Testimony of James E. Smith
On Behalf of the American Bankers Association
Before the
Subcommittee on Commercial and Administrative Law
of the
Judiciary Committee
United States House of Representatives
March 16, 1999

Chairman Gekas and members of the Subcommittee, my name is James E. Smith. I am President and CEO of Union State Bank and Trust, in Clinton, Missouri. I am immediate past Chairman of the American Bankers Association's Government Relations Council. I am pleased to be here today on behalf of the ABA. The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Mr. Chairman, I would like to thank you for your leadership on the issue of bankruptcy reform. Given record numbers of bankruptcy filings and their inevitable impact on both lenders and borrowers, these hearings are very timely. ABA strongly supports near-term enactment of H.R. 833, which would create a means-tested approach to consumer bankruptcy, and make many necessary improvements in commercial bankruptcy law. H.R. 833 is an effective and bipartisan response to current problems in the bankruptcy system.

I would like to first discuss the very important improvements this bill makes in the consumer area. The fact is that our consumer bankruptcy system is in serious trouble. We believe that a needs-based approach is the best way to achieve an appropriate balance between providing relief for debtors who truly need it and preventing abuse of the system by those who have the capacity to repay at least a portion of their debt.

Under current law, bankruptcy is too often used as the first resort, rather than the last resort. By taking advantage of flaws in the current system, individuals can wipe their debt-slates clean even though they have the capacity to repay all or a portion of their obligations. Moreover, there is ample evidence that a small but growing minority of borrowers is abusing the credit system by taking loans with no real intent to repay.

H.R. 833 also proposes some important improvements in commercial bankruptcy law. For example, it will create a simplified framework for small business bankruptcies. It will also end abusive single asset real estate bankruptcies by lifting entirely the debt cap on cases subject to expedited Code provisions. It facilitates the completion of "prepackaged" Chapter 11s. At long last, it limits repetitive judicial extensions of the exclusivity period in Chapter 11. It provides a beneficial framework for the resolution of cross-border bankruptcies. And it includes important resolution of the treatment of swaps, derivatives, and other financial instruments when a counterparty becomes insolvent, which will enhance the safety and soundness of the financial system.

I would like to make three main points in my statement today.

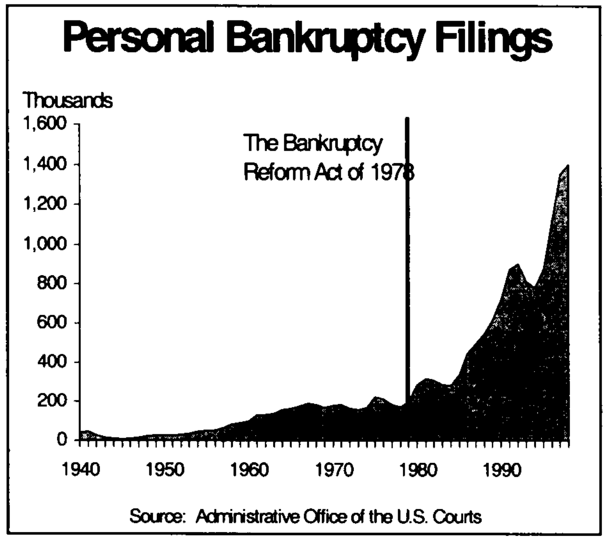
- The record number of personal bankruptcies - occurring at a time when our economy is very healthy - is a clear sign that our consumer bankruptcy system is broken. While the situation today does not pose a safety and soundness problem for banks or thrifts, it is important to recognize that rising bankruptcies will inevitably have an impact on the cost and availability of consumer credit which in turn will negatively affect overall economic growth.

- A ***needs-based system*** as proposed in H.R. 833 balances the twin goals of debtor relief and creditor recovery. The fundamental flaw in the current consumer bankruptcy system is that debtors are permitted complete discretion as to whether they will enter into a Chapter 7 liquidation plan or a Chapter 13 repayment plan. A needs-based approach would send a strong message that bankruptcy should be a last resort for troubled borrowers.

