Statement before the United States House of Representatives

Committee on the Judiciary

Subcommittee on Commercial and Administrative Law

Hearing on H.R. 901 the "Medical Bankruptcy Fairness Act"

Peter S. Wright, Jr., Esq.

Professor of Law

Franklin Pierce Law Center

Concord, New Hampshire

Thursday, July 15, 2010

The views expressed in this testimony are those of the author alone and do not necessarily represent those of Franklin Pierce Law Center or its affiliate, University of New Hampshire

Mr. Chairman and Distinguished Members:

My name is Peter Wright and I am a clinical law professor at Franklin Pierce Law Center in Concord New Hampshire. My job involves supervising and mentoring law students in the development of professional skills as we represent real-life clients in a variety of cases. My clinic, the Consumer and Commercial Law Clinic, operates year round and accepts cases on behalf of low income clients whose problems involve consumer credit, mortgage foreclosure defense, and consumer bankruptcy. I have held this position since 1998 when I left private practice to pursue a teaching career.

The perspective I bring to bear on H.R. 901 is necessarily shaped by my allegiance to the low income debtors whom I represent in bankruptcy court. I have also had first had experience observing the impact of debilitating medical conditions upon elderly citizens through the fourteen years I served part time as a Medicare hearing officer. In this position, I directly observed the struggles of elderly citizens challenging the denial of claims for benefits in what is admittedly a complex and confusing system of federally funded health care. I also heard from them about the financial setbacks they endured because of inadequate reimbursement of claims or the denial of coverage for claims which were appealed. In many cases the onset of debilitating medical conditions prevented them from continuing to earn money to supplement their meager retirement funds. In a number of cases I would hear how unanticipated medical conditions saddled them with debt not covered by the Medicare program or through non participating providers.

I come before the committee today to share my perspective from the trenches of the plight of individuals who are forced to seek bankruptcy protection because of prolonged illness, the effects of accident or other medical catastrophe. Because the legal services we provide are offered without charge, the demand for our services is overwhelming. Our intake process is largely a matter of triage. Most of the cases we see these days involve mortgage foreclosure defense, counseling and intervention into the HAMP and private loan modification programs, and representing individuals seeking relief through bankruptcy. In the face of the pressure of so many calls for assistance, we give first priority in our bankruptcy acceptance process to homeowners seeking to retain their homestead, rather than simple debt relief. A very important factor is whether the individual has lost control of budget and finances because of a medical calamity. Those cases receive heightened priority in our case acceptance process.

Because of our acceptance criteria, I am not able to offer any objective statistics to the debate which this committee has heard in the past about whether or not medical bills are a driving force in the bankruptcy. I can provide anecdotal evidence based upon the triage we perform that the principal drivers of consumer bankruptcy are prolonged unemployment, catastrophic and chronic medical conditions with related bills, and divorce. It is true that some individuals are poor money managers and amass staggering amounts of consumer debt, often owed to credit card companies. We tend not to accept such cases so that we may be available to those cases driven by long term unemployment, prolonged and serious medical conditions or divorce.

It is certainly true that medical debt related to serious and long-term illness can push a family to bankruptcy. Such debt can arise even when the family has health insurance coverage because of co-pays, deductibles, and limitations in coverage. In my experience the incidence of medical debt and interruption of income caused by the illness or injury have a cumulative effect which often propel the debtor and family to seek bankruptcy protection. Because so many families are living paycheck to paycheck on the edge of financial calamity, any significant interruption in income pushes them over the edge. Late payments on credit cards trigger default penalties and outrageous interest rates. Late mortgage payments set in motion an impossible game of catch-up with partial payments held in suspense and even complete payments treated as partial when late-penalties are deducted. We have seen unemployment figures exceed 10% during the recent economic crisis. While many of these cases are caused by layoffs during the slowdown, the disruption of work because of prolonged illness can be every bit as devastating to the family income.

H.R. 901 recognizes this critical fact by devoting two of the three definitions of "medically distressed debtor" to the situations where the individual's income is interrupted. The first, 39B (B) defines "medically distressed debtor" as a debtor who, in any consecutive 12 month period during the three years before the date of the filing of the petition –

> Was a member of the household in which one or more members (including the debtor) lost all or substantially all of the members' employment or business income for four or more weeks during such 12 months due to a medical problem of a member of the household or dependent of the debtor;

The second definition which recognizes that a medical condition can interrupt income flow addresses the situation where an obligor under a support or alimony order is unable to pay because of a medical problem. That section reads,

> Was a member of the household in which one or more members (including the debtor) lost all or substantially all of the member's alimony or support income for four or more weeks

during such 12 month period due to a medical problem of a person obligated to pay alimony or support.

