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## The Future of Bankruptcy: A Roundtable Discussion

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*Participants:* **Marianne Culhane**, Professor of Law, Creighton University School of Law

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**The Honorable William Edmonds**, Chief United States Bankruptcy Judge, Northern District of Iowa

**Daniel L. Keating**, Associate Dean for Academic Affairs and Tyrrell Williams Professor of Law, Washington University School of Law

**Katherine Porter**, Associate Professor of Law, University of Iowa College of Law

**John Pottow**, Assistant Professor of Law, University of Michigan Law School

**The Honorable Charles E. Rendlen, III**, United States Bankruptcy Judge, Eastern District of Missouri (formerly United States Trustee for Region 13)

**The Honorable Eugene Wedoff**, United States Bankruptcy Judge, Northern District of Illinois

**James J. White**, Robert A. Sullivan Professor of Law, University of Michigan Law School

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**Cecil:** I am going to begin with a question that Dean Keating just posed to me, because I believe that it is at the crux of the BAPCPA provisions. We would like to get the views primarily from the bench on it. Professor Elizabeth Warren argues, based on her empirical research, that most people end up in bankruptcy because of a health care catastrophe, divorce, or the loss of a job. Professor Warren's critics argue that most people file for bankruptcy because of poor consumer choices, bad decision-making, ignorance, and being enticed by credit cards. The question for our judges is what percentage of each do you think reflects reality based on the cases that you have seen?

**Wedoff:** It is a combination of both. If people are living close to the edge, then when they have a medical emergency, the loss of a job, or a divorce, they can't keep up. If they weren't living close to the edge, if they had substantial savings, or if they had one spouse staying at home so that that spouse could go to work when the other spouse lost a job, they would have a certain safety margin. They don't have that safety margin. Now Professor

Warren argues that they don't have it because they can't — the cost of actually living in the United States has increased so much that to be a middle class family always requires both spouses to work and requires that they spend all of the money that they get. I don't know if that is true or not, but I do know that it is the combination of having no savings and having substantial debt combined with a health care catastrophe, divorce, or the loss of a job that causes the difficulty.

**Edmonds:** I agree with Judge Wedoff. We have all of the situations where consumers have job loss, medical problems, or divorce and they end up in bankruptcy. On the other hand, I think that we live in a culture of excessive credit. I speak with high school students in our town every year and it seems to me that we have credit card companies saying to them, "You can have all this stuff!," "You deserve it!," "Go for it!," and "We're going to give you a piece of plastic that allows you to get it!" There is no self-control for a lot of people and so when one of these catastrophes, such as job loss, happens, and they will, the excessive debt forces people to file for bankruptcy. I have to sit down with my kids and almost wring their neck and tell them that they cannot keep moving credit cards around; they can't have all these credit cards. It's bad. I guess my feelings are that the debtor education that we're now requiring for bankruptcy is too late. We should be educating students in high school. I used to argue that everybody should take four years of philosophy in high school. I gave up on that a long time ago. We should be taking four years of credit card management education.

**Cecil:** That's in fact what Professor Porter was saying yesterday. You have to start the education process in grade school. You have to hit them over the head in high school. By way of analogy, it is very clear that my students have learned that exercise needs to be a part of their daily lives. I keep working at it personally, but exercise is ingrained in them. I think that if we had credit education training sessions early on, credit management would be ingrained in them as well.

**Edmonds:** It's fascinating to me that we live in a culture where we satisfy our deepest emotional problems by buying things.

**Wiener:** Yes, it's true.

**Wedoff:** I just have to comment on that 52" flat screen TV in our hotel room that we heard mentioned yesterday. One of the ads that came up repeatedly was this attractive red-haired young woman talking to us about how we could get satellite high speed internet. The commercial goes, "\$100 off if you act quickly," but the very last thing she says with a big smile on her face is "You deserve it." Which is just your point. That is the message that we are getting over and over again. Talk about educating children early; I told my kids from the time they first were able to watch TV what the difference was between a commercial and the cartoon. I told them to be careful about the commercials because all commercials lie. Can you figure out where the lie is in this commercial?

**Edmonds:** And there is a great difference too in people. In consumer bankruptcy schedules, it is interesting that if you throw out the fixed costs,

such as your home, the other items should be roughly the same for a four person family on the wealthier side and everybody else, but they're not. People get used to spending as much as they possibly can on things. And so when they file bankruptcy and I look at their expenditures on Schedule J, what they think is necessary is crazy.

**Keating:** Even with homes, you say that you assume that home costs are a constant, but mortgage companies are figuring out ways where you can really buy more home than you can afford to keep up the debt service on. They are so aggressive with programs like negative amortization and zero interest that you can qualify for a bigger mortgage with a smaller payment. Unfortunately there eventually is a big balloon payment or the mortgage is negatively amortized, so even on homes consumers make a choice about whether they want to stretch themselves financially or give themselves a financial margin.

**Edmonds:** We have people that are filing Chapter 13 bankruptcy that have absolutely no equity in their homes. I am always surprised that creditors leave that issue alone so frequently. I've had only a couple of cases where someone has raised it and I have said "You can't stay in this house. You have been there a year. You owe \$180,000 on a \$110,000 house. Maybe you should rent for three years until you get out of this."

**Porter:** I think that our federal government's policies historically of pushing people toward home ownership are not necessarily doing people a favor financially. The average person who bought a house last year put down three percent. That was the average. So there are lots of people putting down zero to balance out the very few people who put down ten or fifteen or twenty percent. The average American home costs \$218,000 right now and the median income is \$43,000. So when you think about some of the older generation who were my age when they bought their first house, it might have cost their entire salary. For example, my mom made \$17,000 as a schoolteacher and her first house cost \$17,000 or \$20,000. That's not true for people anymore. Even those who want to be cautious are finding it difficult to find affordable housing, in part because the availability of credit is fueling higher housing costs.

**Wiener:** It's an issue of predatory lending as well. How these people are getting loans with three percent down for a \$218,000 house means that they have to pay a huge amount of interest. Somebody has to stop these predatory lending practices.