- While commercial bankruptcy filings have diminished due to strong economic conditions, certain reforms would be desirable. In particular, we recommend the following: expedited treatment of small business reorganizations; assuring that all single asset realty cases are resolved quickly and fairly; preventing endless extensions of Chapter 11; and, if Chapter 12 is made permanent, assuring a quick and fair resolution for lenders.

Before turning to a discussion of these points, let me reiterate our support for the reforms proposed in H.R. 833. This bill effectively addresses the serious flaws in current law, especially in the consumer area where the problems are the most severe.

Consumer Bankruptcy



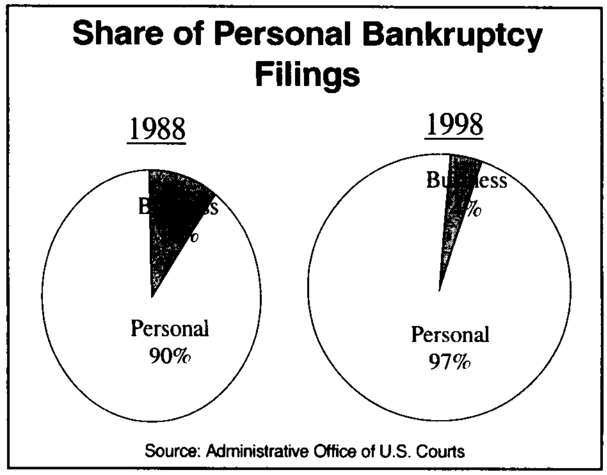
Mr. Chairman, the final numbers are now in on personal bankruptcies for 1998, and they once again set a new record. About 1.38 million people declared bankruptcy - a 3.2 percent increase over the 1997 level. This means that ***one in every seventy U.S. households filed for bankruptcy in 1998***. What is equally stunning is that this record was set in a year where Gross Domestic Product hit new highs and the unemployment rate was at historic lows. Personal bankruptcies have nearly doubled so far this decade, up 94.7 percent since 1990. Clearly, consumer bankruptcies are increasingly disconnected from the general state of the economy and suggest to us that underlying causes are likely rooted in today's flawed bankruptcy laws.

The impact of the change in consumer bankruptcy law in 1978 is clearly demonstrated on the adjacent chart. Following passage of the Bankruptcy Reform Act of 1978, there has been a dramatic rise in the incidence of personal bankruptcy filings. The Bankruptcy Code currently contains many flaws which both encourage unnecessary filings and lead to abuse. These flaws include, first and foremost, the lack of any effective and uniform screening standards to determine whether a debtor truly needs Chapter 7 liquidation or has the financial ability to fund a meaningful Chapter 13 plan. Chapter 13s have a standard length of only three years, while most consumer loans today are for longer terms or entirely open-ended. Debtors find it too easy to "load up" on debt in contemplation of filing and to then discharge it, even where it has been used to satisfy nondischargeable obligations. The amount owed on valuable collateral such as autos can be crammed down just weeks after purchase. Debts acquired through fraud can nonetheless be discharged in a Chapter 13 case. Creditors operate under a statutory "gag order" which prevent them from bringing evidence of abuse to the court's attention. And serial filings can endlessly forestall repossessions and other actions within creditors' rights when there is no intention to go through with the bankruptcy; while serial bankruptcies are available to discharge a debtor's responsibilities every half dozen years.

These and other defects in current law and practice have led to today's bankruptcy reality - an overloaded court system giving assembly line treatment to a record number of bankruptcy cases, many of which receive excessive or undeserved relief based on unsubstantiated claims.

Approximately 97 percent of the filings in 1998 were non-business bankruptcies. This is quite different from the experience of the 1980s. For example, from 1980 to 1987, consumer filings ranged between 82 to 86 percent of total filings. In 1988, personal bankruptcies grew to 89.6 percent of total filings, and the percentage has risen every year since then.

Today's consumer bankruptcy crisis poses no imminent danger to the safety and soundness of the financial system. Banks and other lenders have tightened underwriting standards and reviewed pricing in light of current conditions, and they have ample capital and reserves.



Share of Personal Bankruptcy Filings

Source: Administrative Office of U.S. Courts

But the fact that there is no immediate danger does not mean that there is no reason for concern. At some point, without bankruptcy reform, lenders will dramatically tighten lending standards, a move that will have consequences for the overall economy.

