Courts

March 24, 2009

Chairman Whitehouse, thank you for inviting me to speak before this Subcommittee on the important subject of abusive credit card practices and their relationship to bankruptcy.

My testimony will address the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"); the sweeping changes it made to the Bankruptcy System, including its goals, the restrictions it placed on a consumer debtor's ability to file for bankruptcy and in particular, its impact given the current economic crisis. In addition, I will also discuss the historical context of bankruptcy as an available form of relief premised upon an assumption of a balanced system, which places debtors and creditors on equal footing. In this context, I will comment on the impact of high cost credit on consumer bankruptcies, the function of the proposed "Consumer Credit Fairness Act" (S.257), and end my testimony by offering some of my own observations and experiences over the last 20 plus years as a bankruptcy judge.[1]

I) BAPCPA

BAPCPA was implemented on October 17, 2005. With this legislation, Congress "substantially rewrote the Bankruptcy Code" by significantly raising the hurdle for consumers to

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[1]I wish to acknowledge the assistance of my law clerks, Adam Glanzman, Esq. and Anthony E. Hope, Esq., Jeanne Naughton, Esq., Staff Attorney for the United States Bankruptcy Court for the District of New Jersey, my Judicial Assistant Rosemary Paul and Jennifer A. Bosset, my judicial intern in the preparation of this written testimony.

obtain a discharge of their debts.[2] "The law placed more requirements on bankruptcy filings" and increased filing fees.[3]

A key provision of BAPCPA, and perhaps also one of its most controversial provisions, is the "means test," a test requiring an analysis of a bankruptcy petitioner's financial condition to determine whether a Chapter 7, providing for a liquidation of assets in exchange for an immediate discharge of qualifying debt, or Chapter 13, conditioning the discharge of debt upon a three to five year repayment plan, is appropriate. Specifically, the means test "involves taking an average of a debtor's past six months of regular income and subtracting typical expenses for rent, food, insurance, transportation and child support (if applicable)."[4] If there is an amount of disposable income remaining after this calculation, the debtor, under a "presumption of abuse" standard, will be required to commence a Chapter 13.[5] Debtors whose current monthly income (augmented by the current monthly income of a non debtor spouse) is at or below the applicable state median income are within a "safe harbor" and not subject to the means test.

Another of BAPCPA's modifications is the requirement that a debtor receive consumer credit counseling from an approved credit counseling provider within 180 days prior to a bankruptcy filing.[6] In addition to this prepetition credit counseling requirement, BAPCPA

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[2]Ben Woolsey, Bankruptcy law updates close loopholes in repaying debt. March 18, 2009. http:// www.creditcards.com/credit-card-news/bankruptcy-law-key-provisions.

[3]LaToya Irby, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. March 18, 2009. About.Com. http://credit.com/od.consumercreditlaws.a.bapcpa2005.htm.

[4]Woolsey, supra.

[5]Ibid.

[6]Irby, supra.

further requires that every individual debtor attend a post petition course in financial management. Both the prepetition credit counseling and the postpetition financial management course are mandatory for purposes of seeking relief under the Bankruptcy Code and obtaining a discharge respectively.[7]

Other noteworthy BAPCPA provisions place a limitation on the discharge of consumer debt, in particular credit card debt. Under the revised Code, cash advances totaling more than $825 on a credit card within 70 days of filing are presumed to be non-dischargeable. In addition, charges of luxury goods or services totaling more than $550.00 on a credit card within 90 days of filing are presumed non-dischargeable. [8]

Moreover, it also extends the statutory proscription on successive or "serial" bankruptcy filings and elongates the period of time that a bankruptcy filing is reflected on a consumer's credit report from 7 to 10 years.[9]

Proponents of BAPCPA- among them the banking and credit card industries, car and mortgage loan lenders- advocated that by setting the bar higher for people who could file bankruptcy, the legislation would discourage bankruptcy petitions submitted in an attempt to abuse "the system by deliberately running up [credit card] debt and running away from repayment obligations through the bankruptcy process."[10] Conversely, consumer advocates

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[7]Credit Woolsey, supra.

[8]http://www.davelima.com/Blog/bid/5586/It-s-Alive-Chapter-7-Bankruptcy-After-BAPCPA

[9]Connie Prater, Bankruptcies creeping upwards as economy sours. March 18, 2009. http://www.creditcards.com/credit-card-news/bankruptcy-law-third anniversary.

[10]Ibid. See also Woolsey, supra.

strenuously opposed BAPCPA by noting that "the vast majority of people filing for relief under the Bankruptcy Code are not abusers, but families in serious financial trouble due to illness or divorce. Amending the Bankruptcy Code to make it more difficult to resort to bankruptcy, they contended, would create more stress and suffering for [middle class] families by delaying debt relief." [11]

II) The Historical Context of Bankruptcy

The current system of bankruptcy law, as it concerns individual bankruptcy filings, can be assessed in terms of three central bankruptcy concepts: liquidation (as embodied by Chapter 7), rehabilitation (symbolized by Chapter 13 and less often Chapter 11) and the discharge or forgiveness of debt.[12] These concepts trace their roots directly to the Bible.[13] For instance, the Bible "makes it clear that people are generally expected to pay their debts. Leviticus 25:39."[14] "However, this moral and legal obligation to pay just debts must be balanced by such considerations as the need for compassion" for the poor, preservation of the family unit, and the call to cancel debts at periodic intervals. Deuteronomy 15:1-2, 7-10.[15] As these statements reveal, the quest to arrive at the perfect balance between compelling persons to repay their debts

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[11]Ibid.

[12] David A Skeel, Jr., Debt's Dominion, a History of Bankruptcy Law in America. Princeton University Press, Princeton, U.S.A. (2001) at 7.

[13]See Discharge Hearing conducted by the Hon. Vincent J. Commisa, Chief Judge, United States Bankruptcy Court for the District of New Jersey (June 13, 1985). (Exhibit attached).

[14]Brett Weiss, Bankruptcy and the Bible. January 28, 2007. http://www.bankruptcylawnetwork.com.

[15]Ibid.

and society's obligation to forgive debt and to provide debtors with a "fresh start" has existed since ancient times. It is this healthy tension that has fostered the development of the bankruptcy laws in this country from the early days of bankruptcy referees to the present. It is also the pendulum responsible for BAPCPA as well as the Consumer Credit Fairness Act, the very Act which is the subject of this Senate Subcommittee's Hearing.

(II) BAPCPA's Impact

A) Increase in Bankruptcy Filings.

The implementation of BAPCPA on October 17, 2005 followed a spike in bankruptcy filings approaching 2 million. Post BAPCPA, filings then fell to a low of 617,000 cases in 2006.[16] Overall, in 2007, the proportion of debtors filing a Chapter 7 petition accounted for 60%, of all consumer cases, down from more than 71 % in 2003, while Chapter 13 bankruptcies have increased from 29% in 2003 to 39% in 2007.[17]

In spite of the numbers above, which could be interpreted to show BAPCPA's effectiveness at staving off bankruptcy filings and preventing perceived abuse, the number of bankruptcy filings began to once again increase in 2007 and to continue to climb upward in 2008. Throughout 2007, more than 850,000 bankruptcy petitions were filed.[18] During 2008,

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[16]Prater, supra.

[17]Ibid.

[18]Ibid.

filings in the U.S. bankruptcy courts rose 30% over the previous year to a total of 1,042,993.[19] The September 2008 filings are the highest of any 12 month period since the 2005 implementation of BAPCPA, when there were 1,112,542 filings in the 12-month period ending September 30, 2006.[20]

According to the latest statistics released by the Administrative Office of the United States Courts, Chapter 7 cases accounted for 65% of all cases filed in 2008, compared to 60% in 2007. Chapter 7 cases rose 40% to 679,982. Chapter 13 filings rose 14% to 353,828. During 2008, filings by debtors with predominantly nonbusiness debts, which accounted for 96% of overall filings, rose 30 % to 1,004,342.[21]

Impact of high interest credit on Bankruptcy

High cost consumer credit generally comes in the form of credit cards, payday loans, student loans, refund anticipation loans, and subprime mortgages. For the purposes of my testimony, I will focus on the impact of high interest credit cards.

At least one study has found that nearly sixty percent of credit card holders do not pay their bills in full every month.[22] It has been reported that the average interest rate for standard

[19]U.S. Courts. News Release. Workload of the Federal Courts Grows in Fiscal Year 2008. March 17, 2009. http://www.uscourts.gov/Press_Releases/2009/caseload.cfm

[20]Ibid.

[21]Ibid.

[22]Michael S. Barr, *An Inclusive Progressive National Savings and Financial Services Policy*, 1 Harv. L. & Pol'y Rev.161, 174 (2007).

bank credit cards topped 19% in March 2007.[23] The Federal Reserve reported that 46.2 percent of all families held credit card balances with the average credit card balance approaching $7,300.00.[24]

In September 2006, the Government Accountability Office (the "GAO") estimated that in 2005 the number of U.S. credit cards issued to consumers exceeded 691 million.[25] The report stated that "[T]he increased use of credit cards has contributed to an expansion in household debt, which grew from $59 billion in 1980 to roughly $830 billion by the end of 2005." The report estimated that "the majority–about 70 percent in recent years–of issuer revenues came from interest charges," and estimated penalty fees to account for an additional 10 percent of total issuer revenues.[26] The report concluded that disclosures used to provide information about the costs and terms of using credit cards generally had serious weaknesses which reduced their usefulness.[27] The report stated that in 2005, about 80 percent of active U.S. accounts were assessed interest rates of less than 20 percent–with more than 40 percent having rates of 15 percent or less.[28] The GAO also estimated the average, default interest rates to be approximately

[23]Credit Card Statistics by Mark Brinker, updated February 2009. http://www.hoffmanbrinker.com/credit-card-debt-statistics.html

[24] "Changes in the U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," dated February 2009 at A38, A45.

[25]See Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate entitled *Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers.*

[26]*Id.* at 8.

[27]*Id.* at 33.

[28]*Id.* at 5.

27 percent.[29]

Professor Elizabeth Warren of Harvard Law School has conducted extensive research on the causes of bankruptcy filings. In a 2006 article published in the Stanford Law Review, Professor Warren, together with Teresa A. Sullivan and Professor Jay Lawrence Westbrook argued that "the cental characteristic of consumer bankruptcy over two decades has been increasing financial distress marked by rising levels of debt."[30] Using data from the Consumer Bankruptcy Study of 2001 of natural persons filing for Chapter 7 or Chapter 13, Professor Warren and her co-authors state that recent "debtors have substantially larger debt loads than in the previous years."[31] The authors state that "from the early 1980's to the present, Americans' debt burden compared with their disposable income has risen considerably," and note that "at the same time, increased layoffs, high divorce rates, lack of medical insurance, income volatility, and rising housing costs have left families even more vulnerable to bankruptcy."[32] Focusing on credit cards which they describe as the dominant form of lending in recent years, the authors indicate that "interest rates are often ruinous for a family with substantial credit card debt, particularly if the family had missed a beat in making on-time payments," as "the combination of late fees, over-limit fees, default rates of interest and other charges means that credit cards for

[29] *Id.* at 70.

[30] Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 Stan. L. Rev. 213, 218 (2006).