**Wedoff:** The ugly specter of paternalism is starting to appear on the horizon. If you believe in a free market, then you believe that consumers ought to be able to get loans at high interest if that is the only way they can borrow. Similarly, you believe that they should be able to go to riverboat casinos if that's what they really prefer. And they should be able to buy heroin if that's what they really enjoy.

How many times have we heard the credit industry compared to drug pushers? It is not an analogy that I personally think is accurate, but I've heard it many times. And there are some points of contact between the two busi-

nesses. Certainly, teaser rates for credit cards to get people interested in using them and developing a balance that they carry over and pay interest on month-to-month are similar to free samples that cigarette manufacturers used to distribute on the streets. There is a sort of habituation to the use of credit that seems to develop in people; so there are some similarities. The differences are that you can see very good, effective uses of credit, even for people who may have to pay high interest, if they are using credit to better themselves, to provide for genuine necessities, or to invest in their education. The problem, I suppose, is one of debtor education and, perhaps, there is a role for a little bit of paternalism. Maybe no-down payment mortgages or interest-only mortgages are not a good idea.

**Dickerson:** I see a difference between sub-prime lenders and predatory lenders, which is a term that Dr. Wiener used. Predatory lenders are inserting certain credit terms that benefit only them or are just lying and filling out forms, pretending that the borrower actually signed the forms, or are inserting clauses that no one knew about until the closing. I guess I view those lenders differently than sub-prime lenders, who are making loans to debtors that do not have particularly good credit at higher interest rates than more credit-worthy debtors could get. I agree that to the extent we want to prevent those high interest loans, or the zero down or negative amortization loans, maybe we are being somewhat paternalistic. But for the true predatory lenders (and as you might guess, I have strong views about them), we should treat them differently than we do the pure sub-prime lenders.

**Wiener:** Of course the problem is how to find the line between predatory and sub-prime lenders. The predatory lenders are marketing to segments of the population that they know they can get. And they are using marketing techniques that are extremely effective.

**Wedoff:** Is a payday lender predatory or sub-prime?

**Dickerson:** I would say both. They are sub-prime, but there are some predatory aspects of the payday lending industry.

**Pottow:** The responses of the judges vindicate my pessimism about reforming the bankruptcy system because I think the cause of bankruptcy is, as they say, both bad debt practices and personal catastrophes. It's both the exogenous factors, such as the shock of the loss of income during unemployment, the health stuff, and the factors raised by Professor Warren, but it is also the consumptive factors, whether they are pushed upon us by culture or whether they are changeable personal behavior that we can alter through aggressive re-education early on. But it's clear that there are endogenous consumption choices going on that create debtors' problems as well. It is both. And the problem we have with bankruptcy reform is that it's such a touchy political issue where two constituencies are talking past each other. Each one is terrified to concede ground on the other side for fear that it's going to weaken their position. I wish that I could say something more positive. We have one of the lowest savings rates of the industrialized world. And yet we are told in response to September 11<sup>th</sup> that we must do our patriotic duty and go out and buy more stuff to help the American economy. I just don't see

how that's going to help us structurally. The bankruptcy reform movement is clearly the dominant party in one of those two camps, but I don't see any movement on the other side of the camp or even concession on the part of the dominant side. It's like "We won and we don't have to talk about re-education or savings rates or talking about structural changes to the health care system in this country." It's not even on the table right now.

**Wedoff:** But education is part of BAPCPA. The idea is that if debtors ever go into bankruptcy they are going to be educated as to whether they really need to be in bankruptcy, and then, theoretically at least, they're going to get a course after they get into bankruptcy that's going to help them with their budgeting and their financial management thereafter. Now I personally don't think that this education is going to work. I don't know if anybody here has had the experience of getting cited for a minor traffic violation and being given the alternative of getting traffic education instead of having a permanent mark on their record? This has happened to me, I'm embarrassed to say. And I went to the school and sat with a group of fellow students for about three hours listening to a not-very-entertaining lecturer tell us things like "you ought to obey the speed limit"; "you ought to keep a reasonable distance between your vehicle and the vehicle ahead of you"; and "you ought to signal when you are going to make a turn." All of this was news to most of us in the room. And, when the program was over, I was meeting with a group of my fellow students afterwards and the question that seemed to be bouncing back and forth more than any other was "how many times have you gone to this?" I'm afraid that consumer financial education may have some of that same flavor.

**Keating:** I agree with Judge Wedoff in his skepticism about how much consumer education is going to help. And I analogize to the area of health, diet, and exercise because today we know so much more about what we need to do to be healthy and maintain our proper weight than we did twenty or thirty years ago. But guess what? Americans are heavier than ever. There are more overweight Americans today than there were thirty years ago when we didn't have as much education. So yes, maybe some people just don't understand credit, but even after they understand, they still have to make hard choices that get to delayed gratification, which is a tough, tough thing to do. And so I think that we are still going to be dealing with the human impulse to get as much as we can now because of easy credit terms that weren't available before. In the end, more people are going to make bad choices just because they are available to them.

**Wiener:** There is education and there is education. What you are talking about is the transmittal of information. As a psychologist dealing with those kind of topics, I can tell you that for the past twenty-five years my field has been completely convinced that transmittal of information is the most important issue in education. I think in the last ten to fifteen years, even five years, we have come around again to understand that issues of motivation and emotion are as important, if not more important, in educating people to do things that they need to do in their best interest than the transmittal of information

alone. Really, what we are discussing is that those issues of emotion have to come into play in designing education systems. Having said that, it is easy to say, but not as easy to do. But I do think that the kind of effort we need to make has to be along those lines.

**Wedoff:** This is getting back to what Professor Jacoby started us out with yesterday. What does bankruptcy really accomplish in the lives of people who go through it? If the structural problems that we have been talking about today are not at all addressed in the bankruptcy process we really have not advantaged people much at all. One of the questions on the list Professor Cecil provided for us is whether Chapter 7 is a better model than Chapter 13. For people who have developed bad habits of borrowing and spending, I believe Chapter 13 is the better model. Chapter 13 creates a budget and gives people a very strong incentive to live within that budget. I think Chapter 13 worked better when it had a super discharge because we want to motivate people to go through the fairly difficult process of living on a budget for three to five years. I think it worked better when we had real strip down of secured loans to the value of the collateral, but even in its present form, Chapter 13 has the potential for serving an educative function that isn't present in Chapter 7. And if we can make Chapter 13 as effective as possible for people who have those bad habits, I think we do them a greater service.