For example, my bank is very active in making small "micro" loans to low income individuals. These loans are often as low as $200-$300 dollars. Given this small loan size, we cannot afford to do expensive background checks. Rather, these are truly "character" loans. The rise in personal bankruptcies has forced us to re-evaluate these types of loans, however. Even though the loans are not large, it does not take too many losses to make this entire line of micro loans not worth offering.

The same process of reconsideration is likely to occur for many other banks in all kinds of consumer loans. Simply put, a tightening of underwriting standards means either the price of credit rises, or less credit is offered or both. In my case, it may determine whether a whole line of credit products will be eliminated – something that would be sad for my bank and my community.

Perhaps even more troubling is what I call "stealth bankruptcies" in which borrowers show excellent credit histories right up to the day they file and wipe out their lenders. Those borrowers look just like many others who never file bankruptcy. There are two examples from my community that I would like to share with your Subcommittee, Mr. Chairman. The first was a case where a borrower bought a brand new Dodge truck three weeks before declaring bankruptcy. It was nearly a year before he had to turn the now used and abused truck back in to the lender. The second was a case of a rancher who borrowed to buy 50 head of cows and calves. He sold the animals in 30 days, declared bankruptcy and walked away with all the money.

Clearly, these are severe abuses of the system. There are many more examples of borrowers who have chosen bankruptcy as a first resort, rather than trying other available alternatives such as working out revised payments with lenders or availing themselves of consumer credit counseling assistance. Let me share a few stories I have heard from bankers across the country.

- A banker from New York says that a lawyer in his area is advising clients to pay their nondischargeable debt with credit card cash advances, and then file Chapter 7. The credit card balances, which are unsecured debt, can then be discharged.

- A New Mexico banker made a loan to an employed individual secured by an automobile in 1995. The individual declared Chapter 13 after having made only six payments over

14 months. Only one loan payment was made under the Chapter 13 repayment plan, and the bankruptcy trustee subsequently dismissed the plan. But when the bank repossessed the car, they were told the individual had filed another Chapter 13 – so the bank had to return the car. The bottom line is that the individual still has a good job and still has the car – and the bank is out $21,000.

- A banker from Ohio reports that a customer borrowed money to buy two automobiles, then literally disassembled the cars, sold the parts, and declared bankruptcy.

- A banker from Texas tells of a couple who took out a SBA loan to start a business. When the business did not do well, the bank tried to work with them to develop an appropriate course of action. Rather than working with the bank, however, they filed Chapter 7. They had good income from other jobs, owned a mortgage-free residence (which was protected under the bankruptcy law), and had virtually no other debt – in other words, they had the ability to repay all or some of the loan. The bank lost over $12,000.

Consumers Have Complete Discretion for Choosing Chapter 7 Over Chapter 13

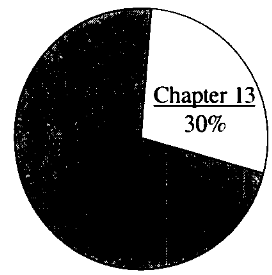
These stories point out that there are very serious flaws in the current consumer Bankruptcy Code. Perhaps the most fundamental flaw is that filers are allowed total discretion over whether they should file in Chapter 7 or Chapter 13, regardless of ability to repay. In Chapter 7, repayment is based on assets. Filers must either reaffirm their secured debts by acknowledging post-bankruptcy personal responsibility to pay them, redeem their secured debts by making full payment, or surrender their collateral. Unsecured lenders receive payment, if any, out of the bankruptcy trustee's liquidation of debtor property which exceeds applicable exemption levels (which are mostly set by state law). Nineteen out of twenty Chapter 7 filings are "no asset" cases in which there is no nonexempt property to liquidate and unsecured lenders lose 100 cents on the dollar. Chapter 7 cases constitute about seventy percent of all non-business filings.

In Chapter 13, repayment to creditors is based on income. The debtor agrees to a repayment plan with a three-to-five year duration. Home mortgage lenders are repaid according to the original payment schedule, other secured lenders are assured of full repayment of the portion of their loan which is collateralized, and unsecured lenders receive repayment based on remaining disposable income.