[31] *Id.* at 228.

[32] *Id.* at 249.

families in trouble may easily be running at 24% interest or more."[33] The authors speculate that "changes in the credit industry in making money available to troubled borrowers may have changed the calculus that leads to bankruptcy," as increased lending offered a way for families to delay bankruptcy, but "the interest payments increased so fast that even a small stumble meant that these borrowers would have to declare bankruptcy or literally never get out of debt."[34] This proposition was supported by a 2007 article written by Professor Robert M. Lawless published in the University of Illinois Law Review.[35]

There have many other law review articles written on the impacts of high interest credit and bankruptcy. In a 2006 article published in the Texas Law Review, Professors Susan Block-Lieb and Edward J. Janger argued that "consumers have increased their debt loads over the past thirty years because lenders have become more skilled at exploiting the biases in their decisionmaking, and not because of the details of consumer bankruptcy law."[36] Professors Brock-Lieb and Janger contend that "consumers will purchase and borrow more than rational consumers would have, and that they will be slower to react to a default situation."[37] Specifically, Professors Brock-Lieb and Janger claim that "the demise of usury law and the development of national credit reporting and credit score systems and mass marketing techniques

[33] *Id.* at 232.

[34] *Id.* at 251.

[35] See Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. Ill. L. Rev. 348, 367-368.

[36] See Susan Brock-Lieb & Edward J Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided Reform of Bankruptcy Law*, 84 Tex. L. Rev. 1481, 1563 (2006).

[37] *Id.* at 1565.

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permitted lenders to create a national market for consumer credit available to even the least credit-worthy members of society–at a price." *Id.* Concerning BAPCPA, Professors Brock-Lieb and Janger argue that it severely limits overleveraged consumer borrowers from obtaining relief in the bankruptcy system, and, in effect, rewards consumer lenders for taking advantage of consumer limitations. "[38]

In a 2008 article published in the Iowa Law Review, Professor Katherine Porter argued that the credit industry seeks to profit from financially distressed and vulnerable consumers by encouraging families to borrow after bankruptcy.[39] Professor Porter hypothesizes that postbankruptcy debtors are marketed credit cards offers, unsecured loans, car loans, second mortgages and live checks since "postbankruptcy families cannot discharge their debts in bankruptcy for a number of years."[40] Professor Porter suggests that "families who do not repay quickly or in full are the most profitable customers for some lending products," as "ultimate repayment may not be necessary for a highly profitable transaction."[41] Concerning BAPCPA, Professor Porter argues that "the credit card industry's lending decisions were not subjected to the same scrutiny as debtors' borrowing decisions," and that lenders were not "held to the same moral standard as debtors for evaluating the appropriateness of their financial practices." *Id.* at 1372.

In a 2006 article published in the Tennessee Law Review, Professor Rashmi Dyal-Chand

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[38]*Id.*

[39]See Katherine M. Porter, *Bankruptcy Profits: the Credit Industry's Business Model for Postbankruptcy Lending,*93 IALR 1369 (2008).

[40]*Id.* at 1374, 1420.

[41]*Id.* at 1418.

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argued that credit card borrowers do not understand the implications of borrowing on a high interest credit card, and that "borrowers rarely read the fine print in advertisements and contracts they receive, relying on the statements in bright bold letters to make decisions about which card to obtain."[42]

Analysis of Current Bill

The proposed Consumer Credit Fairness Act would disallow in bankruptcy any claims arising from a "high cost consumer credit transaction" defined as a "an extension of credit by a 'creditor (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602(f))), resulting in a consumer debt that has an applicable interest rate (as determined in accordance with section 107(a) of the Truth in Lending Act (15 U.S.C. 1606(a)), and including costs and fees incurred in connection with the extension of such credit) that exceeds at any time while the credit is outstanding, the lesser of—the sum of 15 percent and the yield on the United States Treasury securities having a 30-year period of maturity; or 36 percent." Currently, under that standard, the CCFA would apply to any interest rate higher than 18.5 percent. Additionally, the proposed Consumer Credit Fairness Act would excludes debtors with any debts arising from a "high cost consumer credit transaction" from the means test.

The articulated purpose of the 2005 BAPCPA amendments to the Bankruptcy Code was to inject balance into the adjudication of debtor-creditor rights. In fact, the myriad requirements placed on consumer debtors, including the use of means-testing, may have created substantial burdens on consumer debtors without the desired result - increased repayment of debt. It is clear

[42]See Rashmi Dyal-Chand, *From Status to Contract: Evolving Paradigms for Regulating Consumer Credit*, 73 TNLR 303, 338-339 (2006).

from experience that debtors' use of credit cards as a "family lifeline" to cover basic living expenses such as food, sustenance, utilities, health care, and tuition is a trend that is seen throughout the cases that come before our courts. The proverbial "robbing Peter to pay Paul" has resulted in spiraling debt that high interest consumer loans only exacerbate. The disallowance in bankruptcy of a specific category of high cost loans contemplated by this bill may act as a disincentive to such practices. As well, the specter of disallowance of claims in bankruptcy may encourage out-of-court settlements. The disallowance of the claims, as opposed to subordination of the claims, would also result in a greater recovery to other unsecured creditors with valid and bona fide claims. In my experience on the bankruptcy bench it must be emphasized here that bankruptcy relief is largely utilized by individuals as a last resort for legitimate, non-abusive purposes. The fresh start afforded by bankruptcy to individuals suffering under enormous debt loads, particularly in the current economic climate, is a laudable goal. The disallowance of certain high-cost credit claims will, in certain instances, substantially decrease the debt burden on debtors, increasing the prospects for successful reorganization and/or repayments through orderly liquidation to bona fide creditors.

While many debtors and their families' income fall below the applicable respective state median income levels and escape the means test, the elimination of means-testing for this category of consumer debtors would make the pathway to Chapter 7 relief more readily available. Again, to the extent that repayment is the goal - such a remedy may be an additional disincentive for predatory lending practices.

It is worth noting that while the remedies in the legislation are limited to bankruptcy filings, this involves the much broader issue of predatory lending practices that reach far beyond the bankruptcy arena.

In closing, thank you for the opportunity to testify before this Committee on these important issues. I stand ready to provide any additional information on these points to the Subcommittee that may be of assistance.

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Judge Commisa

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

FILED
JAMES J. WALDRON, CLERK
JUL 9 1985
U.S. BANKRUPTCY COURT
DISTRICT OF N.J.
BY JANICE ZARILLO, DEPUTY

IN THE MATTER OF: :

DISCHARGE HEARING

Transcript of Proceedings

Thursday, June 13, 1985
Courtroom "A"
Federal Building
Newark, New Jersey

B E F O R E:

THE HONORABLE VINCENT J. COMMISA
United States Bankruptcy Judge

Reported By: Lynn Sansone
Certified Shorthand Reporter

WAGA and SPINELLI
Certified Shorthand Reporters
405 Northfield Avenue
West Orange, New Jersey 07052
(201) 731-9666

THE COURT: Good morning, I'm Judge Vincent Commisa, Judge of the Bankruptcy Court for the District of New Jersey.

This is a Section 521 hearing convened in accordance with the provisions of the Bankruptcy Code, which requires your presence and requires me to be here to explain to you the effect of your discharge in bankruptcy.

Before I get into my presentation, let me apologize to you, because I'm sure that much of what I'm going to say to you has been covered by your attorney and you will have to bear with me because, as I stated earlier, the statute require me to make this presentation to you.

You have been, or should have been, supplied with two documents, two forms. The first of which is entitled Waiver of Appearance of Counsel. That form merely requires your signature and it excuses your attorney from being present at this hearing.

The second one is entitled Reaffirmation Agreement, and I will address myself to that later on in the hearing.

One of the reasons requiring you to be present, is to impress on you the fact that the proceedings you have gone through are not administrative, but they are judicial in nature. So, your appearance is required here in the presence of a Judge. It is probably the first time that you have been in the presence of a Judge throughout all of these proceedings These are judicial proceedings.

A discharge in bankruptcy relieves you of the legal obligation to repay debts that were incurred before you filed your Petition in Bankruptcy, and were listed in the Schedule of Debts attached to the Petition in Bankruptcy.

So, there are two requirements that must be complied with. The first, is the debt has to be incurred before you filed the petition. The second requirement, is it must be listed in the Schedule of Debts. So you see, if you incur a debt on December 28, 1984, you file a petition on January 4, 1985, you do not list that debt in the Schedule of Debts, it is not discharged.

But, if it is listed in the Schedule of Debts, it meets the two requirements and it is discharged.

In the same vein, you file a Petition in Bankruptcy on January 4th. You list in the Schedule of Debts a debt that you intend to incur five days later, January 9th. That debt is not discharged. It was incurred after the petition was filed.

So, there are two simple requirements. The debt must have been incurred before the date the petition was filed and must be listed in the Schedule of Debts.

Excepted from all that I have to say today are certain debts which are listed in Sections 523 and Sections 725 of the Bankruptcy Code. Those sections deal with denial of a discharge in the bankruptcy or the nondischargeability of a particular debt.

They include such debts as alimony. Those debts are never discharged. Support and maintenance, they are never dischargeable. Debts secured through the use of a false financial statement. They are not dischargeable. Debts incurred through the use of false representations, false pretenses. Debts incurred for student loans, et cetera, et cetera.

Those areas are not subjected to the conditions that I am going to lay forth to you in my presentation.

In any event, as I stated earlier, a discharge relieves you of the legal obligation to repay those debts. One important thing that you must remember. If you forget to list a debt in the Schedule of Debts, it is not dischargeable and then you are legally obligated to pay.

One of the problems we have to deal with that arises with increasing frequency, is that after you receive your discharge in bankruptcy some of your creditors, whose debts have been discharged in bankruptcy, continue to make efforts to collect on those debts.

They will start a suit on the debt. They will try to execute on a judgment they have received. They will try to attach your salary. Try to execute on your automobile or other properties that you have, all concerning themselves with a debt that has been discharged in bankruptcy. A debt that meets the two criteria set forth.

In most of the cases, when you advise a creditor that that debt has been discharged in bankruptcy, they will cease and desist. They will stop all of these. The problem that arises that is of interest to you, is when you get a creditor who doesn't care about your discharge in bankruptcy, doesn't care that you have been granted this relief by a federal statute. That person's mind is made up and they intend to collect on their debt regardless of whatever happens.

They will engage in all of these procedures that I have set forth.

When you are confronted with that type of illegal activity on the part of a creditor, and remember this intent is to drive you up a tree and force you into a state of mind where you say, it is better that I pay that debt off rather than to hire an attorney to protect my rights and bring an action against that creditor. Your thought is that I'm spending more money and I'm pouring in good money after bad.

Well, you don't have to take that attitude any more because Congress, in Section 524 provides that if you are subjected to these illegal collection efforts you may retain the services of an attorney, hire him to bring an action in this Court and seek a judgment providing (a), a Contempt Order against that creditor, which usually means a fine; and (b) an injunction against that creditor preventing him from engaging in these illegal collection efforts.