**Cecil:** That's the question. If people think that in theory that Chapter 13 is better than Chapter 7, and we certainly haven't debated that to any extent yet today, statistics show that most Chapter 13 bankruptcies fail, and that's when debtors were required to propose only a three-year plan.

**Wedoff:** Most don't go into discharge at the end of the plan payments, but that doesn't necessarily mean that they fail. Most of the Chapter 13 bankruptcies that I've presided over were dismissed because the debtors were able to refinance the secured debt that got them into Chapter 13 in the first place. The debtors went on to take care of their other debts in the ordinary course and did not have to pay eight to ten percent to a bankruptcy trustee for the privilege of paying those debts. So that is a success as far as I can tell. We don't know what the real percentage of success is in Chapter 13.

**Rendlen:** If you want statistics, there is an interesting difference between the Western and Eastern districts of Missouri in Chapter 13 cases. In the Western District, fifty-three percent of the debtors with confirmed Chapter 13 plans received a discharge—a high number compared both to the national average and to the Eastern District's average. This high number of discharges in large part is related to the fact that there were comparably few instances of filing and re-filing in the Western District. By contrast, it was a common practice in the bankruptcy culture of the Eastern District to dismiss a case and re-file when the chapter 13 debtor faced difficulties under a confirmed plan. And also in Chapter 13 the educational process that occurs on the Western District is much greater than in the Eastern district, so statistically there is an argument that the lawyers who work on the western side of the state actually work harder to make Chapter 13 bankruptcies work through

the system because there are more penalties for re-filing on that side of the state.

**Cecil:** We have been focusing on all the negative aspects of the Act, so let's shift gears now. What are some good things that the Bankruptcy Reform Act did for the bankruptcy system?

**Dickerson:** Skeptical though I am about credit counseling, I think that to the extent that credit counseling and all of the studies that Professor Porter mentioned yesterday yield good and useful data, that is a positive. Even though generating data wasn't the reason that the credit counseling provisions were put into the Act, the recent study by NACBA shows that we wouldn't have had access to that data as quickly but for the fact that every debtor now is forced to go through the credit counseling. It would be great if, to be approved by the U.S. Trustee's office, the credit counseling agencies were required to keep data in a certain way so that people like us could then look at the data and see what was really going on. But at least there is the potential for us to get a real sense of why people file for bankruptcy. We could answer the question that Dean Keating posed to the members of the bench, because all debtors would be required to answer certain questions at the consumer counseling agencies. That's potentially a good.

**Pottow:** I like the auditing provisions. I think they will be very important to the system of bankruptcy and possibly very helpful to the debtors themselves. I think it will eliminate the temptation, if there is one, to slide through bankruptcy and think that you can conceal assets. I think it will inject some random terror into the system which will have the good effect of building confidence in it for those outside the system who distrust the bankruptcy organism, as Professor White called it. If we find a lot of concealed assets through the auditing provisions, we can change the system for the better. And if we don't find a lot assets, it will shut up a lot of people who have been falsely criticizing it. Either way I would be happy with the results.

**Rendlen:** We have been running the auditing study on a pilot basis. Let me just share with you some data, which you will find totally intuitive. A study conducted by the U.S. Trustee's office of approximately six hundred debtors found that people with higher incomes tend to understate their incomes and understate the value of all of their assets far more frequently than is the norm. That's all the study really found. While lower incomes debtors, of course, make mistakes in completing their schedules, these mistakes are often attributable to inadvertency or misunderstanding, rather than a deliberate attempt to hide assets or otherwise commit fraud. And the occurrence of these instances also were within the statistical norm.

**Cecil:** It's good to know that the results from the pilot program on the auditing provisions are already available.

**Wedoff:** I wouldn't say that the two things I am going to mention are the best aspects of the new law. I think the ones that have been talked about are better. But there are two genuinely good things in the law, one of which could be a lot better. The one good thing is *in rem* stay relief because it deals with a problem that is really nasty where it exists. This is the idea of dividing

up ownership of a piece of property into fractional interests and then having each of the owners file a bankruptcy case seriatim. It doesn't help to stop serial filings because it is not the same debtor who is filing; it is a different debtor each time. There was nothing in the Code prior to BAPCPA that gave any express authorization for judges to issue relief from the stay. In one case it would bind a debtor in a subsequent case. Some judges did it. I thought that was judicial activism. Now it is authorized so that where that problem exists, it can really be dealt with effectively. That's number one.

Number two is direct appeal to the courts of appeal from the bankruptcy courts. We heard yesterday that one of the advantages to an administrative model of bankruptcy would be quicker development of binding precedent. One problem that has really slowed down the judicial model is that we have appeals from the bankruptcy court to the district court or a bankruptcy appellate panel, neither one of which is generally perceived as being authoritative. Then there is a need for an appeal to the court of appeals before there could be binding precedent, which only resolves the issue for that circuit. It takes the Supreme Court to ultimately resolve the issue, and there is a special problem in bankruptcy when dealing with consumer cases because the consumer debtor very frequently doesn't have the resources to pursue repeated levels of appeal. Direct appeal has the potential of getting something to the Supreme Court more quickly and notifying the bankruptcy court that there is going to be an appeal of an important issue. So there are potentials there for really improving the system. Now the problem is that the particular provisions for direct appeal are not well drafted. They are very confusing. And they are completely discretionary with the court of appeals. The suggestion that I have made is that BAPs should be constituted as units of appeal the same way bankruptcy judges constitute units of the district. If BAPs could issue circuit-wide binding opinions subject to review by the courts of appeals, I think that we would have knowledgeable judges reviewing bankruptcy issues quickly and effectively, but always subject to Article 3 jurisdiction in the same way that decisions of bankruptcy judges are at the trial level.