An individual filing in Chapter 7 may be directed to Chapter 13 under present law when the judge determines that a Chapter 7 discharge would constitute "substantial abuse." However, such instances are rare. This is due to the assembly line, overloaded nature of the consumer bankruptcy system and the lack of economic incentives for the trustee to undertake an in-depth inquiry into most cases. In addition, *current law prevents those who most likely have information regarding debtor abuses - the lenders - from bringing it to the attention of the court.*

Chapter 7 bankruptcy is a highly unusual legal process. In other civil cases one seeking an injunction to bar legal actions must generally demonstrate the imminent threat of irreparable harm as well as a high probability of succeeding on the merits. But in the current system, the ***mere filing*** of a bankruptcy petition provides an automatic stay, which halts all foreclosures, garnishments, and other legal proceedings against the debtor. In addition, while the law is what we look to for contract enforcement, in bankruptcy the law cancels or rewrites contracts to relieve debtors of their obligation to perform on their contractual promise to pay. These are extraordinarily potent legal powers. They may be necessary to accomplish the renewal function of bankruptcy, but providing them to virtually anyone just for the asking clearly opens up the bankruptcy system to abuse.

Nonbusiness Chapter 7 vs. Chapter 13 Filings in 1998



Source: Administrative Office of the U.S. Courts

Chapter 13 also has been abused by individuals under the current system. Many who file in Chapter 13 never complete their full repayment plan - a fact some critics cite to question the enforceability of a needs-based bankruptcy system. But the real issue here is the ability of these individuals to use Chapter 13 simply to cure mortgage defaults, with no intention to complete their plan; they later file a "Chapter 20" bankruptcy by converting to Chapter 7 and wiping out unsecured lenders. In other words, current law permits debtors to obtain many of the benefits of Chapter 13 without carrying out their repayment responsibilities.

The high proportion of Chapter 7 cases regardless of repayment ability and the rapidly growing number of consumer bankruptcy filings together constitute a significant long-term threat to the availability of reasonably priced credit to U.S. consumers. The "bankruptcy tax", the cost of bankruptcies which is ultimately passed on to other borrowers, is already in excess of $400 per U.S. household. This does not include the cost of the bankruptcy court system that has been overwhelmed by the record high filings. Adding new judges to handle the growing case load will cost taxpayers millions of dollars more. These unfair taxes on responsible borrowers will likely escalate without Congressional action.

H.R. 833 Balances the Twin Goals of Debtor Relief and Creditor Recovery

Administrative Needs-Based Approach to Consumer Bankruptcy

Adoption of an administrative needs-based policy would best achieve the appropriate balance between debtor relief and creditor recovery. We are gratified by the bipartisan consensus that fundamental reforms are needed in the consumer bankruptcy process, and that the heart of these reforms is a needs-based bankruptcy system. Such a system would recognize that consumer bankruptcy, like every other part of the social safety net, should have safeguards to prevent abuse of its most generous benefits. It would also send a strong message that bankruptcy can no longer be regarded as an easy first resort for the financially reckless.

Needs-based bankruptcy reserves complete liquidation of unsecured debts for those borrowers who really need complete debt forgiveness. It is a system that prevents individuals with substantial disposable income from manipulating the bankruptcy system to avoid their repayment obligations if they have the resources to repay all or a part of what they owe.

An administrative needs-based approach is simple and straightforward. First, for those individuals with incomes below a prescribed level, there would always be the option to file in Chapter 7. Second, for those individuals with higher than the prescribed income level, there would be a simple formula to calculate how much an individual can afford to repay based on income and obligations. For example, the clerk of the court or bankruptcy trustee would review the information in the debtor's petition to determine income, deduct the portion required to meet household expenses and pay secured debts and unsecured priority debts, and then calculate how much remains, if any, for the payment of unsecured non-priority debts. If the amount available to pay that latter category of debt exceeds a certain percentage over the normal time span of a Chapter 13 plan, the debtor would be denied eligibility for Chapter 7.

