Opportunity Lost: The Case for Bankruptcy Reform Allowing Bankruptcy Judges to Modify the Principle Balance and Terms of Loans Secured Only by the Principle Residence and Student Loans

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As the economy was seemingly in an endless fall Congress and Wall Street rushed to bail out Wall Street. Lobbyist and self proclaimed experts declared to speak for the welfare of the consumer – what was best for the economy. Such "experts," some who appear on cable business news channels or through sound bites on local television, do not truly understand the plight of the consumer, let alone what is best for the consumer. And, as the consumer sinks into despair, so does the economy.

And now, a final blow to enabling the consumer to have a fresh start; the Obama administration, under the faded banner of "Hope" turned its back on the consumer and failed to support Senator Durbin's Bankruptcy Reform – the Cramdown Provisions – the return of parity. Instead, the Obama administration, taking the lead from the Bush Administration, chose to further enable Wall Street and bring the consumer and our economy ever closer to hyperinflation and ultimate despair. Shakespeare could not have written a better line - "Et tu, Brute!" - "Et tu, Obama!"

<u>The Reality of Wall Street's Fleecing of America</u>

The current financial distress is not new to America. We have seen such carnage before: the panic of 1893, following Reconstruction, and the crash of 1929, each arising from hyper-securitization of debt. During the last 30 years Wall Street has been allowed to securitize debt originating from the purchase of homes, auto financing, student loans, and insurance. In each instance, supported by successive political administrations, mostly in the guise of supporting the consumer. One need only look at the stock market run starting in August 1981 through September 2008, accompanied by trading volume exceeding dollar amounts and number of shares unfathomable by the average person.

Rightfully so, each American should have safe, decent, inhabitable housing. But, this concept was corrupted by the Community Reinvestment Act into every American should own a home. And, who was the beneficiary of enabling each American to believe they had an entitlement? Washington and Wall Street. As long as payments were kept low (rather than prices kept affordable) the consumer would buy homes with mortgages that Wall Street would securitize. Politicians would announce that there are "two SUVs in every driveway and a mortgage being paid by every American!" The problem was that real income would never keep pace with inflation, and the economy had to expand at a certain rate to keep pace with the interest payments.

The auto industry, unable to keep up with ever-increasing union benefits and overhang from retirees, turned to selling auto financing rather than cars. Gone would be the $1999 Ford Maverick. As long as the consumer could make the lease and loan payments, new cars would be purchased every 3 to 5 years. And, Detroit would wind up selling the financing paper to Wall Street who would securitize the debt for resale, just as it did home mortgages. The auto industry, much like the consumer to whom they were selling cars and financing, would become addicted to the new paradigm of credit and debt. To add further fuel to the fire, Washington would enact tax legislation during the Bush administration to give each consumer tax benefits for each gas guzzling SUV they purchased. Detroit would produce and rely upon the sale of the SUV, while the reality of limited world supplies of energy would be ignored. Reality came when Wall Street futures speculators enabled the trading of oil and gas futures contracts to soar over $100 per barrel. Washington, Detroit and Wall Street conspired to ultimately cause the demise of our domestic auto industry, while the consumer paid the tab in the billions of dollars.

Student loans are the third major insult and the most outrageous of the Wall Street-Washington schemes to fleece America. In the name of providing every American with an education, similar to the liberal platform of a home ownership for every American, during the Bush Administration, Congress allowed Wall Street to fund student loans – to kids, guarantied by willing parents – which loans would be guarantied by the government and deemed nondischargeable in bankruptcy. What a perfect, no risk opportunity for Wall Street. And, you guessed it, such loans would be packaged and sold as securities, further reducing the economic risk of the original lender. But, these student loans would be priced at market rates, rather than the 3% to 4% that had been traditional. Colleges, universities and trade schools (and student loan schools) drank from the student loan well, increasing budgets, building edifices to administrations, all with the mistaken belief that there would be no end to the ability of the consumer to fund the payments.