**Cecil:** Gentlemen on this side of the panel? What are the positive aspects of bankruptcy reform?

**Keating:** I'm not generally a fan of new priorities (or elevating priorities), but it is probably a good thing to make domestic support obligations the first unsecured priority. My theory is that if you think of the debtor's children as, in Professor Lynn Lopucki's words, involuntary creditors or similar to tort creditors, it makes sense to put them ahead of creditors who at least chose to extend credit. Now that assumes that the extra money then gets to the children, and that is probably true in some cases, but not in all cases.

**Wedoff:** It was almost a disaster because there was no carve-out for costs of administration. Had the provision gone through as it was originally proposed, we would have had a situation where there were assets available to be collected for child support recipients, but the trustee would have had no incentive to pursue them because there was no money to pay the professionals whose services would be required collect those assets. But that has been

changed. There is a carve-out sort of super priority, if you will, over that first priority. The other thing that is really nice about that debt is that there is now a consistent definition of domestic support obligations, which eliminates a lot of ambiguities that existed before.

**Cecil:** Let's move on to another question. What provision or provisions in the Act do you predict will cause the greatest harm to the bankruptcy system?

**Porter:** I am in the middle of a study, so I've been talking to a lot of practitioners about the new system. As Professor White said in his presentation yesterday, the biggest problem is the increased burden to get in the door at day one. We are going to lose more homes to foreclosure. Now whether bankruptcy would have actually let those people save their homes, I'm not so sure. But all of the practitioners I have talked to have said that they have been getting phone calls from people whose home sale was scheduled that day or the next morning, and the attorneys were not able to get the paperwork and credit counseling done before the foreclosure sale. People were losing their homes as a result. The early decisions that I have seen about the credit counseling waivers for exigent circumstances suggest that if you as a debtor are a below-average-income person walking down the street and you didn't realize that you needed to get on the ball five days before your foreclosure sale, that is too bad. And how exactly we are informing Americans about this, I am unsure. So the greatest harm is that people are losing their homes because of this new law.

**Dickerson:** In the case of *In re Sosa*, which came out of Austin, Texas, the bankruptcy judge's opinion was a shot that was heard around the country. The Sosas were a couple that had a mobile home right outside Austin and the foreclosure sale had been set. Even though there was significant publicity about how debtors needed to file bankruptcy before October 17<sup>th</sup> to take advantage of the old law, the Sosas didn't file then, because they were trying to work things out with their creditors. By the time they saw an attorney about filing for bankruptcy, the October 17<sup>th</sup> filing deadline had passed. The new law added a credit counseling requirement, but the Sosas didn't do credit counseling. They didn't know that they were supposed to do credit counseling. In his opinion, the judge said that the couple was not eligible for bankruptcy because they did not meet the credit counseling requirement, and he could not give them a waiver, even though they desperately needed it to keep their home. The judge was not a fan of the new requirement, and made that clear in his opinion. Again, as Professor Elizabeth Warren would say, the new law is full of little paper cuts that you have to do before filing for bankruptcy. You've got to line up this and that and meet all of these pre-filing requirements. I think that these requirements are going to keep a lot of people, like the Sosas, out of the system. Maybe they shouldn't be in the system. But there may also be some people that need to file for bankruptcy but can't because they don't have all their ducks in a row.

**Pottow:** I have a more structural or theoretical problem with the revisions to the Code, and that is how to raise costs and run the rule of law in

bankruptcy. I would have been more sympathetic to the transparency of a really tight means test. I don't think I would have agreed with it, but at least it would be out in the open that we want to bar more people from Chapter 7. Also the idea of keeping down the procedural costs that Jim White talked about yesterday, and you are discussing today, is another way of accomplishing that goal that is a bit more subsurface. I am less enthusiastic about these procedural hurdles to filing bankruptcy as a way to manipulate behavior. But what really gives me pause is to say within a legal system that the real problem is the lawyers. BAPCPA goes after bankruptcy lawyers as a way to rework the bankruptcy system. And lawyers are the enemy. So in that regard, the thing that gives me real trouble is the provision that says lawyers are not allowed to say this or that to their clients. That provision goes into the attorney-client relationship at the most fundamental, direct level. I think it opens up a new door that I haven't seen a lot of in the law before. I am worried that it's a very dangerous door to start opening.

**Wedoff:** I think that it's unconstitutional. That issue will be addressed. I want to raise the flip side to the point that I made earlier that I think Chapter 13 for many people is the best aspect of bankruptcy. BAPCPA does any number of things to make 13 less attractive. First, if your current monthly income is above the median (and remember how arbitrary that can be), there is a five-year minimum term before you can get a discharge in Chapter 13. Why should debtors be penalized because their current monthly income is at that level even though it is clear that they are not abusing the system and there is no presumption of abuse? That's peculiar.

In addition, the requirements that all auto loans incurred within two and a half years of filing and all collateral other than automobiles for which a secured loan was granted within a year of filing be paid in full in order to retain the property are big problems. I don't understand those provisions. The loss of the super discharge is another big problem, not only because the debts are not discharged, but because they will continue to incur interest and penalties during the entire time of the Chapter 13. So what happens? People who were able to file Chapter 13s and obtain the fresh start in the past are now shut out of chapter 13. They don't have enough income to make all the minimum payments that they are required to make. And that's just when you look at the things that are visible. The invisible additional costs are the extra attorneys' fees and the need to get better counseling before filing the case in the first place. So we have just eliminated Chapter 13, the best thing that bankruptcy has to offer, for a lot of people who need it.

**White:** I have trouble answering both questions (the greatest harms and benefits to the bankruptcy system resulting from BAPCPA). First of all, how did people in my generation get so that they saved money? It is because their parents went through the Depression and said to them every day when they were children "Use it up," "Make do," and "Do without." My father, who was a lawyer up in Iowa, told me at one point that the entire state of Iowa was going to belong to the insurance companies because every farm was under foreclosure and the government called in the insurance companies, who said,

“We are going to put you out of business unless you sell these farms right away, unless you make some kind of accommodation.” So there is a lot of pain that was inflicted in the Depression that produced the behavior in my generation that we don’t buy things on credit.