The Bankruptcy Commission recommended taking a purely *judicial* approach to determine eligibility for filing in Chapter 7. We are convinced that the *administrative* approach outlined above is more efficient and more fair. An administrative system provides uniform and predictable results based upon clear and objective standards. It does not require additional expenditures to have counsel argue a motion before a judge with an overcrowded calendar. And it gives clear notice to debtors, prior to filing, of exactly the extent of relief they can expect to obtain if they file for bankruptcy.

It is important to note that needs-based bankruptcy does not prevent debtors from obtaining substantial relief under the Federal bankruptcy laws. Those who cannot repay their debts would continue to be eligible for complete relief under Chapter 7. Furthermore, under a needs-based system, debtors still may file a Chapter 13 petition (or, in rare cases for high-income individuals, Chapter 11) and obtain the injunctive relief of the automatic stay. Chapter 13 provides avenues for curing defaults and restructuring payments on secured debts which are not available in Chapter 7, and it provides a broader bankruptcy discharge upon completion of the repayment plan. And debtors still can void their legal responsibility to pay a substantial portion of their unsecured debts. But they cannot avoid all repayment obligations when they have the disposable income to make good on a significant portion of what they owe unsecured creditors.

H.R. 833 contains the blended system combining administrative and judicial elements which was agreed upon by Conferees last fall. It requires a motion under Section 707(b) of the Code, with its filing by the Chapter 7 trustee being mandated for debtors above median income who can pay either 25% of unsecured debts or $5,000 over a five year repayment plan. Debtors could only overcome the presumption of abuse under this formula by demonstrating truly "extraordinary circumstances". This approach is, frankly, neither as efficient or as uniform as the administrative approach which was adopted by this Committee and the House last year. Nonetheless, it represents a very substantial improvement over the present consumer bankruptcy system because it effectively incorporates the principle of means-testing Chapter 7 relief.

Other Important Reforms to Consumer Bankruptcy Law Contained in H.R. 833

H.R. 833 also proposes other important reforms in consumer bankruptcy law which ABA strongly supports. For example:

- establishing that significant consumer debts incurred within 90 days prior to filing for bankruptcy should be presumed nondischargeable;
- barring the discharge of fraudulently obtained debt in all consumer bankruptcy cases;
- establishing auditing and documentation requirements for debtor filings, and providing for legal actions if material misstatements are submitted;
- barring Chapter 7 refiling for 8 years after discharge, and setting a limit (5 years) for the first time on Chapter 13 refilings;
- permitting lenders to bring evidence of abuse to the court's attention;
- permitting lenders to be represented by non-attorneys at the initial meeting with the debtor;
- directing the bankruptcy courts to compile and publish new statistical data on filings;
- expediting the initiation of Chapter 13 payments and assuring adequate protection payments in the interim;
- establishing 5 years as the normal length of a Chapter 13 plan for those debtors with above median income;
- clarifying that debtors lose the benefit of the cramdown of under-secured debts when they convert from Chapter 13 to 7, ending "Chapter 20" abuses;
- establishing that collateral securing a note cannot be subject to cramdown in any bankruptcy filed within 5 years;
- requiring that debtors generally first try to resolve their difficulties through credit counseling, and generally requiring debtors to complete a financial management training program as a condition of the discharge;
- quadrupling, to two years, the length of time a debtor must reside in a state to take advantage of its homestead exemption;
- subjecting debtor's attorneys to sanctions for abusive petitions and motions; and
- establishing a "debtor's bill of rights" to provide debtors with a description of their legal rights and options and what services should be provided by those preparing their filing.

H.R. 833 also contains extensive new provisions to assure that bankruptcy can no longer be used as a device to avoid the payment of alimony, child support, and other familial obligations. In particular, child support is made the first priority among all unsecured debts; debtors must continue to pay child support after filing; and a discharge will not be granted until child support payments are brought current. We applaud these provisions. The lending industry supports all reasonable steps to assure that children and spouses are paid first before other creditors.

We do have reservations about certain provisions of H.R. 833 which arose in the Conference Report on H.R. 3150. The requirement that a debtor waive in writing a court hearing on a valid reaffirmation agreement is a step backward from the elimination of this burden on the courts that was made by the 1994 Reform Act; in any event, if this change is adopted, there is no justification for exempting debts owed to credit unions. New Truth in Lending Act disclosures regarding minimum payments on open-end credit and requiring representative examples of payoff times can be accommodated, but earlier proposals for account-specific calculations would not only be a data processing nightmare but could well mislead consumers. And the requirement that credit card companies not terminate account holders solely because they do not incur finance charges is far preferable to earlier proposals that would have legislated the pricing structure for this product.