And, now, three of the first two legs of the consumer's chair have been cut off, leaving student loans and insurance remaining. What will it take? How many more trillions of dollars? How high will inflation need to go? As the Founding Fathers might be found to say: "Is it time to remove the despots – Wall Street – from government?"

<u>The Consumers' Despair</u>

From the perspective of a consumer bankruptcy lawyer, in response to repeated snickers of how good things must be, the best response is to describe the situation with three possible analogies:

First, "I am a field medic. I am getting ready to perform countless surgeries using only the bare minimum of medical technologies to treat the wounded afflicted by the ravages of warfare. I am in a small town in Southern Pennsylvania. It is the morning of July 3, 1863, and Pickett has not crossed the road yet."

Or, it can be described as such: "I am a triage surgeon in a local hospital, equipped only for the occasional car accident. We have just gotten a report that there has been a train wreck outside of town, on which train there were 300 million people who were partying and having a great time, but the train was without an engineer, a brakeman, or a conductor, and nobody saw that the track was out. The bodies are strewn all over, and being brought in by the locals using whatever means of transportation are available. The dying and wounded are sorted out; those who survive will be forever scarred – a generation lost!"

And, finally: "For the last 30 years Americans have been fed intravenously a drug called credit that makes them feel good. They got low doses at first, but as the euphoria wore off, they were fed more and more to make them feel better and better. They were told that credit was the new economy. They were made to feel good about owing more than they could afford. They were made to believe that they were the foundation upon which the greatest democracy and economy in history was to flourish for all time. Growth was essential to support the addition of interest piled onto the cost of every good bought and sold. But now, there is no more of the drug called credit, and the addicts are seeking rehab to be weaned off of their addiction. Those that survive will realize that never again can they be addicted to credit. But, the credit industry is not so willing to give up their addicts, and the Senate is all too willing to enable the continued servitude!"

But neither Congress nor Wall Street will ever hear or see it described that way, and certainly never let the public think it to be so. These images are perceived too severe for the American public to either comprehend or accept. The American public, however, is far more astute and aware. They know that the world as they know it has forever changed, and that they must change with it. So too, if reality does not take hold, the American public will find itself the indentured servants of Wall Street, forever the addicted, and forever disenfranchised from the democracy of our the Founding Fathers. And, certainly, with passage of the TARP, and now rejection of bankruptcy reform, Wall Street has completed its stranglehold on both Washington and Main Street. Not since the late nineteenth and early twentieth century, has the American public been so manipulated. But Obama is no Teddy Roosevelt!

This article is intended for those who care and who want to understand and make a difference in how we move forward as a society. If you do not believe it is intended to speak to you, then it is for your children – your legacy. The realities are not new, merely repackaged by those who peddle influence and power. As the tobacco industry has been put to task for killing millions, so too must the credit industry be put to its task. The moneychangers must be removed from Washington and each state capitol – just as they were from the Temple over 2 thousand years ago!

Congressional Influence Peddling Impairs Congressional Judgment.

The three examples above most graphically and without apology describe the current condition of the American consumer. Our elected officials, who are lobbied and influenced into their own hypnotic stupor, know little, if anything, about the current state of their constituents. They exist in the luncheon and dinner world of Washington, far away from the warring couples whose marriages are torn apart by the inability to feed their children or pay the mortgage as it comes due. Wall Street comes to Washington, testifies before Congressional committees, and return to their homes in Greenwich, Connecticut, or Woodcliff Lake, New Jersey, to sleep well at night. They have done their duty – their bonuses and those of their employers preserved; paid for by the public.

For Congress there is a hefty regular salary with automatic annual cost of living increases; far more than could ever have been dreamt of at home. Why do so many go home from Washington wealthier than when they first left? And far more than their constituents can expect. Congressman and Senators don't pay Social Security, have all of their benefits and vacation and travel paid, and live in a world of perceived power; seen only since the Romans!