**Wedoff:** But you didn’t have the availability of credit either. I remember when I started my law firm job making an unheard of sum of \$16,500 a year, I was offered a card from Sears-Roebuck after a very thorough investigation with a \$500 credit limit.

**White:** I always had more credit than I ever used, so that never occurred to me. I’ve never, except for my mistake once, let my credit card run over one month and that was deeply ingrained by my parents, who went through the Depression. So if BAPCPA inflicts all of this pain and screws up the system so that it is not good for anybody, eventually thirty years from now those people will be saying to their children, “Debt is really bad.” That will be better training than anything we can teach in the fourth grade. We need to know more about how we influence the behavior of creditors and how debtors get to be savers instead of debtors. That is a complex question and the bankruptcy system probably has an impact on it. And how painful and unpleasant the system is and how painful and unpleasant it is to fall behind in your debt probably has an effect on how you incur debt later on and how your children incur debt later on. So, I can’t answer the questions. If you told me a lot of pain for ten years would change this problem and we would have a generation of people who use credit wisely, I would say let’s inflict the pain. If you say that won’t matter, then I would say we ought to change the statute and make it more generous.

**Porter:** I am glad to hear Professor White acknowledge that the reason that bankruptcy and bad credit are happening to people in my generation is a failure of parenting among his generation. There is a responsibility for your generation’s failure to adequately parent my generation.

**White:** My daughter, a lawyer, once bounced a check when she was renting in college. It was to me; I was the payee of the check. So I would concede that I have not been completely successful.

**Edmonds:** The failure of parenting, however, is a whole mal crux and probably the earliest of the problems is advertising that is stronger than life. I speak to kids who are juniors about bankruptcy and debt. It has turned into a lecture on how to look at credit card applications so that they don’t get into trouble. Every year I ask at the end how many students have credit cards. These kids are seventeen years old and a lot of hands are going up. How many have two? Those numbers are going up. I think that even if parents try, they are having trouble keeping up.

**Porter:** That was my humorous point, but my serious point is that I think what we have seen is a time lag between the freer availability of credit (such as the deregulation of credit, from mortgages to credit cards to reinvigoration of payday lending, changes in usury laws, and securitization, which makes some of this credit flow) and how we understand as consumers what those increased risks mean for us on a concrete level. So I do not think

that people today are less moral. I really resist that. What I do think is true is that people today are engaged in riskier financial behavior and I think some of that is because they do not properly understand that what they are doing is, in fact, risky. Professor Dickerson and I were talking about whether the fact that we teach bankruptcy makes us financially conservative, and she responded, "Oh, yeah, I have every kind of insurance known." I said that I do too. I won't let my husband buy a CD if it is over his monthly limit. Professor Dickerson said that I was being paranoid, but I responded, "I don't know. One in seventy households went broke." One in seventy — that's a lot. I don't have that much confidence. Now, given my graduate degree I know demographically that I am a low-risk person, but I think there is a big lack of understanding as to how these forms of credit really expose people to risk. And I think some of it is educational and some of it is our government, which has not recognized fully what its policies are doing to ramp up people's risk even further.

**Pottow:** It is no secret that consumer credit is a handsomely profitable industry, even with healthy rates of bankruptcy discharge of that debt. So Professor White's agnosticism on the demand side is well taken. Because we can inflict a lot of pain and change the demand for credit, but if we are fighting an uphill battle on supply that is outpacing our efforts of demand, then we are just wasting our time. I think you've got to have both factors working together.

**Keating:** Following up on Professor White's desire to inflict more pain on this generation, what if we got rid of consumer bankruptcy altogether for a time? What would the world look like? What do you think would happen?

**Wedoff:** There would be pressure on state governments to provide alternative debt relief, exemptions would go up, bans on wage deductions would go into effect, moratoriums on debt collection might be enacted, and there would be enormous pressure at the local level to deal with it.

**Keating:** Who would bring that pressure? Do you think that the debtors as a group have effective lobbying force that would get them anywhere?

**Wedoff:** What would happen is that there would be newspaper stories of people losing their homes, people unable to support their families, people jumping out of buildings, if you will, the Depression sort of thing that I think would lead to the state response. That has already happened in Illinois, by the way. Our exemptions were doubled in response to BAPCPA. They were very low and they're now at the federal level.

**Dickerson:** It also happened immediately after Katrina. There, certain moratoriums were placed on some of the federal mortgage loans. In addition, the governor of Mississippi found an archaic law that no one really knew was on the books, and he basically imposed a ban that prevented foreclosures of certain types because there was no bankruptcy relief available. They did at the state level what couldn't be accomplished at the federal level.

**Wedoff:** Dean Keating, what you have really asked for is a thought experiment. What would really happen if we didn't have debt relief? Wouldn't what happens be a real decline in consumer spending - a real decline in eco-

conomic activity at the consumer level with people afraid to buy that new wide screen television or the new camcorder?

**Keating:** How long would it take for people to become afraid?

**Wiener:** I think that people would continue to spend pretty much at the same levels that they are currently spending, but there would be more foreclosures against their homes and they would not be able to support their families.

**Wedoff:** That would be the short-term, but isn't Professor White's point that once that happened to the parents the kids would realize the mistakes their parents made? Kids always realize the mistakes their parents make; they are so sensitive to that. They would come to the conclusion that they shouldn't spend so freely.

**Pottow:** The problem is that that is an expensive lesson to teach, and the dislocation and fallout costs make it an inefficient way to teach the lesson.

**Wiener:** There are other ways to teach the lesson.

**Pottow:** Yes, more efficiently.

**Wiener:** Inflicting pain may, in fact, be a reasonable approach to solving the problem, but I'd like to think that there are alternative approaches about educating the next generation on how to use credit in a wise way other than inflicting pain. I am convinced that inflicting pain is not the most appropriate and effective way to do that education. Of course, as a public policy researcher I am of the opinion that what we need to do is to figure out what the solution to this problem is by collecting the data, looking at the data seriously, taking seriously the opportunity to do research and figure out how it is that we can, in fact, train the next generation to spend more wisely and more appropriately without inflicting pain.