And (c), most important, a judgment assessing counsel fees and costs against that creditor. So you see, it will not cost you any money to hire an attorney and to incur legal costs to protect the rights you received in your bankruptcy proceedings. Keep that in mind, and in any event, you should be readily able to ascertain whether or not your debts have been discharged in bankruptcy if you have a copy of the Schedule of Debts attached to your petition. Ask your attorney to supply it to you and keep it available with all your other papers.

Let me repeat, if you are subjected to illegal collection efforts, you don't have to worry about spending money or attorneys' fees and costs. They may be and will be assessed against the creditor who has engaged in these illegal collection practices.

We referred earlier to another document that you were supplied with and it refers to Reaffirmation Agreements. Reaffirmation Agreements, for purposes of bankruptcy, is no more and no less than the following:

It is a new promise to pay an old debt that was legally discharged in the bankruptcy proceedings. I will repeat it. The Reaffirmation Agreement is a new promise to pay an old debt that was legally discharged in the bankruptcy proceedings for which you have no legal obligation to repay.

Now, how does that come about? In a variety of ways, but in 99 percent of the situations it comes about as follows:

For example, say that about three years ago, four years ago you needed an automobile to get to and from your place of employment. You went out and shopped and found a 1973, '72 or '74 Plymouth, for example. They wanted about $1500 for the car.

You didn't have the cash to pay for it, so you applied for and secured an automobile installment loan. You promised to repay it over a period of 36 months, sometimes 48 months. And you know the interest rates on those loans are high. Some rise up to as high as 27 percent. In addition, they add on all types of insurance.

You pay for a year, and you find you owe more money than you originally borrowed. Well, you start making those payments. You have the car that you needed to get to and from your place of employment. You are making the monthly payments and you gave them a lien on this car, and that lien is reflected in the upper left-hand corner of your Certificate of Title.

Part of the agreement was that if you missed on your monthly payments or you defaulted on them, they would have the right to reclaim the car. Well, you make payments for about a year, year and a half and all of a sudden, you hit on bad times, which eventually lead to your filing the Petition in

Bankruptcy.

You list the debt remaining, which is still about 16, 1700 because most of what you paid went to interest. You list the debt. You file your petition. The debt, which is 16 or 1700 is discharged in bankruptcy because it meets the two tests I gave you. It was incurred before you filed the petition and you list it in the Schedule of Debts.

However, because they are secured creditors they have a right to reclaim the automobile. The debt is extinguished and they have the right to reclaim the car.

That doesn't help you, because you still need a car to get to and from your place of employment. You find that your credit is at an all time low. You are in bankruptcy proceedings. You decide that you want to enter into a Reaffirmation Agreement, keep the car, continue to make the monthly payments. You know what they are. You know what the car is, so you enter into a new agreement to repay an old debt with a 15 or $1600 balance that was legally discharged in the bankruptcy proceedings. It is just that simple.

Congress gives you that right. It does impose on the Court the duty to examine the Reaffirmation Agreements and to approve them only if they don't create a hardship on you and your dependents and are in your best interests.

In the example I gave you, the Court would probably deny you the right to reaffirm. It is not in your best interest to reaffirm a debt of 15 or $1600 on a car that probably is worth only about 8 or 900. That's the value of that car now.

I have given you the extreme example. In most cases the value of the car, the amount of the debt are pretty close and if they are not, the Court will listen to mitigating circumstances.

You may reaffirm debts on everything except real estate. Real estate that is covered by a mortgage.

You may reaffirm a debt on a television set, hi-fi set, living room furniture, kitchen furniture, washer, dryer, appliances, et cetera, et cetera. In all those cases, as we state, you must satisfy yourself and the Court and your attorney the amount of the debt is equal to the value of the secured property.

You must reaffirm that debt before the date of the Section 524 hearing, which is today. There is a limitation in time on it.

Don't worry if you enter into the agreement and then you have second thoughts about it. Congress has provided that for a period of 60 days after you reaffirm a debt, 60 days from the date of the 524 hearing, you may change your mind and set aside the reaffirmation if you have so decided. You don't have to worry about being forced into a decision within a certain time period.

The purpose and intent of a Bankruptcy Act and the

Bankruptcy Code, and this Bankruptcy Code and its predecessor has been in existence since 1898, Congress has stated, the Courts have stated the intent is quite clear; to give you a fresh start in life. A fresh start in life has been construed for ages as something that is necessary and is for the well-being of the individual concerned, such as yourselves and for the community.

In enacting the Bankruptcy Code, and here it is. It is quite a large volume, there is a lot of material in it. If you search from the beginning to end you will not find the word bankrupt in it, and there is a reason for that. It is not an accident.

Congress eliminated the word bankrupt and substituted in its place the word debtor. And, the reason for it is the word bankrupt has come to have a terrible connotation in the community.

You all know what I'm talking about. Somehow or other, many people in the financial and the social community who think that because you filed a Petition in Bankruptcy you are somewhat of a lesser citizen or a person than they are.

That if you file a Petition in Bankruptcy, that your moral code is all mixed up. That's a lot of hogwash. We can't do anything about the way they think. They have these ideas and they are going to have to live with them.

What concerns me more than anything else are the moral pangs of conscience that you yourself suffer because you have filed a Petition in Bankruptcy.

Because of this attitude that has existed for a long time, you begin to think there is something wrong with yourself. And as I say, these moral pangs of conscience that bother you, that upset you and indeed sometimes torture you are of a concern to me.

I'm going to take a few minutes out to talk about this in the hopes that if you are suffering these moral pangs of conscience and you are subjected to this type of abuse, maybe my words can give you some solace.

The oldest written law that this civilization has in its possession is a stone tablet. And, on this stone tablet are etched and carved the following words: "The debts of a farmer whose crops have been destroyed by snow, hale, wind or rain, are hereby forgiven."

It is the concept of bankruptcy. Forgiveness of debts for causes over which you have no control. The stone tablet goes back to the year 2079 B.C. Over 4,000 years ago.

When you hear some people talk about bankruptcy being some newfangled concept invented by some wild-eyed liberal, intended to break down the pillars of Wall Street, it is not so. The concept of bankruptcy goes back to 4,000 years, 2079 B.C.

To those self-righteous people who think there is somethi wrong with you because you filed a Petition in Bankruptcy, I invite you and them to pick up the Bible and turn to Deuteronomy, chapter 15, which provides for the discharge-ability of all debts every seven years and in the Old Testament it is called God's discharge.

So, to some of these self-righteous people who are so ready to condemn you because you filed a Petition in Bankruptcy, that religious authority should satisfy them. More important, should satisfy you if you are suffering moral pangs of conscience.

On a more secular note, go back 2,000 years to Julius Caesar. Shakespeare, Churchill and a lot of people called him the greatest man of action who ever lived. He did a lot of things. He was a great general.

If you studied Latin, you study his books. He was a great author. He straightened out the calendar.

What you don't know, is one of the reasons he was assassinated was because of his bankruptcy legislation. He eliminated all interest on all debt because he felt it was a burden on the individual and the community. Then he went one step further, and I think you would all love this, he provided for a year free rent for everybody who filed a Petition in Bankruptcy. He was the type of man who left his entire fortune to the citizens of Rome. We haven't had many like that lately.

He enacted those laws because he felt the citizens were entitled to a fresh start in life. I'm not going to go on and give you other examples of this.

Through experience, we found that our comments have been appreciated by people such as yourselves and they have relieved these moral pangs of conscience that we talk about. They are a real thing. We have files on that.

I hope my words have given you some confidence in yourself and help you give yourself a good fresh start in life.

In addition to what I have told you, remember, you may not be discriminated against for invoking the provisions of any federal statute or law.

Keeping that in mind, I have come to the end of my presentation to you. You have some idea now what your discharge in bankruptcy intends and what it does.

Again, my apologies to you because I am sure that your attorneys have told you this and I have kept you here and repeated information you are familiar with.

On a personal note, I hope I never see you again in this courtroom. I hope you have better luck in the future than you have had in the past. Go. May God bless you all.

You are dismissed.

(Whereupon the hearing was adjourned.)

CERTIFICATE

I, LYNN SANSONE A Notary Public and Certified Shorthand Reporter of the State of New Jersey, do hereby certify that the foregoing is a true and accurate transcript of the proceedings in the above-entitled matter as reported by me stenographically on the date and at the time and place hereinbefore set forth.

I DO FURTHER CERTIFY that I am neither of counsel nor attorney for any party in this action and that I am not interested in the event nor outcome of this litigation.

Lynn Sansone, CSR
A Notary Public of New Jersey
License No. XI00604

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CONGRESSIONAL TESTIMONY

S. 257, The Consumer Credit Fairness Act

Testimony before
Subcommittee on
Administrative Oversight and the Courts
Committee on the Judiciary
United States Senate

March 24, 2009

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Thank you for the opportunity to testify before you today on S. 257, the Consumer Credit Fairness Act. My name is David John. I am Senior Research Fellow at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Let me make it clear from the start that my purpose today is not to defend in any way abusive credit practices. I find them as abhorrent as those who are testifying in support of this bill, but I have strong reservations about the approach used in S. 257, and believe that it will end up making the situation for low and moderate income workers in need of credit even worse than it is now.

Unfortunately, economic literature on the economic effect that high interest lenders have on their customers is spotty, with many studies as interested in proving a point as in objective research. Activists take it for granted that there is a "debt trap" where customers of high interest lenders find themselves deeper and deeper in debt to the lender as interest rates and fees combine to make it impossible for them to repay their loans. Such a trap may well exist in both specific cases and in general. However, there is research from the New York Federal Reserve Bank[1] which suggests that the debt trap may not exist in all situations, and in fact some consumers may be better off with the presence of high interest lenders than they are without them. This paper looks at Georgia and North Carolina after payday lenders were banned, and found higher incidences of bounced checks, complaints about the collection methods of lenders and bankruptcy filings after the ban than before it. This suggests that high interest lenders meet a definite need, and raises questions that legislation like S. 257 may end up causing more problems than it solves.

The first question is who the affected borrowers would be. While it is clear from many data sources that individuals from any and all socio-economic levels can be customers of high interest lenders due to either sudden income shocks or poor financial

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[1] Donald P. Morgan and Michael R. Strain, "Payday Holiday: How Households Fare after Payday Credit Bans", Federal Reserve Bank of New York Staff Report no. 309, November 2007 revised February 2008, at:

management skills, the largest proportion of customers fall into three groups. These are low-to-moderate income workers who have limited access to other credit sources either because of low income, poor credit histories, or the simple fact that few banks and other lenders have branches that are easily accessible to these consumers. Second are first time borrowers who may have high potential to become good credit consumers, but for now have no credit history and no one willing to co-sign their loan application. Finally, there are consumers who have poor credit histories or who may have just emerged from bankruptcy, and are seeking to rebuild their credit records.

Credit products are primarily priced by the risk of the customer. Thus, customers with either poor credit histories or none at all, can expect to pay significantly higher interest rates than those with better credit records. The high interest rates cover significantly higher chance of default along with much higher collection costs. However, these high rates are usually temporary. As new borrowers demonstrate their ability to responsibly handle credit, they qualify for lower and lower interest rates, often by switching lenders. The same is true for borrowers with poor credit records who are seeking to restore their reputations.

