STATEMENT OF

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UNITED STATES BANKRUPTCY JUDGE
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION AT MEMPHIS

BEFORE THE
HOUSE JUDICIARY COMMITTEE'S
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

FIELD BRIEFING ON HOME FORECLOSURES IN MEMPHIS

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Chairman Cohen and Members of the Subcommittee:

I am so very pleased to have been given this opportunity to speak with you. Many who know me have heard me say that I would give anything for a Member of Congress to sit where I sit for just one day. Since we are at this beautiful law school rather than in my courtroom, I will do my best to help you see and hear what I see and hear on a weekly basis. I specifically have been asked to comment on the question of whether the Bankruptcy Code should be amended to permit home mortgages to be modified through Chapter 13 plans. It is my conclusion that it should. After some introductory remarks, I will provide three anecdotal examples of families who might have been helped had the Bankruptcy Code provided for modification of home mortgage loans. While I cannot speak to the economic impact upon the mortgage lending industry of the amendment under consideration, I can certainly speak to the economic, social and emotional impact of the current law upon these and countless other families.

INTRODUCTION

As you no doubt know, the Western District of Tennessee, which includes Memphis, has consistently experienced one of the highest per capita bankruptcy filing rates for some forty years. Of special interest is the fact that a significantly higher percentage of these filings consist of Chapter 13 cases (historically known as "Wage Earner Plans") rather than Chapter 7 cases ("straight bankruptcy"). The percentages are reversed in most other judicial districts.[1] In Memphis, the percentage of cases filed under Chapter 13 is consistently in excess of 70%.

There are many reasons why the bankruptcy filing rate is so high in Memphis. These include: (1) the local legal culture: Chapter 13 cases can be filed with "no money down" and thus provide attractive relief for persons in financial distress; (2) the historically low homestead and personal exemptions provided by Tennessee law; (3) the fact that Tennessee is a power of sale, rather than a judicial foreclosure, state; and, ironically, (4) the high percentage of cases filed under Chapter 13 in this district. For various reasons, a very low percentage of bankruptcy debtors actually make all the payments required under their plans in order to receive a discharge. Thus, the bankruptcy filing statistics in high-volume Chapter 13 districts such as the Western District of Tennessee, the Northern District of Alabama, and the District of Utah, reflect a number of "repeat filers" - persons who have filed a previous Chapter 13 case that was dismissed when complicated paperwork was not properly completed, or the debtor was laid off from her job, or her child or parent got sick and had to be cared for. I don't view this as an artificial inflation of the bankruptcy filing

[1] The history of the Chapter 13 program is fascinating and has specific ties to Memphis. That history is recounted in an excellent article written by Professors Dixon and Epstein, "Where Did Chapter 13 Come From and Where Should It Go?" 10 Am. Bankr. Inst. L. Rev. 741 (Winter, 2002), available on Westlaw.

statistics, nor do I view all of the dismissed cases as failures; they simply represent the reality that for many people it is extremely difficult to complete five years of bankruptcy plan payments without a hiccup. I will now move to the anecdotes.

FIRST ANECDOTE

I begin with the story of a debtor whose name I do not know. He was a father who came before me very early in my judicial career. He had fallen behind in his mortgage payments, and had filed a Chapter 13 case in order to keep his home. The case I had may not have been the debtor's first - I simply don't remember now. The debtor's mortgage lender quickly filed a motion for relief from the automatic stay.[2] At the hearing, the debtor explained to me that his wife was disabled and that they had four children at home. He told me that this particular house was especially important because it was across the street from the children's school. He said that his wife couldn't drive, so the location of the home made life a little easier for his family. Unfortunately, for reasons that I no longer recall, this debtor had fallen so far behind in his mortgage payments that he could not afford the plan payment that would have been required to make both his ongoing mortgage payment and his arrearage payment.[3] I had to tell him that he could not afford to make his plan payments and feed his family. I told him that his house was simply shelter - that the most important thing was that wherever they found to live, his family would be together. Even as I said these words, I knew that they were somehow false. Afterward, the Chapter 13 trustee who had been in the courtroom assured

[2] The automatic stay is, of course, one of the most fundamental bankruptcy protections that prevents secured lenders from foreclosing or repossessing their collateral during a pending bankruptcy case. *See* 11 U.S.C. § 362(a).