Commercial Bankruptcy

Business bankruptcies now constitute less than five percent of all bankruptcy filings, indicating that there is no business bankruptcy crisis. However, there are some reforms that could improve the operation and effectiveness of Chapter 11's framework for business reorganizations. In particular, Chapter 11 does not work very well for small businesses. One of the Bankruptcy Commission's better recommendations was for the creation of a less complex and expedited Chapter 11 process for small businesses. That proposal would encompass 85 percent of all Chapter 11 filings. We are pleased that H.R. 833 includes a workable version of this proposal. It will help ensure that small businesses have the best possible chance of successfully reorganizing by taking advantage of a system which is less complex and expensive.

We are anxious to see the removal of the $4 million debt cap that unwisely limits the effectiveness of the action taken by Congress in 1994 to curb abusive single asset realty bankruptcies. Again, H.R. 833 accomplishes this important goal.

Another key reform would be to set some firmer limits on a judge's ability to approve repeated extensions of the exclusivity period in Chapter 11s. This is the time span during which only the debtor-in-position may propose a plan of reorganization. Chapter 11 was meant to be a way station in which companies could adopt and implement a plan to rejoin the economic mainstream; it was not meant to be a semi-permanent state of existence which coddles existing management. At some point certain, other parties in interest to a case should have the right to step forward and propose their own reorganization plan for a vote, if the debtor has been unable or unwilling to do so. H.R. 833 sets a firm limit on such extensions at 20 months past the initial six-month period. While this still may be too generous, at least companies will no longer be permitted to operate in bankruptcy beyond that period without ever adopting a reorganization plan.

H.R. 833's provisions addressing the status of financial instruments in bankruptcy will add desirable stability to the financial system. Generally, instruments such as swaps and derivatives would not be included in "property of the estate" and would therefore be immune from creditor seizure. The netting of various types of exposure under "master netting agreements" would also be recognized.

In our interconnected world, cross-border insolvencies involving multiple jurisdictions are increasingly common. H.R. 833 would facilitate their orderly handling by establishing new rules on venue and other key considerations.

We are, however, compelled to raise serious concerns about some of H.R. 833's commercial provisions.

The most offensive is a provision which was obtained by shopping center interests. It would compel their tenants in reorganization to affirm or reject their leases within 120 days after filing. This imposes an impossible deadline for major retailers operating from dozens or even hundreds of locations. Have no doubt, this alteration will make it far more likely that troubled retailers will fail to reorganize and that the jobs associated with them, both directly and at their many suppliers, will be jeopardized. This provision is also patently unfair to the broad spectrum of their unsecured lenders - not just banks, but suppliers, professionals, and workers. When a commercial real estate lease is assumed under coercion the entire unexpired portion of the lease becomes an administrative expense priority if the reorganization fails. We have no objection to a landlord being paid for the time the space is actually occupied, but there can be no justification for paying them for the lease term after abandonment to the economic detriment of all these other parties. This provision must be addressed and rewritten to provide retailers with a reasonable period in which to decide where to continue operations, and to provide fair treatment to all unsecured creditors.

Another provision provides trade creditors with an additional 25 days in which to file reclamation claims for return of their goods. We have no objection to this procedural improvement. However, at the same time you address this matter you should add a technical correction to the 1994 Reform Act to clarify that a debtor's ability to voluntarily return goods is subject to any liens or other security interests that apply to them. In addition, you should oppose any attempt to make the reclamation rights of an unsecured creditor superior to the rights of a secured lender holding a lien on those goods. Certain trade creditors are pressing for such a change. It would completely undermine the legal basis of secured lending and threaten the availability of one half trillion dollars' worth of secured credit extended to U.S. businesses each year. ABA would forcefully oppose such a threat to this critical commercial lending activity.