**Wedoff:** I would like to know if we have a macroeconomist in the audience, because my question is this: if there was a significant decrease in consumer spending, what would that do to the economy of the United States?

**Culhane:** Ronald Mann has recently been doing some writing on ways perhaps to structure a tax on creditors who lend to debtors when it is already clear at some level that the debtors likely might not be able to repay that debt. Especially with the technology and sophisticated credit reporting that we have these days, I believe that it is possible for creditors to make this determination if they decide to use the information available to them. I just wonder if there is anything that should be done to affect supply, as opposed to just demand?

**White:** Professor Culhane, I think that we should have a study. Pick out one thousand people who are going to get stupid mortgages, such as the ones where they have negative amortization. Of the thousand people who wouldn't have gotten mortgages ten or twenty years ago, find out what happens to them. It might be that ninety-four percent of them struggle through and wind up with a much bigger house than they could have gotten ten years ago, and six percent of them go under. We might say that is a fair tradeoff. We don't want to discourage this kind of debt. The trouble with Professor Mann's proposal, of course, is that it allows Big Brother to decide. I have a deep skepticism about Big Brother and whether Big Brother will make the right choices.

**Pottow:** What I find so persuasive about Professor Mann's article is that he is such a died-in-the-wool libertarian, that if he is so distressed by this situation as to recommend government intervention, it really must be a big problem.

**White:** I don't like the idea.

**Pottow:** The tradeoff is exactly as you said. Do you want to contract consumer spending, which you're going to have to do at some level? If you are going to cut off this credit, you are going to have to contract the consumer economy to save the dislocation costs. And none of us have the empirical data yet to answer the question of whether a societal tradeoff is better.

**Porter:** I think there are a couple of small things that we could do to change credit habits. One of Ronald Mann's other articles, which will become part of his forthcoming book, suggests ways that we can change the liability rules between credit and debit cards and get rid of affinity programs so that we motivate people to use debit cards. Right now a truly wise consumer will use credit, because she is better protected if she charges something on credit rather than using a debit card. But that just encourages the use of credit. Encouraging people to use debit cards is an easy policy fix, with no particular expense.

I also do not think that home equity mortgages should be tax deductible. Americans are so cheap about taxes. They will do anything that they think will get them a buck off their taxes. We know that people will put money in medical savings accounts that they end up not using because they want the extra tax dollar, right? I think that getting rid of the tax deduction on home equity loans would help convince people not to take out home equity loans. And I think that there is some evidence that a shockingly large number of those sub-prime mortgages that you were talking about go into foreclosure. I cannot give you the exact statistics, but it is very, very high. In addition, minority groups are much more likely to have these sub-prime mortgages. We are currently seeing the highest ever minority home ownership rates.

**Pottow:** And the highest foreclosure rates.

**Porter:** The minority foreclosure rate has gone up three to four times as fast as other foreclosures. So we are just putting people into homes and setting them up to fail. Not only are there financial costs of that failure in terms of their credit reports, but there are also psychological costs. One of my co-authors has done some interesting research on how going bankrupt affects marriages — it's not good in terms of divorce rates.

**Edmonds:** Debtors are not saving their homes with these second mortgages. They are ending up in Chapter 13, which only accomplishes one thing, and that is to cure the arrearages on the homestead (and maybe to pay taxes). There is nothing left for unsecured creditors under the best interests test.

**Porter:** Maybe we need something specifically designed to help people in trouble with their homes. That may be down the road as we live with the consequences of everybody owing 110% or 120% on their homes.

**White:** That's going to help people make stupid choices when buying homes.

**Porter:** I want to change the ex ante behavior. But I am dubious that it will happen. I am frustrated with the government harping at me to buy a home. I gave in this year. People say that Americans have an obsession with home ownership. I understand that it is most people's largest asset, but perhaps it shouldn't be. If the empirical research I have done has suggested anything, it is that people would be much better off having their largest asset be something that is a little bit more liquid than their home. Then when the time comes and they have one of the shocks that Judge Wedoff was talking about, they can tap into it in a form that is less risky to their family than losing a house.

**White:** Let me make a different point than before, which is that home ownership is desirable in some sense precisely because it is not liquid. It is forced savings. Now that debtors can get equity lines of credit, home ownership is not forced saving anymore. Out in California I talked to some people who boggled my mind. They use home equity lines of credit like checking accounts. So, you make a nice point. That means that if my goal is to create a way of producing savings, we've lost that.

**Porter:** I think that is right.

**Keating:** This raises a tax point in my mind that I want to ask Professor Cecil. Professor Porter raises the point that we reward people in our tax system for borrowing, at least for home equity loans, and then we tax the interest income on a savings account. Are there ways that we could change the tax laws to try to reward people for saving and punish them for borrowing?

**Cecil:** There certainly are. There is the consumption tax where we tax you on what you spend, and we don't tax you on what you save. The problem with that tax system is that it is terribly regressive in nature because people in the lower income echelons, who are oftentimes minorities, are the ones who are more likely to have to spend everything that they earn. I do think that there are some incentives in the tax code for spending that there shouldn't be, like the home equity loan. I just took out a home equity loan with a variable interest rate. When I took out the loan it had about a four percent interest rate, and a year later it was over eight percent. I took money out of savings to pay off the home equity line of credit, but I learned a really scary lesson. I'm a pretty smart person when it comes to tax laws, but there were no tax savings there. So I agree with Professor Porter that the tax laws should not be incentivizing that sort of spending.

**Pottow:** Dean Keating, you raised an interesting point that a lot of the current legal reforms with respect to payday lenders are being done at the state level. Why is that, I wonder?

**Porter:** Why are they doing things at the state level? Because they can't get any traction at the federal level. North Carolina has the first and most aggressive payday lending law in the nation. What is interesting is that North Carolina is a banking center. The Center for Responsible Lending is there. They built a grass roots movement door-to-door. North Carolina had a real problem with predatory and payday lending and they passed the first big

predatory lending law. There is just a feeling that the federal government can't compete.