The lobbyists peddle influence upon the Congressional staff. These influence peddlers have emerged from the legions of former Congressional staff or Congress itself. Wall Street insures the Congressional pensions, finances the influence peddlers, and assures that the blind trusts are well financed. The influence peddlers can further be seen in the face of the Mortgage Bankers Association, representing the dealers of debt and the credit based euphoria, or as better known today: divorce, substance abuse, despair, and rising crime.

To add insult to injury, Wall Street took billions (more likely trillions) of dollars from the public coffers, only to fund the lobbyists to influence the Senators, supposedly at the leadership of Harry Reid of Nevada, to reject bankruptcy reform, most importantly to reject authorizing bankruptcy judges to modify the terms of principal residential mortgages.

To allow bankruptcy judges to conduct judicially supervised loan modifications would cost Wall Street about $4,500 per loan modification. How many millions of loans need to be modified, and how many billions would the Treasury be saved and Wall Street loose through judicially supervised modifications?

In September 2008, not only did Congress hand Wall Street a $350 Billion blank check, but, as well, handed Wall Street years of tax benefits the likes of which cannot be calculated. What Congress did, by example, is allow Wells Fargo Bank to acquire Wachovia Bank for $10 Billion with taxpayer money. If, for example, Wachovia had $200 Billion in toxic assets, Congress has allowed Wells Fargo Bank to take the tax benefit, not of the amount it cost Wells Fargo to acquire Wachovia, but the principle amount of the loans that are toxic. In essence, Wells Fargo was handed $10 Billion in cash and $200 Billion based tax relief. And, the same is true of, for example, J.P. Morgan Chase's purchase of WAMU and Bank of America's purchase of Countrywide. In each instance Congress wrote the check from the public treasury and handed Wall Street an untold amount of tax benefits. Did the consumer receive a similar handout? Of course not!

The actions of Congress, couched, spun and publicized for the benefit of the American public, are in reality the classic "troika." It is a coming together of power and influence to carve up and feed on the soul of the American consumer, the taxpayer, the constituent, the father and mother of the son sent to Iraq or Afghanistan. In the summer of 1863 they were the generals who sent Pickett across the road against a volley of canyon and musket fire that turned the skies black. They are those that sent our young into Iraq, costing the lives of thousands who died, tens of thousands maimed, and trillions of dollars in debt. So too, more sadly, they are the enablers of the addiction of credit. "Credit is necessary to run the American economy," they pronounced. In essence, honesty be said, they are the drug lords against which the drug war should be fought!

But, the Democratic Senate elected on a platform of change, and the Obama administration, notwithstanding a pledge for change and new hope, turned their back on the millennium tested method to fight that war – judicial intervention to conduct loan modifications. Our elected officials, the purported guardians of our society, owing a fiduciary duty to their constituents, abandoned the American public! Wall Street HAD to be saved! But, at what cost and for who would Wall Street be saved?

<u>Bankruptcy Courts Have Historical Experience and Ability to Reset Mortgages.</u>

The truth was distorted in a way that would make George Orwell proud. The truth is that the Bankruptcy Court is an institution founded upon the biblical pretext of the Lord's Release - Deuteronomy 15, over 3000 years old and the forgotten foundation of our capitalist system. As well, our bankruptcy courts are rooted in our own Constitution. Congress shall enact uniform laws on bankruptcy, the Founding Fathers declared. It could be said that Jefferson is on the nickel because when he died he did not have two to rub together. Monticello was sold to pay off his creditors.

Since 1978 the Bankruptcy Courts have been operating, literally, on millions of Americans who from time to time fell victim to the ravages of the economy, their own personal demons, divorce, cancer, floods, earthquakes, hurricanes, you name it, the Bankruptcy Courts have seen it all. The 1978 Bankruptcy Code overhauled the Bankruptcy Act of 1898, enacted to restore the nation's economy ravaged by the panic of 1893.

