

# Senate Banking, Housing and Urban Affairs Committee

## *Subcommittee on Financial Institutions & Regulatory Relief*

### Hearing on Bankruptcy Reform

**Prepared Testimony of Mr. Oakley Orser  
Vice President for Credit  
Belk Stores of North Carolina  
On behalf of the National Retail Association**

**10:00 a.m., Wednesday, February 11, 1998**

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Good Morning. My name is Oakley Orser. I am Vice President of Credit for Belk Store Services. I am testifying on behalf of the National Retail Federation. Belk Stores is a member of the NRF and I am past chairman of its Credit Management Advisory Council. It is a particular pleasure for me to be here today. I want to thank the Chairman for providing me with the opportunity to testify before this distinguished committee.

By way of background, the National Retail Federation is the world's largest retail trade association with membership that includes the leading department, specialty, discount, mass merchandise and independent stores, as well as 32 national and 50 state associations. NRF members represent an industry that encompasses over 1.4 million U.S. retail establishments, employs more than 20 million people, 1 in 5 American workers, and registered 1996 sales of nearly \$2.5 trillion. NRF's members and the consumers to whom they sell, are greatly affected by the recent surge in consumer bankruptcies.

Bankruptcies are surging. In the past two years, filings have risen nearly sixty percent (60%). In North Carolina, Chapter 7 bankruptcies have grown by 103% in that same time period. In 1997, the U. S. broke the one million filing record that had been set only the year before. Last year there were more than 1.3 million bankruptcy filings, the overwhelming majority of which (more than 95%) were consumer filings. Mr. Chairman, I would like to put these numbers in perspective. We have a strong economy, a steadily increasing stock market, low unemployment; the public is optimistic about the future. And yet, approximately one in every 80 households in America filed for bankruptcy just in the past year.

Bankruptcy filings are nearly four times higher now than they were during the much worse economic conditions that prevailed in 1980. Rational economics does not explain this increase in filings. But a continuation of this level of filings will wreck economic havoc upon our economy.

It is estimated that \$40 billion was written off in bankruptcy losses last year. This money did not just disappear. The cost of these losses and unpaid debts are borne by everyone else. When an individual declares bankruptcy rather than pay the \$300 they may owe to Belks; or the thousand dollars they may owe in state taxes or other bills, they force the rest of us to pick up their expenses. Everyone else's taxes are higher, everyone else's credit is tighter and everyone else pays more for merchandise as a result of those who choose to walk away. That \$40 billion ultimately gets paid by the nation's 100 million households. Last year, to make up for these losses, it cost each of our households an average of \$400. This year's number threatens to be even higher (\$450).

Now I want to be clear. We cannot eliminate all of these losses. Some of them are unavoidable. Bankruptcy must remain an option for those who have experienced serious financial setbacks and who have no other means of

recovering. The bankruptcy system exists to help those who have suffered a catastrophic accident, illness or divorce, or those who have experienced the loss of a business or job from which they cannot otherwise recover. It is both the last resort and the safety net for people in trouble. The knowledge that the bankruptcy system exists to catch them on a financial fall, even though it might never be used, is important. Finally, most people who file for bankruptcy need relief. We must be very careful to distinguish the average filer, who uses the system properly, from that smaller, but important group of others who misuse the system for their benefit.

It is the trend with which we must be concerned. We believe changing consumer attitudes regarding personal responsibility and inherent flaws in our bankruptcy process have caused many individuals, who do not need full bankruptcy relief, to turn to the system regardless. They use it to wipe out their debts, without ever making a serious effort to repay. Some of this change in usage results from a decline in the stigma traditionally associated with filing for bankruptcy. Some of it results from suggestions by others urging individuals to use bankruptcy to "beat the system." Whatever the cause, it must be stopped.

My experience at Belks, and that of other credit managers at other stores with whom I have spoken, convinces me of this fact. For example, for many years we have tracked the payment history of those of our customers who carry and use the Belk card. The vast majority of our customers pay as agreed. In the past, however, we would occasionally see customers whose payment patterns were more erratic. They might fall behind by a few months, make payments to catch up, fall a couple of months behind again, attempt to recover, and so forth. This kind of payment history suggested to us that the customer was experiencing some sort of financial difficulty. We would monitor the account and intervene as necessary, perhaps by suggesting consumer credit counseling or by limiting their credit line so as to minimize the amount of damage, prior to their possibly experiencing a financial failure.