**Edmonds:** What is North Carolina's lending law?

**Porter:** I can't remember the specifics, but basically it bans high-cost loans.

**Edmonds:** Like a usury law?

**Porter:** Some states that have done this have gone to increased disclosures with high cost loans, but the North Carolina law actually prohibits certain kinds of high cost loans.

**Wedoff:** It is a usury law.

**Porter:** Yes, it is a usury law. I believe that it only applies to home loans. From talking to consumer law professors and consumer law advocates, I think that the feeling is that they can make progress at the state level.

**Cecil:** So what else can be done at the state level? We know that generally the political mechanism at the federal level works very slowly. Can anybody think of some ideas where state law can step in to help keep consumers out of bankruptcy rather than having to go all the way to the federal system to change the law?

**White:** Just go to North Dakota. It is the last communist state. The biggest bank in the state is the state bank. It had all kinds of laws that prohibited foreclosure. All of these laws were passed during the 1930's. You could go look at their statutes from the 1930's and enact them. It would solve everything you want.

**Wedoff:** They would stop urban sprawl.

**White:** It would also keep the population down.

**Porter:** It would also stop economic growth. The economy of North Dakota isn't doing too well. The one problem I see with the state level is preemption by the federal government. That is what is happening in North Carolina. All the state level activists, and even the attorney generals of some states, are trying to stop predatory lending. For example, Iowa is gearing up for a big battle about title lending, which is often called "auto pawn." Part of the issue is that increasingly the federal government is coming in and saying that it controls the banks, and uses federal preemption to stop states from enacting these types of laws. It is becoming very hard to use state law, even if the initiative is there. We are losing what Dean Keating has called our laboratories because of federal level preemption. We are losing the chance to see whether some different things would work because of it.

**Pottow:** You can't even have state usury laws, right? Because the *Marquette* decision says you can just locate your bank anywhere.

**Dickerson:** There is one other thing that we might be able to do at the state level and that is education. Although the No Child Left Behind Act controls education funding, states basically control what is taught in their public schools. I am a strong advocate that high school is too late for the education to take place. I even think that middle school is too late. My husband is a middle school math teacher and it is horrifying what students don't get in math in the middle schools. Largely I am a devotee of Sesame Street because

Sesame Street had this great program a few years ago where they taught rights, responsibility, and respect. It was geared toward the two-to-five-year-old crowd, but it was a financial literacy program for that age group. Maybe we don't need to start at age two, but I think that it is a good thing to start at age two. Both my two and three year olds can say the word interest. They know that interest is good. We put our money in the bank because we get interest on it. And that's more money. So I think that states control educating people about good and bad credit decisions. The federal government can't come in and say that the No Child Left Behind Act prohibits that form of education.

**Porter:** I think the parallel to democracy and the idea behind having public education in a democracy is that if we are going to empower people with the choice, the ability, and the freedom to govern themselves, we need to have educated people. If we are going to have an open and free flowing credit economy, to make that economy work we must equip people with the ability to understand the choices that are available to them. And we have not done that.

**Wedoff:** Isn't that naive idealism?

**Porter:** Don't you recognize me as the young bleeding heart liberal that will wise up to become Professor White?

**Wedoff:** I have been unable to completely shed my naive idealism, and one of the things that really troubles me is one of the questions here. Did the credit industry get what it paid for? What a weird question. If you have the idealistic notion of what happens in Congress, people don't buy things from Congress. They engage in a free flow of ideas. They come up with legislation that is in the best public interest. And what is reflected in the question is an understanding that of course that is not what happens. What happens is that interest groups buy the legislation that they want and the only question is whether they get their money's worth. And so we talk about federal preemption that stops states from experimenting with ideas that may help consumers. We are seeing another reflection of a group that has obtained legislation that serves its purpose, not necessarily the public interest.

**Keating:** I want to follow up on the education point with Professors Porter and Dickerson. Suppose you get the education that you want at the lowest levels in the schools. Are you then also willing to say that now that they are so well educated, we are going to give them the right to make choices, even bad choices? So we are not going to try to prevent certain kinds of lending as long as there is full disclosure? To put it in another way, can you say on the one hand that we need more education to make good choices, but then we are going to take some choices away because we think that they are so bad?

**Dickerson:** No, and I'm glad that you used the word disclosure, because I have difficulties with disclosure. Consumers get these single-spaced, tiny print, forms that nobody reads, or an internet disclosure that takes 15 minutes to read, and they just scroll to the bottom and hit "I accept" even though they are agreeing to arbitrate in North Dakota. As long as there is true education

that starts early, then some people will make bad choices and, for me at least, that is fine. Because I am assuming that if there is true education, most people won't make bad choices. I wouldn't take away those choices.

**Keating:** What if you learned over time that even with great education and great disclosure, lots of people made bad choices?

**Porter:** I know that is going to be true. I lived in Las Vegas, which was a great place to do some hands-on investigation about payday lending. It is everywhere in Las Vegas. One day I went to a payday lender and there was a line out the door. I started talking to people and I asked them "What are you doing here today?" They know they are being ripped off. The kinds of education that we are thinking about are very holistic and focus on developing a whole approach to building finance. But, at the end of the day, there are some people who simply cannot live on what they are earning right now. And those people will borrow even though they understand on some level that payday lenders are not doing them any favors. There are very few people who think that payday lenders are their friends. And I draw a big distinction between payday loans and home equity lines of credit, where I see lots of very smart, well-educated people with good incomes such as Professor Cecil on the path to trouble. The big difference between home equity loans and payday loans is that, at least after the first loan, people understand that they are being ripped off by payday lenders, but they are poor. Poor people will borrow. There is always a certain fragment of people in this country who are trying to live on very, very low incomes. And some of them are the people that we see in bankruptcy court.