The 1898 Act prohibited refiling for complete relief – Chapter 7 – but once every 7 years – the Lord's Release. The 1978 Code reduced the interval to 6 years. In 2005, under the direction of the Conservative Right, Congress elevated itself above the Lord's Release. Congress increased the interval to 8 years, and restricting access to a fresh start. Ironically, or maybe not, those who were more prudent by not incurring secured debt to purchase large SUVs, boats or unaffordable housing, could be denied a fresh start. Renters and those living outside of certain Metropolitan Statistical Areas were discriminated against. The credit industry had not merely influenced the 2005 Bankruptcy Abuse Prevention Consumer Protection Act, but had actually authored it. Not a word needed to be changed! On April 20, 2005, then President Bush merely signed it into law.

<u>A Simple Solution To Provide a Return to Affordability</u>

But, now, the American public must look to their elected officials to revisit the tragedy wrought upon its constituents. The Bankruptcy Courts, once again, must be looked upon for judicial salvation; to enable the American public to be relieved, released, and discharged from the burdens of their addiction to credit. Modernly speaking, there needs to be the opportunity to hit the "reset button" on the economy, where everyone, or almost everyone, starts anew from a fresh start.

The solution lies, quite simply, in an ability of the Bankruptcy Courts to do the following with respect to home mortgages when an individual or couple files for relief under Chapter 13 or Chapter 11 of the Bankruptcy Code for the purpose of saving their home residence:

(1) Value the real property that is claimed as the principle residence of the debtor to an amount based upon not only a customary appraised valuation, but valuation based upon affordability – the amount after regular household necessary expenses that remains to pay for housing. The traditional Fannie/Freddie Guidelines are a start.

(2) Remove from the residence any lien, be it voluntary, statutory, or judicial, that is not otherwise secured by any (not a dime) of equity in the residence;

(3) Allow the debtor to confirm a Chapter 13 or 11 Plan based upon their current ability to service the balance of the mortgage that has been reduced, based upon an interest rate that is set over a period of 40 years at an interest rate equal to two points over that which banks are allowed to borrow from the Federal Reserve (the Fed Funds Rate); and

(4) Require that the debtor remain in the Chapter 13 or 11 for a period of 5 years, during which time all mortgage payments must be kept current and all real property taxes must be paid through the Chapter 13 or 11 (so as to assure payments) and all personal income taxes must be kept current, so as to assure the treasury is funded.

What happens to the liens that have been "stripped" away from the residence? Those liens are not effectively "stripped" until the debtor has satisfied in full all mortgage payments due under the Chapter 13 or 11 Plan and has fulfilled all other obligations due under the Chapter 13 or 11 Plan. Those liens are not treated like general unsecured debt, because they are not, and they are not treated as secured debt either, because they are not. They are separately classified and broken down in the following priorities: (1) statutory tax liens; (2) the undersecured portion of the mortgage that has been reset; (3) the wholly undersecured mortgage that once may have been a HELOC; and (4) the judicial lien.

<u>An Effective Chapter 13 or 11 – Consumer's Right to an Economic Reset</u>

The source for payment of the Chapter 13 or 11 would not change, as all of the debtor's property and income remains under the jurisdiction of the Bankruptcy Court until the discharge is entered. Tax refunds received during the 5-year period of the Chapter 13 or 11, inheritances, or any increases in earnings are all property of the estate. And, if the debtor were to sell or be able to refinance the principle residence during this 5-year period, on a sliding scale from 50% down to 10% of all appreciation in value would be attributable to payment of the above.

<u>Responding to the Higher Interest Argument</u>

The Mortgage Bankers and American Bankers Association have successfully argued that with such reform interest rates will rise and there will be fewer loans made. But, where are the statistics for such assertions? Under the original 1978 Bankruptcy Code courts were allowed to modify the loans secured by the principal residence, and not only did interest rates not rise, but mortgages were more prudently made upon affordability. The better argument, therefore, is that by not allowing judges to modify the principal residential loan, Wall Street was given an allowance to make ever more risky loans. Washington would enable more Americans to purchase homes, even if not truly affordable. Therefore, how would they respond to the argument that they need to continue making mortgages to survive, themselves?