While it may seem that this legislation will encourage lenders to reduce their interest rates to these borrowers so that they will fall below the caps in this legislation, it will not. For responsible lenders who base their interest rates and fees on the risk that the borrower will either not repay the loan or that it will require extensive contact with him or her to get payments, a very costly process, the added risk that such products will not be recoverable in bankruptcy will simply result in their withdrawing from the market. The products will become too risky for reputable financial institutions to offer.

Certain other reputable lenders will continue to offer products to these borrowers, and may even lower their fees, but they will increase the requirements to qualify for such loans in a way that will reduce the number of potential customers. The combination of higher credit standards and fewer credit providers will leave high risk borrowers with either no credit available, or force them into the hands of less reputable lenders.

Some less reputable lenders will react to the inability to recover high interest loans in bankruptcy by raising their fees even higher so that they can make their profits faster. Their customers will not find any relief from the passage of this bill. Other even less reputable lenders, who never use the legal system for collections in the first place, will be delighted if the result of this legislation is a rise in the number of consumers forced to use their services.

The sad fact is that changing the interest rates charged for high risk loans is very unlikely to change the demand for them. This is especially true in hard economic times when record numbers of Americans are already losing jobs, having their hours of work reduced, or for other reasons finding it ever harder to meet their financial obligations. At the same time financial institutions are raising credit standards so that fewer and fewer customers qualify for their lowest rate products and raising both fees and interest rates for riskier customers and in many cases cancelling the credit lines of higher risk customers. All of these actions simply serve to increase the demand for higher cost credit products.

These tighter credit standards are likely to last for some time. In addition, recent massive increases in the money supply and federal spending may result in renewed inflationary pressures, which will further increase interest rates. This is where the specific language of S. 257 could cause additional problems.

The bill's definition of "high cost credit consumer transactions" is too broad and could encompass transactions that no one regards as usurious, especially as regards "costs and fees". This would subject more lenders to having their loans disallowed when borrowers file for bankruptcy – perhaps, in some cases, to that lender's great surprise. The bill's definition specifically includes any credit transaction where the combination of interest rate and fees exceeds "at any time while the credit is outstanding" the sum of 15 percent plus the yield on 30-year Treasury bonds.

Under this definition, a traditional 30-year mortgage issued in October 1981 when mortgage interest rates peaked at an 18.45 percent annual percentage rate came under the bill's definition as a "high cost credit consumer transaction" in December of 2008, when the interest rate on 30-year Treasury bonds dropped to 2.87 percent. Depending on fees paid during closing, it may have come under the bill's definition well before then.

The bill's definition is even more stringent than that contained in the last Congress' H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, which limited its reach to loans where the rate exceeded a spread over a Treasury bond rate on "the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor." S. 257's open ended liability places any fixed rate loans made during periods of high inflation at risk of being considered as high cost credit and being inexcusable under bankruptcy.

Other areas of the bill are also troubling. By granting a bankruptcy filer "who has any debts arising from a high cost consumer credit transaction" relief from requirements that those who have sufficient income to repay some of their debts must do so before receiving a discharge. This language invites gaming of the system. A prospective filer could take out a small, high-interest-rate loan for the express purpose of getting into Chapter 7 rather than Chapter 13 and thus avoiding any obligation to repay from future income. Such a loophole would provide hundreds of new customers for the very lenders that proponents claim to oppose, some of whom might be directed to the lenders by less reputable bankruptcy attorneys. This provision effectively guts the 2005 bankruptcy reforms.

In conclusion, S. 257 is unlikely to reduce high interest rate lending. All that it is likely to do is to either make it harder for certain populations to find credit at all, or to make it even more expensive for them to do so. The sad fact is that the customers of such lenders only utilize them because those customers have no other choice. The demand for those credit services will be there no matter what the cost. This bill, which is essentially a price cap or attempted prohibition, is not likely to reduce that demand at all.

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Written Testimony of

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Before the
United States Senate
Committee on the Judiciary

Hearing: Abusive Credit Card Practices and Bankruptcy

March 24, 2009

Mr. Chairman, Members of the Subcommittee:

I am pleased to testify in support of the Consumer Credit Fairness Act, S.257, legislation proposed by Senator Whitehouse that would address abusive credit card practices.

There are five major points I wish to make in my written testimony:

1. S.257 enacts an essential principle of fairness: a creditor that causes a debtor's financial ruin should not be allowed to use the courts as a collection agency or share in bankruptcy distributions the same as innocent creditors.
2. S.257 will encourage safer and sounder consumer lending by discouraging lenders from making loans that they cannot reasonably expect consumers to repay, including "sweatbox" lending models.
3. S.257 is not a usury law, and arguments against usury laws are inapplicable to S.257.
4. By waiving the means test for consumers with high-interest-rate debt, S.257 encourages efficient bankruptcy filings, discourages strategic gaming of the bankruptcy system, and promotes the core bankruptcy principle of "equity is equality".
5. S.257 will give financially distressed consumers additional leverage to renegotiate their debts outside of bankruptcy.

I. Creditors Who Cause Consumers' Financial Ruin Should Not Be Allowed to Use the Courts as Collection Agencies

Bankruptcy courts are courts of equity.[1] Perhaps the most famous equity maxim is that "He who comes into equity must come with clean hands."[2] The clean hands maxim expresses the principle that a party should not be able to invoke the power of the courts to benefit from its own wrongdoing. This principle is age-old; in I Kings, the

[1] *See, e.g.*, Young v. United States, 535 U.S. 43, 50 (2002), United States v. Energy Res. Co., Inc. 495 U.S. 545, 549-50 (1990); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988).

[2] *See* Precision Instrument Mfg. Co. v. Auto. Maint. Mach., 324 U.S. 806, 814-15 (1945) ("The guiding doctrine in this case is the equitable maxim that 'he who comes into equity must come with clean hands.' This maxim is far more than a mere banality. It is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief, however improper may have been the behavior of the defendant. That doctrine is rooted in the historical concept of court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good faith. This presupposes a refusal on its part to be 'the abettor of iniquity.' Thus while 'equity does not demand that its suitors shall have led blameless lives' as to other matters, it does require that they shall have acted fairly and without fraud or deceit as to the controversy in issue."). The maxim is also express as "he who seeks equity must do equity." *See* Manual Enters. Inc., v. Day, 370 U.S. 478, 526 (1962).

See also Mfr.'s Co. v. McKee, 294 U.S. 442, 451-52 (1935) (refusing to apply "clean hands doctrine to void debtor corporation's high-interest-rate contract because state law did not permit corporations a usury defense).

prophet Elijah rebukes King Ahab for benefiting from the escheat of property after arranging a judicial murder: "Hast thou killed, and also taken possession?"[3]

S.257 recognizes this basic point of fairness: creditors who cause debtors' financial ruin should not be allowed to use the courts as their collection agents. The United States courts should not be enforcers for loan sharks. The Bankruptcy Code currently gives courts that power to equitably subordinate creditors who acted improperly.[4] But because equitable subordination is a discretionary remedy,[5] it is applied inconsistently. What S.257 does is to label a particular type of creditor behavior inequitable *per se* and provide for disallowance rather than subordination.[6]

High-interest-rate debt should be *per se* disallowed in consumer bankruptcy cases. While one might reasonably debate the proper threshold for what qualifies as "high-interest-rate debt," the impact of high-interest-rate debt on consumers and on other, more moderate creditors is undeniable.

A. High-interest-rate debt Contributes Substantially to Consumer Financial Distress and Bankruptcy Filings

High-interest-rate debt is financial quicksand.[7] The interest accrues faster than a consumer can pay off the loan. Not surprisingly, Professor Ronald Mann has shown that dollar for dollar, a consumer with credit card debt (often a high-interest-rate form of debt) is more likely to file for bankruptcy than a consumer with any other form of debt.[8] Even small debts at high interest rates can increase the chance of a bankruptcy filing. A study by Professors Paige Marta Skiba and Jeremy Tobacman found that a single payday loan of only $300 increases the chance of a bankruptcy filing by 2.84%.[9] High-interest-rate debt strongly correlates with bankruptcy, which suggests that it contributes to consumer financial distress and bankruptcy filings.

Consider, for example, the median consumer bankruptcy filer in 2007 with credit card debt. This median consumer had $17,513.00 in credit card debt,[10] which was 20% of the median consumer's total debt and half of unsecured debt (including taxes, rent, alimony, utilities, medical bills, and student loans). This $17,513.00 in credit card debt

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[3] I Kings 21:19.

[4] 11 U.S.C. §510(c).

[5] *See, e.g.*, English-Speaking Union v. Johnson, 381 B.R. 1 (D.D.C. 2008).

[6] Subordinated claims are still allowed and will be paid if there are sufficient funds to do so. *See* Adam J. Levitin, *Finding* Nemo*: Rediscovering the Virtues of Negotiability in the Wake of* Enron, 2007 COLUM. BUS. L. REV. 83 (2007).

[7] In the corporate debt context, high-interest-rate debt is politely known as "high-yield debt" and commonly referred to as "junk" because of the limited likelihood of repayment. "Junk debt" is not "investment grade."

[8] RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS (2006).

[9] Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* 30, *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

[10] 2007 Consumer Bankruptcy Project Database. For a description of the 2007 CBP Database, *see* Robert M. Lawless, *et al.*, *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349 (2008).

was also 65% of the median consumer bankruptcy filer's gross annual income.[11] Consumer bankruptcy filers earn less than the median American household, but the $17,513 is still over 37% of the median gross annual national income.[12] Over a year at 36% annual rate of interest, compounded daily, interest on this debt would amount to $7,584.44 or 16% of the median gross annual national income and 28% of the median gross income of bankruptcy filers. Few consumers can service that level of interest from their disposable income, let alone pay down principal.

To pay off such a loan by making minimum payments for five years, the Office of Comptroller of the Currency's recommended amortization period for credit card debt, the consumer would have to make monthly payments of $632.80. These payments would be 28% of a median consumer debtor's gross (pre-tax) monthly income, and 16% of the national median gross (pre-tax) monthly income. For a consumer who also has to pay taxes and provide basic necessities of food and shelter for her family, this sort of debt burden is near impossible. A consumer with this sort of high-interest-rate debt is on a sure path to financial ruin.

Creditors and debtors have co-dependent relationships, not unlike pushers and addicts. A creditor who is willing to set a consumer debtor down a near certain path to acute financial distress should not be permitted to invoke the power of the federal bankruptcy courts to recover from the debtors' assets or future income.

B. High-interest-rate debt Hurts Other Creditors in Bankruptcy

Creditors who lend at exorbitantly high interest rates not only harm consumer debtors by shouldering them with unrealistic debt burdens, but they also harm other creditors. High-interest-rate debt makes it difficult for debtors to manage their total debt burden for all creditors. By pushing more consumers into bankruptcy, creditors who lend at high interest rates impose costs on other creditors, including involuntary creditors like tort victims, who cannot protect themselves contractually. One creditor's rapaciousness can mean that all of the consumers' other creditors have to suffer; they have to incur the delay and expense of bankruptcy and will often recover little if nothing in the bankruptcy. A creditor who causes such harms to other creditors by pushing a debtor into bankruptcy in the first place should not be allowed to share in the recovery from the bankruptcy estate.