**Wedoff:** Dr. Wiener's point, though, about the emotional content of spending cannot be ignored. I remember when I was in grade school (and I remember it, so it obviously made an impact on me), my arithmetic book said that Johnny needs one apple. He goes to the store and he sees apples for ten cents apiece or three for a quarter. Which is the best buy for Johnny? And I said, "three for a quarter." I was wrong. It said that Johnny needs one apple. He's not better off with three apples. Boy, that really stuck in my mind: don't buy more than you really need. That's a lesson that kids need to learn, and it's a lesson that is contradicted by virtually every commercial message that we see.

**Cecil:** Including supersizing everything. I want to give Professor White an opportunity to ask Dr. Wiener a question about some of his research.

**White:** You ought to respond to these questions, because I look at my daughter, who is very smart, and the education didn't help her. She knows but she doesn't give a damn. She's going to spend money.

**Wiener:** Just saying that we need to have education early on really isn't enough. The real question that we have to answer is how to educate people to make these rational choices that takes into consideration the emotional effect that purchasing has on them. Now that is not an easy solution. Professors Porter and Dickerson say that we just need to educate kids when they are two years old on Sesame Street and everything is going to be okay. It is not going to be okay. It is a much more complicated issue than that. It is not just simply

a matter of presenting these children with more information. It is based more on the habits that they have developed and the psychology of making these decisions. In part, the solution really is to figure out what it is that causes people to make these bad decisions, despite the fact that they are well educated and can understand what they are doing to themselves.

**Cecil:** And the answer, at least in part, is the study that you have started. I truly have no idea how to educate me not to feel better when I shop.

**Wiener:** One of the most interesting things that our study found is that disclosure really may not work; it may backfire instead. Now for those of us who are rational (all of us on this panel of course make rational decisions on how we spend our money), disclosure can be very helpful. But for all of those people who don't make rational choices, those who actually buy according to their need for emotional clarity, then disclosure can be frightening and cause them to buy just because they have been presented with disclosure information that makes them feel uncomfortable.

**Wedoff:** I think the situation of tobacco use in the United States offers a real analogy here. We have a societal consensus that smoking cigarettes is bad. I think we could develop a societal consensus that spending more than your means allows is bad. What do we do? We don't want to say you can't spend. We do not want to say you cannot use tobacco, because just like in Prohibition, we found it doesn't really work and limits people's freedom too much. But we do have a huge public education campaign about the harm that tobacco use involves. We have also stopped advertising tobacco products. Then we create incentives for quitting, and disincentives for continuing to smoke, like not being able to smoke in the office and having to go around the corner of the office building entrance to smoke a cigarette.

**Cecil:** Let's bring the taxes back into the discussion.

**Wiener:** Yes, with tobacco the tax is on the supply side as well. In this debate, the issue of trying to limit the supply of credit is not one that we take seriously. Professor Culhane raised it earlier in this discussion when she asked, "What about the supply side?" Are there ways to make the supply side just a bit more reasonable?

**White:** Credit is a much more serious problem than smoking. All smoking is bad, but some credit is good.

**Wiener:** It's more complicated than that.

**White:** But if you put a tax on credit you injure a lot of people that you want to borrow.

**Pottow:** That's just a question of trying of finding the optimal tax rate, which means that you have to know how much you want, which is a hard, complicated question.

**White:** It is like saying, "You look kind of poor; we'll impose a tax on you."

**Wedoff:** The parallel in the tobacco area to what we have done to consumer bankruptcy is to say to people who develop lung cancer after smoking heavily, "we're not going to treat you. And you'll suffer, which will teach your children not to smoke."

**White:** To some extent we do that now. The effort to cure lung cancer is apparently less intense than many other cancers for exactly the reason that you suggest.

**Pottow:** Which is disquieting to lung cancer sufferers who are non-smokers.

**Dickerson:** I would like to add one more point about education. I am perfectly willing to assume that, notwithstanding consumer education starting at age two, or age eighteen, or when we file for bankruptcy, some people will continue to knowingly make bad consumer choices. I know we have law students in the room, so hopefully I am not stepping on any toes, but I am always shocked every year at the number of my students that still smoke. They are very educated. They have had a barrage of public campaigns on the evils of smoking, and yet students still smoke. And my view is that, although there are some addictive qualities with nicotine, most students are making a conscious decision to smoke. I am not prepared to say that we have to ban smoking or ban stupid decisions or shut down the casinos to protect people from themselves.

**Wiener:** But can we come up with a public policy that minimizes the number of people who make those kinds of decisions? I don't think we want to put ourselves in a position to say that people can't smoke and can't take out unreasonable loans, but we can have a policy that makes those outcomes less likely to happen.

**Porter:** I think that what you are tapping into is not just about giving people information. There are ways that government policies can tap into peoples' psyches and create incentives for them to make better choices.

**Pottow:** Why is choice so great? There are well functioning economies in countries in the western world that have usury laws. They haven't ground to a halt because consumer credit has been restricted by those usury laws. The arguments I hear are that usury laws are terrible because they de-democratize credit and they take away from people on the margin, who might now not be able to get any credit at all. To which my response is "Fantastic. They won't go bankrupt."

**Dickerson:** Maybe one of the problems is that you have to figure out how high is too high with usury. With payday loans I think it is somewhat easier to determine that they are too high. Three thousand percent is definitely too high. You know it when you see it, right?

**Pottow:** In terms of disclosure, I have a quick anecdote. I charged a \$1.50 luggage cart on a credit card when I went to Boston. I mistakenly used a second credit card that I have, instead of my main credit card. Then my wife had surgery, so I didn't go back to my house and pay my bills until two months later. So I missed two billing cycles on the \$1.50 charge. I got back to the house and opened up the bill for \$78.51. I couldn't remember what I had bought for \$78.51. So I called the company and they said that I had accrued late fees and interest. Because they are required to disclose the interest rate, I found out I was being charged a fifty-eight percent interest rate, which I thought was high.

**Porter:** You could have bought the cart.

**Pottow:** Of course I talked to a supervisor, but I'm a law professor. I don't know how many people would have kept fighting to go up to the supervisor and get the charges reversed. So, yes, I think that I can say that fifty-eight percent interest is too high.

**Cecil:** With that, I am going to take this opportunity to thank our panelists. I think that we all agree that this has been the most fun part of the two-day conference!