Today, however, we are seeing a very different picture. Often the first indication we receive that an individual is experiencing financial difficulty is when we receive notice of his bankruptcy petition. Indeed, it is beginning to approach the point that 50% of the bankruptcy petitions we receive are from customers who are not seriously delinquent. The first indication of a problem is the notice that they have filed for bankruptcy. It appears that increasingly, bankruptcy is becoming a first step rather than a last resort.

Individuals must have a good credit history to qualify for a Belk card. Yet we, and other retail credit grantors have been receiving bankruptcy filings, without warning, from individuals who have been solid customers for years.

We all experience temporary financial reversals in life. Most of us learn that, if you grit your teeth and tighten your belt a notch, you can get through it. But many people no longer see it that way. The rising bankruptcy filings reflect this. Professor Mike Staten at Georgetown University analyzed thousands of Chapter 7 bankruptcy petitions in courts all over the country. His review of debtors' own financial statements gives a strong indication of what is going wrong.

Individuals have a choice as to whether to file in Chapter 7, which generally wipes out all their unsecured debt, or they can file in Chapter 13, often known as a wage-earner plan. Instead of wiping out everything, a Chapter 13 filer attempts to repay as much as he or she can afford and the court discharges the rest. Not surprisingly, most people choose to file in Chapter 7.

Although it was the largest bankruptcy study ever undertaken, Professor Staten's study used essentially the same methodology as had researchers before him. He made two important findings. The first was that the average person filing in Chapter 7 is in serious financial trouble. That is not unexpected. Other researchers had found this, and this is what one would hope to find. Most people are honest and use the bankruptcy laws as they are intended. But Professor Staten did something that other researchers had not done. He looked more closely at subgroups within the Chapter 7 filers; and he discovered that they were not at all alike.

He found that while the typical bankruptcy filer needs relief, and uses bankruptcy properly, a large number of filers are not. He discovered that many bankruptcy filers did not need the complete wipe out of debts that Chapter 7 provides. In fact, based on the filers' own schedules, he found that twenty-five percent (25%) of filers had the ability to repay anywhere from 33% to 100% of what they owed had they instead been in a Chapter 13 plan. Five percent of those individuals could have repaid 100% of what they owed. Instead, they chose a Chapter that allowed them to shift their debts onto the rest of us.

Why are so many persons asking the court to make others repay their debts for them? Why aren't they ashamed to go into bankruptcy court? We think that there are a number of factors.

Part of it is lawyer advertising. You don't need to stay up very late at night to see ads on TV by lawyers promising to make individuals' debts disappear (Call 1800-DEBT FREE). Some of these ads are very aggressive. Some don't even mention bankruptcy - they talk about "restructuring" your finances. I question whether they inform their clients about the serious downsides of filing for bankruptcy. I doubt many of them do. I have heard of cases where all of the preparatory work is done by clerk typists. The client never meets the lawyer until he or she gets to the courthouse. That's a little late to begin financial planning. I firmly believe these "bankruptcy mills" are part of the problem.

I also believe that part of the problem is the declining social stigma associated with filing for bankruptcy. At a time when 1 in every 80 households files for bankruptcy, everyone knows someone, or knows of someone, who has recently declared. Many of these individuals keep their house and their car. They seem to have access to credit (although in many cases what they actually have is a secured credit card - they put \$500 in the bank and they get a card with a \$500 'credit line'). And their friends and neighbors, not seeing the details of your life that bankruptcy disrupts, assume that bankruptcy is not such a bad situation.

In addition, there have been many high profile celebrity bankruptcies. These individuals have extravagant salaries and lifestyles. They declare bankruptcy and yet continue to receive media acclaim. Burt Reynolds and Kim Basinger both recently filed well publicized bankruptcies, and yet in the past two months both also were awarded Golden Globes. Toni Braxton couldn't get by on \$170 million. She filed and continues to be celebrated. I can't help but believe that this sends a message to the public. For many people, the stigma of bankruptcy is fast disappearing.