II. S.257 Will Encourage Safer and Sounder Consumer Lending

S.257 will promote safer and sounder consumer lending by discouraging lenders from making loans that they cannot reasonably assume consumers will be able to repay. No creditor can reasonably expect the typical consumer to be able to service more than a de minimis amount of extremely high-interest-rate debt. The creditor who lends at such exorbitant rates is making a gamble that for every few consumers who are crushed under the burden of the high-interest-rate debt another will somehow manage to pay it off,

[11] 2007 Consumer Bankruptcy Project Database (median annualized gross monthly income of $26,814.00).

[12] Brian K. Bucks, *et al.*, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, 95 FED. RES. BULL. A1, A5 (2009), *at* http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf (reporting national median income of $47,300.00).

making the overall venture profitable. This sort of lending model is premised on pushing some consumers to the limit, and pushing others over the edge.

Alternatively, the creditor might have a more sophisticated lending strategy—the creditor might know that the debt is unsustainable in the long run for almost all consumers, but as long as enough consumers make payments on the debt for a while before defaulting, the operation can still be profitable if the interest rates are high enough.[13] As explained by Julie L. Williams, then the Acting Comptroller of the Currency, "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset…it's not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities."[14]

This is what Professor Ronald Mann has termed the "sweatbox" model of consumer lending—squeezing the borrower as hard as possible for as long as possible without pushing the borrower over the edge into default. The longer the consumer can be kept in the sweatbox of making minimum payments that exceed the cost of funds before eventually defaulting, the more profitable the loan. Thus, anything the lender can do to delay the default, such as making it more difficult to file for bankruptcy, allows the lender to extract greater revenue from the consumer.

All lenders lend for profit, of course, but a lender who lends with an eye to getting its principal repaid and making a profit from the interest is a very different type of lender than one who lends with an eye to turning the consumer into a "perpetual earning asset." No matter how greedy a lender is, a lender that is looking to get back its principal cannot squeeze a consumer too hard lest it push the consumer into default. A lender that doesn't care about getting principal repaid, as much as about extracting maximum payments from the consumer, will squeeze much harder. This business model resulted in things like the "interest only" and "pay option ARM" mortgages that are currently wreaking havoc on the economy. It is an inherently reckless business model because even if lenders do not want consumers to default, they lack sufficient information to make sure that they do not end up pushing the consumer into default. The sweatbox lending model is predatory and unsuited for sustainable lending.

S.257 will encourage safer and sounder consumer lending by creating a disincentive for lenders to make loans that are likely to drive consumers into bankruptcy. While S.257 will create a disincentive for making high-interest-rate loans, it is not a usury law, as section III, below discusses. Its primary effect will be to ensure the integrity and fairness of the bankruptcy system, rather than regulate consumer credit.

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[13] *See* Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 392-97 (2007).

[14] Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, March 21, 2005, *at* http://www.occ.treas.gov/ftp/release/2005-34a.pdf.

III. S.257 IS NOT A USURY LAW AND WILL NOT HAVE THE CREDIT RATIONING OR PRODUCT SUBSTITUTION EFFECTS OF USURY LAWS

S.257 is not a usury law. A usury law limits the interest rate at which a creditor can lend. S.257 does not do that. Instead, it limits use of the bankruptcy courts to creditors who engaged in lending on responsible terms—those under which borrowers could be reasonably expected to be able to repay in an appropriate amortization period.

Traditional usury laws raise three concerns: credit rationing, term substitution, and product substitution. Credit rationing means that lenders are unwilling to advance additional funds to borrowers at permitted interest rates.[15] Thus, a concern with usury laws is that by restricting the rate at which lenders can lend, they restrict the available supply of credit. Traditionally this has been assumed to be a negative impact, although some might argue that credit rationing would have placed a brake on the recent economic bubble.

Term substitution refers to lenders shifting the price terms of a credit product to avoid regulatory limitations. For example, if a usury law applies only to interest rates, lenders might try to circumvent its impact by charging various fees that do not qualify as interest rates. This has been the case in the credit card industry; interchange fees developed in part as a result to avoid state usury laws.[16]

Product substitution means that consumers shift from one credit product to another as the result of regulatory limitations. Thus, a concern with usury laws is that it might result in credit rationing by legitimate lenders, which will cause consumers who are unable to obtain credit from legitimate sources to switch to less wholesome forms of credit like loan sharks. Empirical research on product substitution, however, indicates that it might be less pervasive of a problem than feared; when consumers are unable to access legitimate sources of credit, they frequently curtail their spending rather than turn to loan sharks.[17]

Credit rationing, term substitution, and product substitution are all legitimate concerns for usury laws, particularly ones with a flat rate cap. But S.257 is not a usury law. S.257 does not limit the rate at which lenders can lend. It merely provides that lenders who lend at such high interest rates that they cannot fairly expect many consumers to be able to successfully repay their loans cannot engage the powerful legal engine of the United States bankruptcy system to do their collection work. Put more starkly, S.257 says that the United States courts will not be the enforcers for loan sharks, even when those loan sharks are hiding behind a national bank or federal thrift charter.

S.257 does not function as a *de facto* usury cap either. While critics of the bill can be expected to claim that it will have the precatory effect of limiting lenders from lending at rates above the lower of 15% over the thirty-year Treasury bill, or 36%, this

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[15] Charles W. Calomiris & Stanley D. Longhofer, "Credit Rationing," THE NEW PALGRAVE DICTIONARY OF ECONOMICS. (2d Ed.); Joseph E. Stiglitz and Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981).

[16] Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321 (2008).

[17] Angela K. Littwin, *Beyond Usury: A Study of Credit Card Use and Preference Among Low-Income Consumers*, 86 TEXAS L. REV. 451 (2008).

ignores the fact that most people do not file for bankruptcy and even most people in financial distress do not file for bankruptcy.[18]

Consumers behave much less strategically than simple theoretical economics would suggest. Many consumers try to pay off their debts, even when bankruptcy would be the wiser choice. A study by Professor Michelle J. White, President of the American Law and Economics Association, found that many people who would benefit economically from filing for bankruptcy do not do so.[19]

Most consumers will not jump into bankruptcy merely to rid themselves of a high-interest-rate debt; the trigger event for most bankruptcy filings are dunning calls and notices reaching an unbearable threshold, not a strategic decision to avoid paying a debt. Moral hazard is not a major concern for consumer bankruptcy because filing for bankruptcy imposes severe costs on consumers. Filing for bankruptcy carries with it a profound stigma, and most consumers file with deep shame and embarrassment. Bankruptcy also requires consumers to make all their personal finances a matter of public record. Debtors must pay their attorneys' fees, and many must try to save money they don't have to do so.[20] Bankruptcy filings remain on consumers' credit reports for ten years,[21] which will result in future higher costs of credit for the consumer.[22] Numerous types of debts cannot be discharged in bankruptcy, including those that were fraudulently incurred,[23] and there is a presumption that certain consumer debts for "luxury goods or services" were fraudulently incurred.[24] And even when debts can be discharged, the consumer is barred from future bankruptcy discharges for up to eight years.[25]

For Chapter 13 debtors, the process is even more onerous. In order to receive a discharge in Chapter 13, a debtor must live on a court-supervised means-tested budget for 3 or 5 years.[26] Having to get the court and the United States Trustee to sign off on the reasonableness of daily expenses creates a powerful disincentive against filing for bankruptcy unless the filing is absolutely necessary. Moreover, Chapter 13 insists on full repayment of certain debts, including allowed secured claims, domestic support obligations, and tax liabilities.[27] A below-median-income debtor who does not repay creditors in full can only receive a Chapter 13 discharge once every six years; an above-median-income debtor who does not repay creditors in full can only receive a Chapter 13 discharge once every ten years.[28] Because of the severe costs of bankruptcy, consumers are unlikely to file strategically.

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[18] Ronald J. Mann & Katherine M. Porter, *Saving up for Bankruptcy*, 98 GEO. L.J. ___ (2009).

[19] Michelle J. White, *Why Don't More Households File for Bankruptcy*, 14 J. L. ECON. & ORG. 205 (1998).

[20] Mann & Porter, *supra* note 18.

[21] 15 U.S.C. § 1681c.

[22] *See* Katherine M. Porter, *Bankrupt Profits: The Credit Industry's Business Model for Postbankruptcy Lending*, 93 U. IOWA L. REV. 1369, 1401 (2008).

[23] 11 U.S.C. § 523(a)(2).

[24] 11 U.S.C. § 523(a)(2)(C).

[25] 11 U.S.C. § 727(a)(8).

[26] 11 U.S.C. § 1325(b).

[27] 11 U.S.C. §§ 1322(a); 1325(a)(5).

[28] 11 U.S.C. § 1328(f)(2) prohibits a Chapter 13 discharge if a Chapter 13 discharge was granted within two preceding years, but for debtors who do not repay creditors in full, a Chapter 13 plan must last

This means that S.257 will not have the effect of a usury law, as it will not functionally prohibit lenders from lending at high interest rates. Most consumers with high-interest-rate loans will not file for bankruptcy, so S.257 should have no affect on lenders' ability to originate loans at high interest rates. It will not result in credit rationing, term substitution, or product substitution. Nor does S.257 create a federal right of action for ruinous lending or other lender liability. It will only deny them the use of the federal bankruptcy courts as a collection mechanism.

IV. The Means Test Should Be Waived for Debtors with High-interest-rate debts in Order to Encourage Efficient Bankruptcy Filings and Protect Responsible Creditors

The centerpiece of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was the "means test" that determines which consumers are eligible for filing for Chapter 7 bankruptcy. The means test is a rubric for a complex statutory provision regarding whether a rebuttable presumption of abuse exists for a consumer debtor to file for Chapter 7 and who can raise the presumption. If the debtor's filing is found to be an abuse of Chapter 7's provisions, then the case must be dismissed or converted to Chapter 13 or 11.

The means test can only be applied if the debtor does not qualify for a safe harbor "median income" test.[29] If the debtor's "currently monthly income"[30] (roughly the debtor's average gross income for the last six months) is below the median income for households of the same size in the debtor's state, then no party can raise the presumption of abuse against the debtor. If the debtor's current monthly income is above the median income for households of the same size in the debtor's state, then an adjusted version of the debtor's current monthly income is weighed against a numeric formula to determine whether the debtor has the "means" to repay his or her debts. If the debtor has too much income under the means test, then a presumption of abuse exists. The presumption can be rebutted only by showing additional expenses or adjustments to current monthly income that would put the debtor's adjusted current monthly income beneath the means test's threshold[31] and which are justified by "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces".[32] These special circumstances must be documented in detail.[33]

There is a great deal to strongly criticize about BAPCPA in general and the means test in particular. As a policy matter, the means test is misguided. The means test (and BAPCPA as a whole) are unusually poorly drafted[34] and can easily be gamed by strategic

at least three of five years, depending on whether the debtor is below or above the applicable state's median income. 11 U.S.C. §§ 1325(b)(1), (4). Thus, it is the length of plan, not the time between discharges, that controls for debtors who have repay less than 100% of their debts.

[29] 11 U.S.C. § 707(b)(6)-(7).

[30] The term is defined in 11 U.S.C. § 101(10A).