The fact that two of the three definitions of “medically distressed debtor” are centered upon interrupted income demonstrates that the drafters of H.R. 901 fully appreciated the havoc which a medical condition can cause by disrupting the debtor’s income.

Having recognized the financial distress caused by medical conditions, H.R. 901 offers significant protection to the debtor who must turn to bankruptcy for relief. The centerpiece of H.R.901 is enhancing and assuring availability of a meaningful homestead exemption to any medically distressed debtor seeking bankruptcy protection. To appreciate the value of this amendment, it is necessary to understand how a homestead exemption works. As a general matter, federal and state exemption laws have the objective of assuring that individuals in serious financial trouble are not deprived of the bare essentials of life through the debt collection process. Most exemptions recognize and protect the value of basic essentials needed by families to maintain a subsistence standard of living. Typically such exemptions protect modest amounts of household furniture, appliances, an automobile, tools of the trade, beds, bedding and clothing of the debtor and family. These exemptions assure that the debtor will come through the collection process, including bankruptcy, with at least the basic necessities from all the possessions that the debtor may have acquired over a lifetime. The existence of these exemption laws reflects a policy decision by state legislatures and Congress that, in the competition between the claims of unsecured creditors and the basic well-being of the debtor and family, no individual will be deprived of the basic necessities. These policies also advance the important objective of preventing debtors from becoming public charges, unable to maintain themselves without assistance from the government.

Probably the most important exemption is the "homestead" exemption. "Homestead" generally refers to the dwelling house in which the family lives, as well as enough of the surrounding land to enable a family to make effective use of the property. The homestead exemption may be a unique American phenomenon as it was widely adopted throughout the country during the 1800's to encourage westward migration and settlement. Colonial Texas (under Mexican rule) had one of the earliest homestead provisions in 1829. Georgia and Mississippi became the first US states to follow Texas's lead and enact their own homestead exemptions. An economic downturn – the Panic of 1837 – hit the South particularly hard. Homestead exemptions were adopted in the South as a way to dissuade residents from abandoning that region to make a fresh start in Texas, but also as a way to curb the destructive impacts of the free market by protecting families against financial destitution. Support for these new exemptions crossed party lines. The mass appeal of this unique form of protection led 10 of 14 Southern states to pass their own homestead laws as early as 1859.

Outside the South, the homestead exemption movement also began gathering momentum by midcentury. By 1852, all the northeastern and mid-Atlantic states (with the exception of Delaware, Rhode Island, and Maryland) exempted at least $300 of a homestead from the reach of creditors. Every single mid-western state and territory passed a similar provision by 1858. Alison D. Morantz, THERE'S NO PLACE LIKE HOME: HOMESTEAD EXEMPTION AND JUDICIAL CONSTRUCTIONS OF FAMILY IN NINETEENTH-CENTURY AMERICA, 24 Law & Hist. Rev. 245 (2006)

In colonial times the homestead protection recognized the economic reality that many families made a living or produced food from working the land. Modern statutory homestead exemptions focus primarily on preserving shelter for the family in the dwelling in which they have demonstrated an intent to reside.

The National Consumer Law Center has summed up the utility and value of the homestead exemption in the following excerpt from its manual, Collection Actions – Defending Consumers and their Assets, First Edition (2009), page 275-276.

> Homestead exemptions are designed to protect the home for the debtor and the debtor's family. The only states that do not provide for homestead exemptions are Delaware, Maryland, New Jersey, and Pennsylvania. The remaining states each set a different amount that is exempt. For example, New Hampshire allows $100,000; New York allows $50,000; Florida does not set a dollar amount but allows up to 160 acres outside a municipal area and a half acre within a municipal area. Some states provide a larger homestead exemption for elderly or disabled persons. When a statute caps the value of an exempt parcel of land, but not its acreage, there is no limit on the size of the parcel.
>
> The dollar amount of the homestead exemption generally refers to the debtor's equity of the property. For example, if a $200,000 property is encumbered by $190,000 mortgage then a $10,000 homestead exemption will make it completely exempt. If the area or value of the homestead exceeds the statutory limit and division is not feasible, for example, a quarter acre homestead in a suburb with one acre zoning, the homestead may be sold and the debtor will receive the exempt amount.