Finally, these changes have revealed a flaw in the system itself. Our bankruptcy code allows individuals to choose the chapter they wish, regardless of need. Ms. Braxton filed in Chapter 7. If shame won't keep the subgroup of filers who could repay from either filing or filing in the wrong Chapter, Congress needs to establish a mechanism that will. It must be simple, efficient and fair. Fortunately, some members of Congress are attempting to do just that.

In the House, lead by the Judiciary Subcommittee chair, Reps. Gekas, Boucher, McCollum and Moran, have introduced H.R. 3150. It incorporates HR 2500, previously introduced with great bipartisan support by Representatives McCollum and Boucher. H.R. 3150 would establish a very simple gatekeeper mechanism for the nation's bankruptcy courts. Individuals would have their attorneys fill out essentially the same forms they fill out now. H.R. 3150 would add a few additional lines. After deducting living expenses, secured (typically house and car loans) and priority (such as child support) obligations, it would calculate whether there remained income to pay a significant portion of the filer's unsecured debts. If there was not, the person would choose Chapter 7 or 13 as they saw fit. But if they could make a significant repayment, the calculation would direct them to Chapter 13. Making the determination "up-front," before the individual gets into the court system, is far more efficient than other approaches.

Individuals would still receive bankruptcy relief; they would receive the amount of relief they actually needed. Misuse of the system is not a problem of the poor. The problems are occurring among the middle and upper middle income filers. H.R. 3150 recognizes this. If individuals made less than 75% of the median income or couldn't afford to repay 20% of their unsecured debt, H.R. 3150 would allow them to file in Chapter 7 without question. On the other hand, if an individual could afford to repay 40% of what he owed, H.R. 3150 would require him to repay what he could afford, and the court would wipe out the other 60%. We strongly urge Congress to adopt such an approach.

Senators Grassley and Durbin have also introduced a bill, S. 1301, which attempts to reach the same result. While we believe that their intentions are good, the proposed mechanism in that bill is too complicated to be useful. First of all, the mechanism in that bill, designed to direct individuals to the correct Chapter, does not kick in until after individuals have filed their petitions. At that point, parties could petition the court to move the filing from Chapter 7 to Chapter 13. However, the movement could not be granted unless several complicated showings were made. (One would have to show that the individual could afford to repay; that they had engaged in some sort of abuse; and that no efforts to compromise the debt had been improperly rejected.)

Frankly, for retailers such as Belks, the proposed Senate approach would not work. A typical balance on a Belk card

for a customer in bankruptcy is approximately \$630. A recovery in a Chapter 13 proceeding might be 30 cents on the dollar. It would not make economic sense for Belks to spend hundreds or more dollars in an uncertain effort to move a petition from Chapter 7 to Chapter 13 to recover \$190. This is not to say that \$190 isn't important to us. With tens of thousands of individuals filing for bankruptcy, those one hundred ninety dollar claims add up. It is just that the approach in S. 1301, as a practical matter, won't be used by us, or by any other retailer. This is why the National Retail Federation so strongly supports the simple, up-front approach contained in the House bill.

(There is one other House bill: H.R. 3146 introduced by Congressmen Conyers (D-MI) and Nadler (D-NY). I am not particularly familiar with it, but I know that it does virtually nothing to ensure that individuals are placed in the correct Chapter. Not only is it not an up-front approach; it would not apply to anything less than 100% Chapter 13 repayments. Even if individuals could afford to repay 99% of what they owed - and Professor Staten's data shows that more than 5% of Chapter 7 filers can - the Conyers/Nadler bill would not require them to repay even a penny. It is not an acceptable answer to the growing crises in our bankruptcy system.)

In closing, on behalf of the National Retail Federation, we urge members of Congress to take swift legislative action to address the problems confronting the nation's bankruptcy system. Otherwise, in the not too distant future, we may find that among a large segment of our society, bankruptcy filings will become the rule, rather than the exception. If we are not careful, the costs of the rising flood of discretionary filings may tax society's compassion for those in genuine need. We must not allow that to happen.

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