[31] 11 U.S.C. § 707(b)(2)(B)(iv).

[32] 11 U.S.C. § 707(b)(2)(B)(i), (iv).

[33] 11 U.S.C. § 707(b)(2)(B)(ii).

[34] BAPCPA's uniquely sloppy drafting, including many undefined terms and even missing words, has created tremendous uncertainty for creditors and debtors alike and greatly increased the workload of the federal courts.

debtors (the ones most likely to abuse the bankruptcy process) with the result that the means test only screens out debtors who have an urgent need to file, such as to prevent a home foreclosure. And, the means test encourages bankruptcy filings to occur at suboptimal times that hurt creditors who do not charge high interest rates. These last features argue strongly for exempting debtors with high-interest-rate debt from the means test so that they file at the optimal time and do not have an incentive to game the bankruptcy system.

A. The Means Test is a Misguided Policy in the First Instance

BAPCPA's focus on preventing "bankruptcy abuse" is a misguided policy based on anecdote, not data. BAPCPA, and the means test in particular, is animated by a concern that debtors who could repay their debts over time in a Chapter 13 bankruptcy were instead filing for Chapter 7 and walking away from their debts with little consequence. This was viewed as abusing the bankruptcy system. No one supports abuse of the bankruptcy system, but there is no empirical evidence that there *ever* has been a systemic abuse problem in the bankruptcy system. All that has ever been mustered as proof of systemic abuse are some shocking anecdotes and some tangential statistics, such as past increases in bankruptcy filings. Bankruptcy filing rate increases are hardly conclusive of abusive consumer behavior; they are consistent with other interpretations, including abusive lending practices. No doubt there have and will continue to be some individuals who act strategically. But good policy is not based on a handful of shocking cases, and the bankruptcy system already had the tools to deal with these cases without a presumption of abuse.

B. The Means Test Can Be Easily Gamed by Strategic Debtors and Only Screens Out Truly Desperate Debtors

Both the safe harbor median income tests and the means test proper are easily gamed. The safe harbors and the means test are based around a comparison of the debtor's "current monthly income," which is defined as the average of the consumer's income for the previous six months,[35] and various metrics.

For the median income test safe harbors, the metric is the median income of households of the same size in the debtor's state. Debtors can thus game the system by either reducing their "current monthly income" or increasing their household size. To reduce "Current Monthly Income," the consumer debtor can simply stop working (or stop working overtime or a second job). Alternatively a consumer can increase his or her household size and thus the relevant median income threshold for comparison. The Bankruptcy Code does not define "household." Therefore, it would be fairly simple for a debtor to have a friend or relative move in temporarily and become part of the "household."

The means test itself can be gamed because it is based on an adjusted "current monthly income," which is the debtor's "current monthly income" reduced for secured debt payments, payments for health and disability insurance, and health savings accounts. Not only can debtors reduce their current monthly income, but they can also increase the deductions from it. While attorneys are forbidden from advising clients to incur more

[35] 11 U.S.C. § 101(10A).

debt[36] (a provision of the Code that the 8th Circuit Court of Appeals has found unconstitutional),[37] an attorney could certainly explain the law to a client and let the client draw his or her own conclusions about the need for better insurance coverage or a health savings account.

The result of this is that the means test rewards strategic consumers and penalizes those consumers who file for bankruptcy because of an acute need, like to stop a foreclosure. This is upside-down from the result the means test was supposed to accomplish, but its poor drafting is consistent with the overall character of BAPCPA.

So what, then, does the means test accomplish? As the most recent empirical study of the impact of BAPCPA on bankruptcy filings notes, "instead of functioning like a sieve, carefully sorting the high-income abusers from those in true need, the amendments' means test functioned more like a barricade, blocking out hundreds of thousands of struggling families indiscriminately, regardless of their individual income circumstances."[38] BAPCPA has delayed and kept down bankruptcy filings in general, rather than screen out abusers. This is not what the bill was marketed as doing. It "was not the Bankruptcy Numbers Reduction Act; it was the Bankruptcy Abuse Prevention Act."[39]

C. The Means Test Benefits High-interest-rate creditors at the Expense of Responsible and Involuntary Creditors

The means test does not function to keep out abusive bankruptcy filers. Instead, it merely delays and discourages filings overall. Delayed filings benefit creditors with high-interest-rate debt. Almost all high-interest-rate debt is unsecured debt, and unsecured creditors are prohibited from receiving post-petition interest in bankruptcy.[40] By delaying bankruptcy filings, the means test allows all unsecured creditors entitled to interest to accumulate larger claims.

These claims do not grow pro rata, however; instead, they grow according to the contract (or judgment) rate of interest. Thus, the claims of lenders with the highest interest rates grow the fastest. Because unsecured creditors are paid pro rata in bankruptcy, delay thus has the effect of increasing the bankruptcy dividend for high-interest-rate creditors (like credit card lenders, payday lenders, and refund anticipation lenders) at the expense of other unsecured creditors, like tort claimants, medical bill creditors, landlords, and local merchants and small businesses. This is unfair and contrary to the basic bankruptcy principal of "equity is equality."

By distorting normal bankruptcy filing patterns, the means benefits high-interest-rate creditors—lenders that cause the most acute financial distress—at the benefit of other creditors. The means test thus distorts the hallmark pro rata distribution of the

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[36] 11 U.S.C. §§ 526(a)(4); 101(4A); 101(12A).

[37] Milavetz, Gallop & Milavetz, P.A. v. United States, 541 F.3d 785, 794 (8th Cir. 2008). *But see* Hersh v. United States, 553 F.3d 743, 761 (5th Cir. 2008) (upholding the Constitutionality of 11 U.S.C. § 526(a)(4) under a narrow reading of its application per the doctrine of Constitutional avoidance).

[38] Lawless, *et al*, *supra* note 10, at 353.

[39] *Id.* at 352.

[40] 11 U.S.C. § 502(b)(2).

bankruptcy system by encouraging debts to grow non-pro rata for an extended period before bankruptcy.

V. S.257 Provides Debtors with Improved Leverage for Voluntary Loan Workouts

S.257 will help some consumers avoid bankruptcy by providing them with increased negotiating leverage with creditors who are charging high interest rates. If a consumer is in such financial straights that bankruptcy is a realistic option, S.257 provides the consumer with the leverage to renegotiate the debt with the creditor to make it affordable. A creditor would reasonably prefer to receive payments based on a lower interest rate than to receive nothing in bankruptcy. This does not mean that creditors will necessarily recover less, it is possible to lower rates, but increase amortization term periods to achieve net present value equivalencies while making the debt more affordable to the consumer. S.257 thus encourages a win-win situation by helping encouraging creditors to be more reasonable in their demands and thus not pushing consumers into bankruptcy.

VI. Potential Improvements to S. 257

Although S. 257 is not a usury bill, it could be improved to eliminate national banks' ability to engage in regulatory arbitrage and avoid state usury regulations. Doing so would further encourage responsible lending and discourage creditors from underwriting risky high-interest-rate debt. Currently most financial institutions engaged in consumer lending are not subject to usury regulations. Usury laws were historically the major form of consumer protection in banking because they were a shield against borrowers assuming obligations that they could not reasonably be expected to be able to repay absent significant hardship and privation for themselves and their dependents. While usury laws limited credit availability to some higher-risk borrowers, those were precisely the borrowers who were so desperate for credit that they were unlikely to make wise borrowing judgments.

State usury laws were largely eviscerated following the Supreme Court's 1978 decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*[41] *Marquette* held that because the National Bank Act preempted state law, the usury ceiling that applied to a national bank's lending operations was that of the state in which the bank is located, as provided by the National Bank Act, not the state of the borrower. *Marquette* did not turn on the wisdom of usury regulations. Instead, it turned on the interpretation of the vague language of the 1863 National Bank Act, legislation enacted to help finance the Union effort in the Civil War.

Marquette meant that even if the state legislatures of 49 states enacted a uniform usury law, banks based in the 50th state could end-run this under the aegis of preemption because of *Marquette*. As a result, national banks could base themselves in states with high or non-existent usury ceilings, like Delaware, South Dakota, Nevada, and Arizona so they could export these states' lax rate ceilings to other states. These states have become in-land usury shelters, a consumer credit equivalent of off-shore tax shelters.

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[41] 439 U.S. 299 (1978).

This in turn set off a two-part regulatory race toward the bottom, as banks began to switch to federal charters and look for states with high or no usury ceilings in which to base at least their credit card operations. Some states responded by dropping or raising usury ceilings in order to keep national bank operations in their states. Other states adopted parity laws that would allow their state-chartered banks the same leeway as national banks.[42] As Harvard Law School Dean Howell Jackson and Stacy A. Anderson have noted, "the *Marquette* decision, coupled with the cooperation of several state legislatures, effectively ended interest rate regulation for certain kinds of consumer credit in the United States."[43] Moreover, subsequent court rulings have extended *Marquette* to preempt state regulation of late fees,[44] various loan closing fees,[45] and disclosures in credit agreements.[46]

Marquette thus created a regulatory arbitrage possibility that set off a regulatory race to the bottom. Congress should act to close off this loophole. There is a reasonable debate to be had on usury regulations, but that is one that should be held in legislatures, not determined by the Supreme Court's interpretation of a hoary statute. A 1970s interpretation of an 1863 law should not be what determines 21st century consumer credit regulation. Congress should permit the states, the laboratories of democracy, to go further than S.257 if they wish in regulating high-interest-rate consumer credit. This essential consumer protection power should be restored to the states.

* * * * *

S.257 offers an important protection to consumers and responsible creditors, eliminates an incentive to game the bankruptcy system, and encourages responsible lending. These protections will help ensure fairer, safer, and sounder consumer credit. Now, more than ever, consumers and creditors need reforms that will create a fair and sustainable credit system. I urge the Congress to pass S.257.

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[42] *See* Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518 (2004); Donald C. Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672 (1987). Moreover, Congress subsequently enacted section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. § 1831d (2006)), which grants state banks the power to export local interest rates.

[43] Howell E. Jackson & Stacy A. Anderson, *Can States Tax National Banks to Educate Consumers About Predatory Lending Practices?*, 30 HARV. J.L. & PUB. POL'Y 831, 838 (2007). *See also* Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 10 (2003) (holding that the National Bank Act is exclusive cause of action for usury against national banks). Usury, of course, can be a defense as well as a counterclaim. Even after *Beneficial Nat'l Bank*, it remains unclear whether state law usury defenses or counterclaims are preempted. *See* Vaden v. Discover Bank, 556 U. S. ____, Slip Op. No. 07-773, at 19 (2009).

[44] Smiley v. Citibank, 517 U.S. 735 (1996) (deferring to Office of Comptroller of the Currency's interpretation of its regulation as providing that late fees are treated like interest).

[45] Phipps v. Guar. Nat'l Bank of Tallahassee, 2003 WL 22149646 Sept. 17, 2003 (defining interest to include origination fees, loan discount fees, processing fees and other closing costs).

[46] Am. Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Ca. 2002) (California statute requiring warning statements about implications of making only minimum payments was preempted, despite Truth in Lending Act's provision permitting more stringent state disclosure laws, 15 U.S.C. § 1610(a)).