Because the homestead right is purely a creature of statute, it is necessary to consult the law of the state where the property is located to determine the extent of the homestead protection. Generally, the homestead exemption protects the family which lives in the home and claims it as their primary residence from loss of property to the claims of creditors whether advanced through litigation or other process. Generally an unsecured creditor would be unable to execute on the property by exposing it to sheriff's sale if the scope of the homestead protects the entire interest of the family in that property. The public policy behind the homestead is to promote stability and the welfare of the community by encouraging property ownership and independence on the part of homeowners. While creditors may obtain a judgment against the property owner, that judgment usually may not be enforced against that part of the property or value of the property which is protected by the homestead right. In colonial times it often meant that the executing sheriff would set off a certain part of the homestead to assure that the family retained shelter and enough land to continue supporting itself or producing food. Today the homestead right is usually recognized as a dollar amount. In the execution process the homeowner will be entitled to a cash payout from the proceeds of any sale with the idea that the cash recovered can be used to reassert or reestablish a new homestead after the family moves on. In cases where the value of the homestead is large enough, pursuing a sheriff sale may prove futile and this reality has the effect of preserving the homestead for the family[1].

H.R. 901 would boost the homestead exemption for "medically distressed debtors" seeking bankruptcy protection to $250,000. This enhanced homestead would be available to debtors invoking either the federal exemptions or a particular state's exemption. What class of debtors would most benefit from this expanded protection? As a practical matter this provision would have no effect upon those people whose mortgage debt exceeded the value of their property. Because such borrowers would have waived their homestead exemption for the benefit of the mortgage company, the loss of their home through foreclosure would include loss of the homestead. In such cases the existence of the $250,00 homestead exemption would be unavailing.

However, if we consider the plight of the elderly couple who had managed to pay off the mortgage on the family home over many decades of hard work, the availability of the $250,000 homestead exemption would be of the utmost significance. Such a debtor could invoke the

[1] It should be pointed out that when a homeowner grants a mortgage to a lender to acquire property or refinance an existing loan, the lender always requires the borrowers to waive all homestead rights as to that creditor. Thus, the many individuals facing the loss of their homes through foreclosure may not avail themselves of the homestead protection because that right was waived at the closing table when the loan papers were signed.

statutory exemption contemplated by H.R. 901 and thereby preserve a significant amount of the equity in their home. This preservation of the homestead would be completely consistent with the goal of bankruptcy to provide a fresh start to the debtor. It would also prevent individuals and families from becoming homeless in spite of unanticipated financial calamity. To benefit from this protection, the medically distressed debtor would have to have significant equity in the home. This is usually the case with elderly individuals or couples who have prudently paid off their mortgages over the years.

Beyond preservation of the home, homestead exemption may also be useful in enabling a medically distressed debtor with a generous amount of home equity to pursue a chapter 13 payment plan. Such a debtor might well be ineligible to file a Chapter 13 plan because they would not be able to satisfy the liquidation test which must be addressed in every Chapter 13. The liquidation test requires the debtor to demonstrate that the unsecured creditors would receive more through the Chapter 13 payment plan than would be realized if the debtor simply liquidated all non-exempt property through a Chapter 7 filing. By exempting a significant part of the equity of the elderly couple's home from the bankruptcy estate, the debtor could satisfy the liquidation test and achieve a more affordable payment plan. In those cases where the debtor simply elected to liquidate through Chapter 7, the objectives of the fresh start would be realized by preserving the value of the homestead for the debtor and family. In either case the debtor will be in a better position to realize a fresh start and to avoid the specter of homelessness. Such a result is consistent with the public policy of stabilizing families and communities by preserving the essentials a family requires, including the family homestead.

Conclusion

H.R. 901 is narrowly drafted to benefit a very deserving class of medically distressed debtors forced to seek bankruptcy protection because of unanticipated or prolonged medical conditions and overwhelming medical debt. To realize the intended benefit of the enhanced homestead protection, such debtors must have accumulated significant equity in their homes. Such debtors are usually elderly or retired individuals who prudently managed their financial affairs, avoided the temptations of refinancing to enhance their lifestyles or otherwise engaged in reckless borrowing. Their downfall was usually caused by tragic occurrence of a medical catastrophe which interrupts income flow and saddles them with unmanageable medical debt. It is consistent with the well recognized policy within the American bankruptcy system that such debtors be afforded a fresh start and the ability to preserve their homesteads. Because H.R. 901 creates critical protection to achieve these important objectives, it should be added to our existing bankruptcy law.