[3] The arrearage payment generally is the amount of the outstanding home mortgage arrearage divided over the thirty-six to sixty months of the proposed plan.

me that he would try to keep those kinds of hard cases from reaching the courtroom. He meant to be helpful, but I knew that even though I had made the technically correct judgement, I had failed this debtor miserably.

The worst part of being a judge is that you never get to hear the "rest of the story." I don't know what happened to that family. I don't know whether they were able to work out some arrangement with their lender at the eleventh hour, or whether they were able to find a landlord who would rent to them despite having "bankruptcy" on their credit report, or whether they ended up on the street. I don't know how those four children turned out - whether they beat the odds for kids from families in financial distress and finished school, or simply became another statistic of juvenile delinquency. I do know that had I been able to compel the lender to adjust the principal amount of the debt to the value of the home, that father would have been able to make his plan payments and that family would have stayed in its home.

SECOND ANECDOTE

My second story concerns one of my very best friends, a woman whom I met in my church choir, and who is Aunt Barbara to my children. Barbara has four children from two marriages. When I first met her, only the younger two, both boys, were still at home. Barbara had married just after high school and had never completed college. She has worked all her life, mostly in retail sales, and she is very good at it. While they were minors, Barbara received some support from the boys' father, but it was not always consistent. Because she worked retail, Barbara's income consisted of commissions only. Thus, in the months when there were no sales, there was no income. I watched as Barbara struggled to help her older daughters, her granddaughter, and her boys with all the various things that young people need - Catholic school tuition, books, clothing,

entertainment, braces, and health care. After renting for a number of years, Barbara purchased a small condominium unit in Cordova. She faithfully made the payments until her income plummeted in a prior period of recession, and she could no longer pay all her bills. She fell behind in tuition payments and homeowners association dues. She ultimately was able to sell her condominium, just two steps ahead of foreclosure, and received a Chapter 7 discharge. She had no home and no car either, because when her car lease ran out, she was not able to pay the high mileage fee assessed against her. I knew of an apartment that was available from a private landlord who would not care about her credit score, and her brother, Richard, helped her to find a used car. Slowly, she got back on her feet and much later with Richard's help, was able to purchase a still smaller condominium unit in a high rise building.

Barbara was doing relatively well until the latest financial downturn. Because very few persons were able to buy the products that she sells, her commissions fell through the floor. This time, her brother could not help her because his real estate business, too, was dramatically and negatively impacted by the sudden contraction in credit. He lost some investment properties and ultimately his home to foreclosure. He and a brother who worked with him in the real estate business moved to the Gulf Coast, where they had heard that things were better. Barbara was able to sell her condominium unit, again just ahead of foreclosure, and moved with them. All of you know what happened in the Gulf of Mexico on April 22, of this year. The impact of the Gulf Oil Spill on all the towns along the Alabama Coast has been devastating. Richard and Barbara and their brother again find themselves trying to figure out what to do next.

Richard candidly told me that he blames himself in part for his troubles. He recounted that in its heyday, lenders were virtually giving money away for development projects. He said that he

got caught up in all the wheeling and dealing, and allowed himself to become much too highly leveraged. He also told me that as things started to turn sour, he mortgaged his home again and again to try to meet his obligations. When all was said and done, even though his bank was cooperative, he was left with a very large deficiency judgment. As a result, a family that has lived and worked in Memphis for more than sixty years felt compelled to leave this area to try to start over again. Without doubt, better underwriting would have made a difference to Richard, but the ability to modify home mortgages in bankruptcy might have kept him and Barbara here at home.