We are also concerned about the provision which would allow the judge open-ended discretion to arbitrarily and unilaterally change the makeup of the creditors' committee. This would usurp the role of the U.S. Trustee, cause undue delay, and increase costs. It could also lead to the failure of reorganization attempts if the insertion of "vulture" investors on the committee leads to acrimonious conflict. Any new authority for the court to alter these committees should be narrowly circumscribed.

Finally, we would ask you to consider the addition of language clarifying that a judge may auction assets of a company in Chapter 11 in the absence of a reorganization plan. While this is the practice in some courts, others believe that statutory authority is required.

You should also be aware that during your consideration of H.R. 833, the Supreme Court is expected to issue its decision regarding whether or not the "new value exception" is a part of the Code. We may well urge you to respond to that decision if the Court causes damage to the absolute priority rule.

Farm Bankruptcy

H.R. 833 would make Chapter 12 a permanent part of the Bankruptcy Code. Chapter 12 was passed in 1986 in response to the greatest agricultural debt crisis since the 1920's. Because it was an emergency response to a crisis, the original act was set to sunset in October, 1993. In 1993 Chapter 12 was extended, with little modification, to October 1998. As you know, Congress extended it by six months last October, and it appears that you are about to give it yet another six months of existence.

Since Chapter 12 was enacted, the agricultural economy has improved greatly. Agricultural asset values and farm incomes have rebounded or exceeded the levels they reached in the early 1980's. After an initial surge of filings, Chapter 12 filings have declined significantly. While we would prefer to see Chapter 12 expire as Congress intended, we believe that, at a minimum, its permanent adoption should be accompanied by some fundamental reforms to address ongoing problems.

First, discipline must be restored to reaffirm the original goal that Chapter 12 be an *expedited* resolution of farmer debts. The primary reason for creating Chapter 12 was that the existing bankruptcy chapters were too expensive and too time consuming for farmers to be able to effectively use to reorganize their businesses. Because of the crisis atmosphere that surrounded the legislation, Congress acted to make sure that any farmers that could quickly reorganize would be able to do so. Today a farmer under Chapter 12 protection has 90 days to file a reorganization plan after the order for relief has been filed. The debtor is supposed to be allowed extensions by the court only in cases where the debtor should not be "justly" held accountable. In practice, the courts have been far too willing to grant repeated extensions in Chapter 12 cases without adequate justification required by the code. We believe that extensions should be limited to a maximum of 60 days, and that debtors be given a maximum of 150 days to file a plan before claim holders can initiate liquidation actions.

Second, excessive cramdowns of secured claims are often granted on the basis of unduly low appraisals provided by the debtor. In Chapter 12, lenders that have their claims crammed down to the value of the collateral lose any opportunity to recover the value of their claim in the future if the debtor defaults on the plan, or if the debtor chooses to sell. In Chapter 11 (business bankruptcy), lenders may make an election that allows them to recover unsecured claims if the debtor defaults on the plan or sells the business. Under this election in Chapter 11, a debtor that successfully completes the plan will receive all of the benefits of the court ordered cram down. Only if the debtor defaults or voluntarily sells will the lender have the opportunity to try to recover the full value of the claim. A similar provision in Chapter 12 would create a powerful incentive for the debtor to successfully complete the plan, and would provide for equitable treatment of lenders in case of a default or voluntary sale.

Finally, we are adamantly opposed to the provisions of H.R. 763. That bill would double the debt limit for Chapter 12 eligibility, taking Chapter 12 far beyond the small family enterprises it was intended to help. It would also grant the special protections of Chapter 12 to individuals who had not farmed for up to three years. We urge you to reject that proposal.

Conclusion

Mr. Chairman, the ABA appreciates this opportunity to address you on bankruptcy issues. We think it would be a terrible mistake to ignore what the record levels of personal bankruptcies are telling us - namely, that the current system is broken and must be fixed. We believe that H.R. 833 is a good approach to reform of the system. It would establish a bankruptcy system which provides appropriate debtor protection while also preventing abusive use of the system by individuals who have the capacity to repay all or a portion of their debts.

We appreciate your and the Subcommittee's interest in this issue, and we look forward to working with you and other Judiciary Committee members to ensure that bankruptcy reform is enacted in this Congress.