Allowing Bankruptcy Judges to modify loans would not only not increase interest rates, but in allowing such modifications, they would stabilize the slide of values of the percentage of loans in distress, the balance not in distress would therefore also be stabilized, based upon reducing the slide of values. And, would not those loans that are subject to Chapter 13 or 11 loan modifications and plan payments be attractive mortgages to be securitized? And, wouldn't those that emerge from a successful Chapter 13 or 11 Plan be better credit risks, as they have become better managers of a family budget?

None of those honest answers matter, given the necessity of Wall Street's credit industry to find ever more victims to the credit addiction, just as the tobacco industry cares little for the lives of its newest teen addicts. And, what would be Washington's response?

It depends upon what the despots of Wall Street tell them to say!

The Loan Modification Myth

Wall Street has convinced the Senate that only Wall Street can effectuate loan modifications. What Wall Street has begot upon the American consumer and the Senate enabled further, is the proliferation of the loan modification industry. This industry consists of mortgage brokers, realtors and lawyers salivating over the corpses of those that grabbed for that which they could ill afford – mortgages exceeding their income.

Look at the players, and one can only wonder how the Senate could allow the fox to rule the hen house, or the inmates to control the prison, or the insane to run loose in the institution. It is the same cast of characters that led us to where we are today. There are unscrupulous realtors and mortgage brokers, many of whom are paying lawyers to front for them, soliciting ill informed consumers to pay for loan modifications. The loan modification package, much as was the loan package, is presented to the "loan modification negotiator," the same person that a few years earlier had been processing the same loan for approval. Required now to prove income and expenses to this loan modification negotiator, a unilateral decision made on how much, if any, of a loan modification is, or is not, bestowed upon the consumer. The loan modification company pleads its success, even though there is no benefit to the consumer, and therefore, no return of funds – sometimes thousands of dollars. The cycle is complete!

The statistics on how many loans are really modified in such a manner that the consumer gets a reset is yet unknown. But, without a complete financial restructuring of all other debt, the consumer is doomed to be sucked down into a deeper black hole of despair. Yes, there may be a 3-year reprieve, but to what end if there is no effective reorganization of personal financial condition? And, again, what does the credit industry care, as long as there is a continued dependence upon credit, payment of interest, and belief that one's credit score, above family and health, is paramount to personal success.

Student Loan Defaults Must Be Immediately Addressed.

As part of this vision of consumer relief, would also be allowing the Bankruptcy Courts to similarly reset the terms of student loans at the same interest rate as those for mortgages secured by the principle residence. The reason can be found in the example of the 29 year old young woman with a post graduate degree in Psychology and $185,000 in student loans, making minimum wage counseling autistic children while she tries to earn her intern credits for her license. She received no guidance from the financial aid counseling at her school – whether she would ever earn sufficient funds to service her debt. Her loans have interest rates as high as 8.5%, and the lender is without risk because the student loans are guarantied or arguably nondischargeable in bankruptcy. Was her financial aid counseling her counsel, or merely the surrogate for the student loan credit industry?

The underlying purpose for addressing the coming student loan debacle is the same as that for mortgages. Eliminate the abuses of Congress and Wall Street. During the last 8 years lenders were allowed to securitize student loans, being allowed to charge a market rate of interest for those loans made to students, guaranteed by parents, further guaranteed by the government and deemed excluded from a discharge in Bankruptcy.

So perfect was the financial scam that schools arose that catered to students who would not be academically qualified for traditional schools, but through liar loans would qualify for student loans. And, just as with home mortgages, these loans filled the need of Wall Street to sell securities and multiply its ability to leverage greater amounts from pools of loans.

But, the young, who are the legacy of our society, were to be the victims. You did not hear a cry to regulate this activity, as you hear the cry to regulate cigarette sales to kids, but the addiction is the same! And, baby boom parents believed they were doing the best for their children by co-signing for the student loans. A dose of parental enabling! An addiction of a generation lost!