THIRD ANECDOTE

I cannot tell you the third story I wanted to tell you, at least not in any detail that would permit you to identify the persons I wanted to tell you about. I cannot tell you because this family is in the midst of a mortgage modification, they felt that they could not give me permission to talk about them. I have heard from so many others in a similar situation, unfortunately, that it will be relatively easy for me to tell you the kind of story that they would tell you if they could. Their story is one that I hear almost weekly from bankruptcy lawyers and bankruptcy debtors: the current federal programs to promote voluntary loan modification simply don't work. The loan has been sold and the appropriate lender or servicer cannot be located. When they are, the loss mitigation officers are non- responsive. Borrowers are treated as criminals. Deals are offered and withdrawn. The same loan that is being discussed in one department is sent to foreclosure by another. Outside counsel are instructed simply to foreclose, and have no access to decision-makers. It goes on and on and on. The common denominator is simply this: the lenders hold all the cards. There is no one to level the playing field for the borrowers. Even though there have been numerous reports to the effect that foreclosure costs lenders MORE THAN loan modification, lenders continue to use fear

to coerce deals from distressed borrowers that have little hope of success. I have heard numerous times from bankruptcy lawyers that even when their clients are able to get through all the red tape and achieve a modification of their loans, they receive merely a band-aid, rather than a true fix. Rather than writing down the interest rate or writing off principal to reflect current market conditions, the lenders simply push unpaid portions of the original loan payments to the back of the loan. As a result, the borrowers' problems are merely put off to another day. And these are the lucky few who actually get a positive response to their loan modification request.

THE BANKRUPTCY SOLUTION

As my colleague, Judge Kennedy, has no doubt told you more eloquently than I can, there is a relatively simple fix to the situation that currently exists. That is to amend the Bankruptcy Code by deleting the current exception to loan modifications for residential mortgages found after the initial comma in 11 U.S.C. § 1322(b)(2). That section presently reads:

> (b) Subject to subsections (a) and (c) of this section, the [Chapter 13] plan may–
>
> (2) modify the rights of holders of secured claims, ***other than a claim secured only by a security interest in real property that is the debtor's principal residence***, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

The highlighted language quite often makes the difference between a debtor being able to propose a plan that is capable of confirmation and not. Keep in mind that real estate values in Memphis have not seen the wild swings of other areas. The remarks that I am making address an inherent and on-going problem with the Bankruptcy Code as it presently exists. I am not unaware of the claims made by those in the mortgage lending industry that the sky will fall if this change is made. I don't believe it. I don't believe it because every other type of consumer and commercial loan is subject to modification in bankruptcy. So far as I can tell, that fact has had no discernible effect on the price

of those types of loans. The way to avoid most unwanted outcomes in bankruptcy is better underwriting, a process that is already well underway.

The other concern that I have heard expressed about amending the Bankruptcy Code in the manner under consideration is that the bankruptcy judges are ill-equipped to manage the flood of requests that would come if the proposed amendment were made. I don't believe that either. Adjusting interest rates and establishing market values is bread and butter work for bankruptcy judges. In fact, in a system as efficient as that of the Western District of Tennessee, there is actually very little litigation over these issues. The lawyers and trustees in this district are practically-minded people who quickly come to agreements about the most efficient methods to establish interest rates and property values. I predict that if the Bankruptcy Code were amended as has been suggested, within a very short period of time - six months or less - there would be almost no litigation in this district over mortgage interest rates or home values.

CONCLUSION

While I am a judge, not a legislator, I nevertheless appreciate the opportunity to express an opinion about proposed legislation that would directly impact in a positive way the people that I serve. For the reasons I have stated, I believe that the Bankruptcy Code should be amended to permit the modification of home mortgages in Chapter 13. I think that such an amendment would have the immediate effect of leveling the playing field between lenders and distressed borrowers, would result in the lenders receiving as much or more than they would in the event of foreclosure, and would not overtax the current bankruptcy court system.

Again, thank you for the opportunity to address you on this very important topic. I will do my best to answer any questions you may have.