

NATIONAL BANKRUPTCY CONFERENCE

*A Voluntary Organization Composed of Persons Interested in the
Improvement of the Bankruptcy Code and Its Administration*

February 4, 2005

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Via Facsimile

Honorable Arlen Specter, Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Honorable Patrick Leahy, Ranking Member
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Re: National Bankruptcy Conference

Dear Senator Specter and Senator Leahy:

The National Bankruptcy Conference ("NBC")¹ welcomes your decision to hold a hearing on S. 256, the proposed omnibus bankruptcy bill, and encourages you to hold at least one additional hearing so that the significant issues raised by S. 256 can be considered. As always, the NBC stands willing to provide the Senate Judiciary Committee and its members with both policy and technical assistance in the formulation, drafting and consideration of bankruptcy-related legislation, including S. 256.

S. 256 is indeed omnibus legislation. It includes much more than a "means test" and other consumer provisions. Among other things, it would change the rules for reorganization of large and small firms, municipalities, family farmers and family fishermen, add an entirely new chapter dealing with transnational insolvency, regulate lawyers and their communications with debtor clients, impose a variety of new obligations on Bankruptcy Courts and United States Trustees, and substantially complicate bankruptcy for all debtors regardless of their circumstances.

Public debate on prior bills has most often focused on the consumer provisions. Without detracting attention from the impact of those provisions and the need for appropriate consideration, we think attention should also be paid to the

¹ The National Bankruptcy Conference is a voluntary, non-profit, self-supporting, non-partisan group of 57 judges, law professors and practicing lawyers that has been working with Congress on bankruptcy legislation since the 1930's. Our members are all recognized experts in bankruptcy law and procedure who are committed to the improvement and integrity of the bankruptcy system.

ADMINISTRATIVE OFFICE
SUZANNE ARMSTRONG BINGHAM
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effect of S. 256 on business, including small business. Our business reorganization procedure in chapter 11 has become the model for new reorganization legislation around the world, because it saves jobs, saves investment and capital, and protects communities. Other countries have come to understand that such a system can contribute significantly to investment and growth. It is in our national interest to preserve and strengthen such a system.

Although S. 256 contains many proposals the NBC supports, including proposed chapter 15 with respect to transnational bankruptcy cases, making chapter 12 permanent, enhanced data collection with respect to all bankruptcy cases, and additional bankruptcy judges, it is our view that S. 256 requires further consideration and that Judiciary Committee hearings are both appropriate and necessary. The framework and the substance of the bill are now eight years old. The last time the Senate Judiciary Committee closely examined the provisions of this legislation was in February of 2001. During that period – indeed, even since bankruptcy bills last passed both the House and Senate more than three years ago – significant developments have occurred that directly affect the presumptions underlying S. 256. Thus, even assuming that all of the provisions of this far-reaching bill were appropriate eight or even four years ago, the Judiciary Committee should carefully consider whether they are appropriate now.

Much has happened in the interim. The country went from a strong and growing economy in 1997, through an economic dislocation that caused a dramatic increase in unemployment (one of the leading causes of personal bankruptcy filings), and back to a period of solid growth, although in some parts of the country unemployment remains a significant problem. Yet, the number of personal bankruptcy filings has not grown significantly during that period. However, the nature of both the consumer and commercial credit markets has evolved in eight years. These facts suggest that the Committee should explore the causes of personal bankruptcy and whether the legislation proposed in 1997 to address a then growing number of bankruptcies is now appropriate. In addition, the Committee should consider the following:

- A number of huge public companies filed for bankruptcy during the last few years (e.g., more than 186 public companies filed during 2002) – sometimes on account of fraudulent activities. How cases such as these would fare under S. 256 should be explored.
- The bill imposes new, more complicated and more burdensome procedures in chapter 11 for businesses with less than \$2 million in debts. Yet studies such as that by Prof. Douglas Baird of the University of Chicago and Prof. Edward Morrison of Columbia Law School (discussed in the Spring 2004 issue of the *American Bankruptcy Institute Law Review*) show that, under current law, bankruptcy judges effectively and efficiently sort out and dismiss small business cases when chapter 11 will not assist in continuing the business as a going concern. Hearings should address whether the solutions proposed in 1997 make sense in light of data not then available.

With respect to personal bankruptcy filings, the Committee should consider the following:

- A study by a team of Harvard University researchers, reported just this week in *Health Affairs*, found that half of all personal bankruptcy filings are caused by soaring medical bills, even though the vast majority of those debtors are middle-class workers with health insurance.

- Investigations by the *Salt Lake Tribune* recently confirmed that most of the people filing for bankruptcy in Utah had a dramatic drop in income, incurred large medical bills or suffered a divorce; that the greatest predictor of whether a family will file for bankruptcy is whether they have children; and that many families that file for bankruptcy are struggling with home mortgages requiring payments exceeding 45% of their annual income, often because of a recent reduction in income. Similarly, data discussed in Warren and Tyagi, *The Two-Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke*, demonstrates that even two-income families operate on the brink of bankruptcy in the event of serious illness, job loss or divorce because both incomes are almost entirely committed to necessities, such as home and car payments, health insurance and children's education costs.

- Investigations by the *New York Times* and other media have documented exploitation of active duty members of the military by lenders, insurers and securities firms. Also, military families are turning to bankruptcy for relief from debts they cannot pay. Because the most common reasons for filing – job loss and medical debts – do not apply to military families, their high rate of bankruptcy filings is particularly troubling.

- Both the Senate and the House are investigating questionable activities of the credit counseling industry and the IRS is currently auditing 50 counseling agencies.

- The FDIC has referred to recent developments in the consumer lending arena as a "revolution," and has indicated that significant changes should be made in the supervision of banks with substantial consumer lending portfolios. We are concerned about, among other things, unsolicited offers of consumer credit with substantial penalty provisions to people who are not required to demonstrate their creditworthiness.

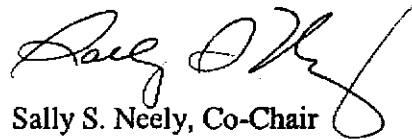
Further, S. 256 contains numerous technical and drafting problems that will create confusion in interpretation, including conflicting time periods for notices and inconsistent or apparently unintentional uses of defined terms. Although these need not be the subject of hearings, an opportunity to discuss these issues with Committee staff would be appropriate and welcome.

Again, we support your decision to hold a hearing on S. 256, and encourage you to consider at least one additional hearing. And, we renew the NBC's continuing offer of assistance with respect to the evaluation and reconsideration of the nation's bankruptcy laws.

Senators Spector and Leahy
February 4, 2005
Page 4

Please feel free to contact me, Don Bernstein (Chair of the NBC), Rich Levin (Vice Chair of the NBC) or Ralph Mabey (Co-Chair of the NBC Committee on Legislation).

Sincerely,



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