Defaults on student loans are the next great financial crisis looming over the consumer and our society. It must be addressed at this time and not later. Therefore, the Chapter 13 or 11 Plan must be allowed to provide for the payment of student loans from disposable income of the debtors at the same interest rate amortized over 40 years. And, as with home mortgage payments and taxes, all payments must be kept current.

Answering the Critics

Now, to answer the critics, the self perceived experts, the influence peddlers, Wall Street, and those who decry people in trouble getting such assistance. To answer Wall Street and the financial industry's influence peddlers is probably the least difficult. Congress has enabled the banking industry since 1978 when deregulation began. Banks have been allowed to issue securities without any form of regulation, and such securities were secured by, what else, home mortgages and student loans, enabling the banks to lend multiples over the actual amount of assets on deposit. Banking, unlike automotive, steel, computers, etc, is an industry that literally produces nothing tangible of its own and risking none of its own capital. After all, banks rely upon OPM (other people's money) to create wealth. Yet, it is the banking industry that receives billions in bailout money and more billions in tax benefits. The consumer? The consumer receives nothing but lip service, and just as Caesar, a dagger in the back!

Enabling consumers to restructure the loans are their principal residences, to be relieved of credit card debt, and restructure student loans, will stabilize a precarious housing market and save a generation. People will regain a sense of structure. Children will learn the concept of affordability, as will parents. Most importantly, there will be certainty with stability in the housing market.

With such certainty will not come stability in the job market? It is true that housing is the cornerstone of our economy, because it is in the homes of Americans that all things bought are kept. Surely, this is far more important than the speculative scare that interest rates will rise. The return of affordability will prevail: People that can afford to keep their homes will do so, and only those that can afford will apply for mortgages will be made loans to buy affordable home ownership.

To answer the critics who say why should some get such a benefit and not those that were "more responsible with their money," the answer is that the Constitution begins with "We the People," and nothing less. Those same people did not complain as they profited from Wall Streets excesses. With those now less fortunate, they profited equally and more, as they preserved and increased their net worth. Allowing people to remain in their homes; be they bought or rented, is what America needs. So too, Americans need to be relieved from the shackles of credit.

If, in further example, we have been playing musical chairs with our homes for the last 30 years, the music has stopped, each American family is sitting in the chair that was left for them, whether they like its color, don't like the person sitting next to them, or the chair is too small to fit the whole family. It is their chair, period. But, some will state that the majority of states did not experience the meteoric rise in home prices that such states as California, Arizona, Nevada, Florida, New York, New Jersey, Connecticut or areas around Washington, DC, experienced; so why should those states be helped at the expense of others? But, it is in those states that the largest percentage of the American public resides and the economy, both domestic and international, emanates. California, alone, is considered the eighth largest economy in the world! And, so, again, "We the People" must take precedence over special interests. Or, as Lincoln stated: "A house divided against itself cannot stand."

Washington Must Act As The Fiduciaries Of Our Society's Trust

Under revisions to the Bankruptcy Code that allows Bankruptcy Judges to reset their home loans and student loans, they will be able to better preserve the family intact hopefully with both parents, stabilize their communities and slow down foreclosures. The American economy will be reset! In computer geek parlance, the Blue Screen of Death will be reprogrammed, so that we can begin all over again.

We must not allow Shakespeare's tragedy to be rewritten with the consumer as the tragic hero. Each Congressperson and Senator must be compelled to act deliberately and with the conviction that each of them owes a fiduciary duty to each of their constituents. Each Congressperson and Senator must be called home from Washington. Each must be compelled to engage his or her constituents in debate, regardless of party affiliation and without pandering. They must see first hand the ravages of their being subjugated to the influence peddlers from Wall Street and elsewhere. Those who are on the public dole must not be allowed to lobby those from whom they are paid. Wall Street must be turned out from Washington until Wall Street learns how to make money honestly. Our elected officials must by compelled to throw the influence peddlers, money changes, out of the houses of Congress! Our Founding Fathers would have it no other way – even if then only idealistically – now realistically.