Statement of Senator Patrick Leahy
Chairman, Senate Judiciary Committee
Hearing on "Abusive Credit Card Practices and Bankruptcy"
Before the Subcommittee on Administrative Oversight and the Courts
March 24, 2009

Thank you, Mr. Chairman, for holding this important hearing to examine the effects of abusive credit card practices on bankruptcy filings.

Hundreds of Vermonters have contacted my office in recent months voicing concerns about the credit card industry. People have shared stories about credit card companies raising interest rates arbitrarily, charging usurious fees, and refusing to work cooperatively with their clients. Most troubling, the biggest offenders appear to be large, national banks that gladly accepted the mercy of taxpayer bailout money when they were in trouble.

At a time when corporate executives are collecting millions of dollars in bonuses, many American families are struggling to make ends meet. Our current credit structure disadvantages many Americans and makes it harder for them to get out of debt. In addition, the current economic crisis has made it more difficult for hard-working families to pay their bills. I believe time is long overdue for more transparent and equitable credit card practices.

Last Congress, I cosponsored Senator Akaka's bill to require enhanced disclosure to consumers regarding the consequences of making only minimum required payments in the repayment of credit card debt.

And this year, I am an original cosponsor of Senator Dodd's Credit Card Accountability Responsibility and Disclosure Act, which would provide a more comprehensive overhaul of the credit card system by improving a number of billing, marketing, and disclosure practices.

Many others also are working on legislation to address the multitude of problems in the credit industry. Senators Whitehouse and Durbin have introduced the subject of today's hearing -- Consumer Credit Fairness Act -- which would disallow bankruptcy claims from credit card companies where the unpaid balances resulted from an extremely high annual percentage rate. In addition, I have joined Senators Sanders, Durbin, Levin, Harkin, and Whitehouse in cosponsoring the Interest Rate Reduction Act, which would set a national consumer interest rate ceiling of 15 percent.

Again, I thank you, Mr. Chairman, for holding this hearing today. I look forward to hearing from our witnesses today about how the bankruptcy code should handle personal and business credit card debts. As the economy continues to remain soft, more families and firms will find themselves the deeper in debt. They should not find themselves pushed closer to the brink to bankruptcy because of outrageous interest rates and fees piling up on their credit cards.

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Written Testimony of Professor Mark S. Scarberry
Pepperdine University School of Law
With Regard to S. 257, 111th Congress,
the "Consumer Credit Fairness Act"

Hearing of the Subcommittee on Administrative Oversight and the Courts
of the United States Senate Committee on the Judiciary, entitled:
"Abusive Credit Card Practices and Bankruptcy"
March 24, 2009

I would like to thank the Members of the Subcommittee for giving me this opportunity to testify. I have been a law professor at the Pepperdine University School of Law since 1982 (though of course here I am not speaking for the University). Much of my teaching, research, and public service during those 27 years has focused on bankruptcy law, dealing both with consumer bankruptcy and with business bankruptcy. On the business side, I am the lead author of a leading law school casebook on Chapter 11 business bankruptcy. On the consumer side, I have written materials used to train lawyers to provide pro bono consumer bankruptcy services, prepared the materials for the American Bankruptcy Institute's inaugural Web-based consumer bankruptcy seminars (known as "Webinars"), and served on pro bono consumer bankruptcy committees, both for the Los Angeles County Bar Association and the ABI.

I try to consider each issue on its own merits, without favoring creditors or debtors. An article I co-authored sixteen years ago argued against allowing strip down of home mortgages in Chapter 13 bankruptcy, and I have recently testified before Congress and spoken twice at Association of American Law School Annual meetings on that subject. But I have also suggested that some other forms of modification of home mortgages in bankruptcy might be appropriate. My latest article on bankruptcy law argues strongly that holders of unsecured claims, like credit card companies in most bankruptcy cases, should not be able to add postpetition attorneys' fees and other postpetition charges to the amount of their bankruptcy claims.

My testimony has three parts. First I will discuss the general approach taken in S. 257. I will do my best to explain why I think it is not the right way to deal with high interest credit card debt. Then I will turn to technical matters. There are aspects of the language of S. 257 that should be clarified. Finally, I will comment on some of the testimony given during the last session of Congress with regard to a similar bill, S. 3259.

I

Simply put, S. 257 defines "high cost consumer credit transactions," provides for bankruptcy claims arising from such transactions to be disallowed, and provides an exemption from the mechanical means test of section 707(b)(2) for any debtor who has any debt arising from a high cost consumer credit transaction. (By the "mechanical means test" I mean the highly detailed provisions of section 707(b)(2) dealing with income and expenses that were intended to provide a clear, bright-line test for substantial abuse of the provisions of Chapter 7—thus removing the need, in at least some cases, for the Bankruptcy Court to exercise discretion.)

Unfortunately, S. 257's approach is unlikely to have any substantial effect on the conduct of credit card companies. Most consumer bankruptcy cases are "no asset" or "nominal asset" cases, in which holders of unsecured claims, like the typical credit card company, receive little or nothing under current law. They will not lose much by charging high interest rates that trigger disallowance of their claims.

Similarly, the threat that, if they charge high rates, the debtor will receive an exemption from application of the mechanical means test will not cause them to reduce their rates. Note that if even only one creditor charges high enough rates for the debtor to have a single debt arising from a high cost consumer credit transaction, all creditors lose whatever benefit they might have gotten from the mechanical means test. Is it reasonable to think that creditors will forbear from charging high rates—thus giving up the chance to collect, at least temporarily, higher payments—where they will receive no benefit from their forbearance unless all creditors similarly forbear? And what is to prevent the debtor from obtaining a little credit—fortuitously or on purpose—from a high cost creditor, thus entitling the debtor to an exemption from the mechanical means test?

The damage that is done by high cost consumer credit seems mostly to be done before a debtor files a bankruptcy petition. S. 257 simply does not seem well-suited to remedy the problem. If Congress wishes to prohibit high cost consumer credit, or to impose conditions on high cost consumer credit transactions (such as by prohibiting, for example, imposition of over-limit fees where the debtor has stopped using the card but accruing interest pushes the debt over the credit limit), then Congress has ample power to do so. Others may speak to whether the benefits of availability of high cost consumer credit outweigh its costs, but it seems to make more sense to address that issue directly rather than by amendments to the Bankruptcy Code, especially where those amendments are unlikely to produce the desired change in conduct.

Similarly, to the extent that the mechanical means test is flawed, that problem should be addressed directly. S. 257 in effect creates a lottery in which some debtors receive an exemption from the mechanical means test but others do not, simply because of the existence of a single, perhaps small, debt arising from a high cost consumer credit transaction. All creditors lose whatever benefit they might have gotten from the mechanical means test, because one creditor charged a high rate. If the mechanical means test is so flawed that no creditors should receive any benefit from it, then Congress should act directly to change it; but if it serves a beneficial purpose, why should one creditor be able to deprive all the other creditors of that benefit?

I would also note that high interest rates sometimes come with special benefits. A high interest rate credit card might have no annual fee, and it might entitle the card holder to higher "rewards" (frequent flyer miles or cash back) than other cards. Such benefits may be particularly important to card users who seldom or never carry a balance on the card.

To the extent that Congress believes high credit card interest rates should be penalized in some way, the triggering level should be set high enough to allow such cards to be offered.

II

On a technical level, there appear to be questions about how S. 257 would operate. The one page description of the bill states that "An 'applicable interest rate' under the CCFA includes an annualized calculation of all penalty fees and charges. This will prevent lenders from 'innovating around' the legislation by shifting from high interest to high fees." But the reference in section 2(a)(2) of the bill to the "applicable annual percentage rate" does not seem to include fees in the calculation unless they are "incurred in connection with the extension of such credit." The "extension of credit" occurs when the credit is used, typically to make a credit card purchase. Where that use of the credit does not trigger the fee, it is not at all clear that the fee would be included in the rate under the language of the bill. A late fee (or even an overlimit fee caused by accrual of interest) does not seem to be "incurred in connection with the extension of … credit" but rather incurred in connection with the failure to repay the debt as promised.

In addition, it is not clear what the purpose is of the phrase "for the purpose of distribution under this title" in section 2(b) of the bill. The "claim arising from a high cost consumer credit transaction" is to be disallowed, but apparently only "for the purpose of distribution under this title." Is there some other purpose for which the claim is not disallowed? This language could allow a lien securing such a high cost consumer debt to survive bankruptcy; note that disallowance of a claim has the effect under section 506(d) of voiding any lien securing the claim, but survival of the lien would not result in a distribution being made under the Bankruptcy Code. Thus if the disallowance under the bill is only a limited disallowance—limited so as to affect only the distribution under the Bankruptcy Code—perhaps the claim will not be treated as having been disallowed for purposes of lien survival under section 506(d).

III

Capable and thoughtful witnesses provided testimony during the last session with regard to a very similar bill, S. 3259. Allow me to comment on some of that testimony. Please note that I did not listen to the oral testimony nor have I read any transcript of the oral testimony.

A point made by Judge A. Thomas Small, testifying on behalf of the National Bankruptcy Conference, bears repeating: disallowance of high interest rate claims can work to the detriment of Chapter 13 debtors who fail, as many do, to complete payments under the plan. Although some debtors in such cases can obtain hardship discharges under section 1328(b), many cannot or for one reason or another do not receive a discharge. In such cases, if a high interest rate claim has been disallowed, nothing will have been paid on it during the Chapter 13 case, and when the case is dismissed, the entire high interest rate debt, with very substantial accrued interest and fees, will still be owed. In such a case the debtor would have been better off had some of the payments made under the plan gone to reduce the amount of the high interest rate debt. In my view this negative effect on debtors reinforces the point made above: if Congress decides to in some way prohibit or regulate high interest rate consumer debt, it should do so directly rather than by amending the Bankruptcy Code.

I have great respect for Mr. John Rao, Director of the National Association of Consumer Bankruptcy Attorneys and an attorney with the National Consumer Law Center. I do think, however, that in his written testimony with regard to S. 3259 there was a slip of the pen or misunderstanding that may have influenced the language of S. 257. (Again, I have not read the transcript of his oral testimony, and he may have corrected this point orally.) His written testimony states that under S. 3259 "the means test under section 707(b) would not apply if a consumer's bankruptcy filing 'resulted from a high cost consumer credit transaction.' " That was correct with respect to what I have called the mechanical means test, section 707(b)(2), but nothing in S. 3259 would have kept the court from dismissing the debtor's case on a finding of substantial abuse under section 707(b)(1) if, as provided in section 707(b)(3), the "totality of the circumstances ... of the debtor's financial situation demonstrate[d] abuse." Mr. Rao went on to state that S. 3259's requirement of a showing that high cost consumer debt caused the debtor to file a bankruptcy petition—a showing that if made would prevent the mechanical means test from being used against the debtor—should be eliminated. He stressed that "[e]specially for debtors below the median income, the expense of proving causation might eliminate any benefit gained by an exclusion from the means test." However, debtors below the median income would have no need to make such a showing; the mechanical means test does not apply to them under current law nor would it have applied to them under S. 3259; section 707(b)(7)(A) prohibits use of section 707(b)(2) against a debtor whose income is below the median. Thus, unless I am missing something, it appears that Mr. Rao's argument did not match up with the provisions of S. 3259. I note that in S. 257 there no longer is a requirement of a showing of causation. To the extent that this change from the provisions of S. 3259 was based on Mr. Rao's argument, it should perhaps be reconsidered.

Professor Robert M. Lawless, for whom I have great professional and personal regard, also testified in connection with S. 3259. I would describe the growth of consumer credit somewhat differently from the way he described it in his written testimony. Although it is certainly true that household debt has risen rapidly for more than a decade, most of the rise cannot be attributed to banks taking advantage of the Supreme Court's interpretation of the National Bank Act to issue high interest credit cards. Far more of the increase in household debt was due to mortgage debt than to credit card debt. Since 1997 home mortgage debt has increased by about $6.7 trillion, while other consumer credit has increased by about $1.25 trillion. See Federal Reserve Statistical Release, Flow of Funds Accounts of the United States, Z.1. Release, Table D.3, Debt Outstanding by Sector (showing home mortgage debt rising from $3.7559 trillion in 1997 to $10.4537 trillion in 2008, while consumer credit was rising from $1.3442 trillion to $2.5962 trillion). Thus the increase in home mortgage debt accounted for 84% of the increase in household debt over that period, and home mortgage debt grew at a faster pace than other consumer credit, growing to an amount two and three quarters times as large in 2008 as in 1997, while other consumer credit had not quite doubled. It may be that consumer credit rose too quickly, but it seems that the major problem, as we now know, was home mortgage debt. Of course now one of our difficulties is that consumer purchasing power has weakened, and steps are being taken to revitalize it. It is possible that we need more availability of consumer credit now, not less.

The dramatic increase in home mortgage debt also accounts for an occurrence that rightly worries Professor Lawless: our household debt exceeds our annual national personal income. But I must disagree with his characterization of that imbalance. He testified that "[e]ven if we devoted all of the national income for one year to repayment and did not spend any money on housing, food, utilities, health care, or any of the other necessities of life, it would not be sufficient to retire our household debt." But about 80% of the debt that we would be repaying would be home mortgage debt—and thus payment for housing—and if we nearly paid it off with one year's income, we would nearly own our homes free and clear. Put that way, the situation seems less alarming.

Professor Lawless also refers to the impressive empirical study he and his coauthors recently published (*Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349 (2008)). The authors conclude that 800,000 debtors somehow are missing from the bankruptcy system (based on lower bankruptcy filing rates than would have been expected), and that the 2005 bankruptcy amendments did not seem to force out the abusive high income filers. Thus Professor Lawless draws the conclusion in his testimony that the 2005 bankruptcy amendments prevented deserving debtors from obtaining bankruptcy relief by purging "ordinary American families in serious financial distress" from the bankruptcy system. He may be right, though his article notes that misinformation about the continuing availability of bankruptcy relief (misinformation given out in many cases by debt collectors) likely was responsible for at least some of the decrease in filings. I would also note that the unemployment rate actually dropped substantially during the relevant period. The rate for 2002, 2003, and 2004 was 5.8, 6.0 and 5.5, respectively, but it dropped to 5.1% for 2005, and then to 4.6% for 2006 and for 2007. (See bls.gov/cps/cpsaat1.pdf). Lower unemployment during 2006 and 2007 could account for some of the reduction in filings. Of course, now that unemployment has risen substantially, bankruptcy filings are rising as well.

In his testimony, Professor Lawless notes (in line with my testimony above), that the threat of loss of bankruptcy distributions would not lead consumer lenders to reduce their rates because "consumer lenders do not expect large recoveries in bankruptcy and [thus] would continue to charge exorbitant rates" despite the provisions of S. 3259. He makes a very good point that "[p]erhaps the most helpful thing Congress could do is to take measures that would lower the costs of filing bankruptcy." I also heartily endorse his call for an amendment to "make clear in section 1325 that the business expenses of a small business owner are deductible expenses in determining the amount of 'disposable income' a debtor has to devote to a chapter 13 plan," and that similar provision should be made in section 707(b).

Finally, I must note that his testimony urges a step that I think would be a mistake, allowing debtors in chapter 13 cases to strip down their home mortgages to the court-determined value of their homes. He argues that "[t]he mortgage lender benefits by getting a promise to pay equal to the value of the house, which is what it would have had if it sold the house outside of bankruptcy." But many chapter 13 plans fail, and a promise to pay is no guarantee of receipt of payment. In fact, the mortgage lender would be stuck with the risk of further loss in the home's value, but without any realistic prospect of gaining from future appreciation. Professor Lawless also argues, as many others have, that allowing strip down of home mortgages would just treat them the same in chapter 13 as vacation homes and investment properties are already treated in chapter 13. As I pointed out when I testified last year, substantial first mortgages on vacation homes or investment real property cannot as a practical matter be stripped down in chapter 13 cases under current law, because the stripped down mortgage would have to be paid off with interest over no more than five years, which would make the payments far too high. See Bankruptcy Code section 1325(a)(5)(B)(ii) (and 1322(d), limiting duration of plan to five years); In re Enewally, 368 F.3d 1165 (9th Cir.), cert. denied, 543 U.S. 1021 (2004); Congressional Oversight Panel, Foreclosure Crisis: Working Toward a Solution (March Oversight Report), page 54, cop.senate.gov/documents/cop-030609-report.pdf. The Congressional Oversight Panel admits that the kind of strip down being proposed for home mortgages in chapter 13 cannot be done under current law with respect to vacation homes or other property (though the Panel analogizes to Chapter 11 practice, without noting that in Chapter 11 creditors have the opportunity to vote on the plan and that undersecured creditors usually can prevent a strip down by making the section 1111(b)(2) election):

"The type of bankruptcy modifications proposed for mortgages on principal residences differs from the debt restructurings that are currently permitted for vacation homes or rental property, if they are modified in Chapter 13. In Chapter 13, all debts, including the reduced principal amount, must be repaid within the three-to-five years duration of the bankruptcy plan. In Chapter 11, by comparison, vacation homes, rental property and mortgages on all business property can be stretched over decades. The proposed bankruptcy modification would permit the modified loan on the principal residence to be held to maturity and repaid over as much as thirty years. The length of the anticipated repayment period in the proposed bankruptcy modification would be more like the treatment of mortgages on vacation homes, rental property and all business property in Chapter 11."

Again let me say that I very much appreciate the opportunity to testify here today. I would be happy to try to answer any questions the Members may have.

United States Senate
Committee on the Judiciary

< Return To Hearing

Statement of

The Honorable Sheldon Whitehouse

United States Senator
Rhode Island
March 24, 2009

NEWS FROM U.S. SENATOR SHELDON WHITEHOUSE

March 24, 2009
FOR IMMEDIATE RELEASE
Contact: Alex Swartsel
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Statement of Senator Sheldon Whitehouse
Chairman, Subcommittee on Administrative Oversight and the Courts
Hearing on "Credit Cards and Bankruptcy"

The hearing will come to order.

With the economy deep in recession, unemployment rates climbing, and teaser rates on home mortgages expiring and triggering higher mortgage payments, American consumers are relying more than ever on credit cards to make ends meet each month. At the same time, banks losing money in mortgages and their other areas of business are attempting to squeeze more and more profit out of their credit card customers.

The standard credit card agreement gives the lender the power to bleed their customers through evolving and ever more crafty tricks and traps. The typical credit card agreement, which twenty years ago was a page in length, has grown to a 20-page, small print contract filled with legalese. In substance, it gives the companies the right to raise interest rates for almost any reason, and in some cases no reason at all.

While interest rates for other types of lending are at historic lows, credit card lenders continue to charge double-digit rates, with average rates around 14% , exclusive of fees. At a time when the prime rate is 3.25% and the average 30-year fixed mortgage rate is under 5%, it is hard to understand why credit card borrowing remains so costly.

Although high in comparison with other types of lending, a 14% interest rate may seem like a bargain to a family that has fallen behind on its payments. When families come up short on their credit card payment, they can find a 10% or 12% annual interest rate morph into a 25% or 20% or 40% penalty rate. Add to that late payment and other penalty fees, and falling behind on a credit card can mean financial ruin.

When a family struggles to pay its bills, when a parent gets laid off or unexpected medical expenses arise, it enters what Professor Ronald Mann of Columbia Law School has called the "sweat box" of credit card debt, like any good trap, the entrance to this one is easy: a high credit limit and soon enough a high credit balance. If you can't pay the balance off, then they have you: a payment delayed, a minimum not met, and now your interest rate doubles, and fees and penalties pile one. You can't escape, and they sweat you. Under this business model, the lender focuses on squeezing out as much revenue as possible in penalty rates and fees, pushing the customer closer and closer to bankruptcy. When its customer finally does fall of the financial edge, the lender can recover a portion of the outstanding principal under the bankruptcy plan.

I have introduced legislation that would give consumers leverage to negotiate for reasonable rates with their lenders and ban abusive lenders from using the bankruptcy court system to enforce their claims. Under the Consumer Credit Fairness Act, or CCFA, claims in bankruptcy stemming from consumer credit agreements carrying interest above a variable threshold - currently 18.5% -- would be disallowed. With the leverage of a bankruptcy threat, a customer struggling under a 30% penalty rate could negotiate for more reasonable

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terms. In addition, bankruptcy filers with debts carrying effective interest rates above the threshold would be exempt from the so-called means test, a tactic that was enacted in the bank-written 2005 reforms to make it more difficult to enter bankruptcy. In practice, the means test delays relief in bankruptcy, keeping consumers in the "sweat box" of credit card debt.

In addition to discussing the nexus of abusive credit card terms and bankruptcy in general, I hope that we will take some time today to explore the CCFA. Following Senator Sessions' opening statement, we will hear from our distinguished panel of witnesses.

Douglas Corey, a constituent of mine from North Scituate, Rhode Island will share his experiences with his credit card lender. Mr. Corey has worked in sales and marketing and is a graduate of Rhode Island College.

Judge Rosemary Gambardella has served on the Bankruptcy Court for the District of New Jersey since 1985. A native of Newark, she attended Rutgers University and Rutgers Law School. Judge Gambardella is a member of the National Association of Women Judges, the National Conference of Bankruptcy Judges, the American Bankruptcy Institute, and former member of the Bankruptcy Judges Advisory Group for the Administrative Office of the United States Courts.

Professor Adam Levitin of the Georgetown University Law Center is a nationally regarded expert in bankruptcy and consumer law. He has served as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel, as an expert witness for the FTC and FDIC on credit card litigation, and as a law clerk for the Honorable Jane Roth of the United States Court of Appeals for the Third Circuit. Professor Levitin is a graduate of Harvard, Columbia, and Harvard Law School.

Professor Mark Scarberry of Pepperdine University School of Law is an expert in bankruptcy and contract law. A graduate of Occidental College and the UCLA School of Law, he is a member of the American Bankruptcy Institute Law Review Advisory Board and Pro Bono Task Force.

David John is a Senior Research Fellow at the Heritage Foundation and specializes in pensions, financial institutions, asset building, and Social Security reform. Prior to joining the Heritage Foundation, he served on the staff of Representative Mark Sanford of South Carolina. Mr. John has a bachelor's and three masters' degrees from the University of Georgia.

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