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Comments on New Bankruptcy Rules

Gary Armstrong to Rules_Comments

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My name is Gary Armstrong. I am a consumer bankruptcy attorney representing consumer debtors in the Northern and Eastern Districts of Texas. I am writing to comment on portions of the proposed bankruptcy rules. These are my comments and do not necessarily reflect the views of my clients or my law firm.

Rule 3001(c) would be amended to require unsecured creditors to file a copy of the last account statement sent to the debtor prior to the filing of the petition and to impose certain sanctions for failure to comply with the Rule.

Currently, in my experience, almost no unsecured creditors are complying with the present requirements of Rule 3001(c) in that almost none of them file a copy of the writing on which the claim is based. Indeed, in the Northern District or Texas, the Court has set forth certain requirements of what must be filed in certain kinds of claims in order to obtain *prima facia* validity. The Court's order is routinely ignored by unsecured claimants. Consequently, I do not expect any amendment that may be adopted to actually be followed by the claimants affected until or unless the Rules make it economically infeasible for the claimants to continue to ignore them. Consequently, I support the teeth added to this rule in the form of sanctions.

In the case of a revolving credit account, or credit card, the 'writing' would typically consist of a standard form credit card agreement, plus supplements and amendments to that agreement. It is most commonly the supplements and amendments that set forth the legal interest rate and fees that may be assessed on the account.

The vast majority of consumers do not understand the terms and conditions of their credit card agreements and rarely even read them or retain them. I once spoke to an audience of consumer credit attorneys about credit card agreements and asked that audience if any of them knew exactly what the terms and conditions were for each of their credit cards, or even where they could lay their hands on a copy. Not a single person indicated that they would have access to that information.

When debtors prepare their bankruptcy schedules, the only information debtors and their attorneys have at hand regarding credit card debt is the most recent information from the purported creditor - whether that may take the form of a demand letter, a billing statement, or a report to a credit reporting agency. Debtors' attorneys rarely have documents available at the time of preparing the schedules to determine whether the balance asserted by the creditor is, in fact, the lawful balance owed on the debt. And, in the case of a debt collector or purported purchaser of the debt, we have no information by which we can confirm that the present claimant is the owner of the debt.

Frequently, though, we can tell that the balance claimed is almost certainly incorrect. For example, many credit card agreements are based on variable interest rates, even after default, typically tied to the change in the prime rate. However, entities that purchase defaulted debts from credit card issuers, while they will often assert that the default interest rate continues to apply during their ownership of the debt, will rarely enter any adjustment to the interest rate. Recently, the prime rate has plummeted. Yet, I have seen no debt buyers file claims based on the lower default interest rates implied by the reduction in the prime rate.

In my experience litigating claims over credit cards in both bankruptcy court and in state court, I frequently find that the purported creditor has no documentary proof of the terms of the contract, including the applicable interest rate and fees. Further, in cases prosecuted by entities that have purchased the debt from a previous owner or holder, the buyer cannot even provide adequate proof that it is the owner of the debt. Frequently claims are sold from one party to another with little more information than the identity of the purported debtor, a last payment date, a last balance amount, and an interest rate. That bare information is submitted to courts as if somehow it was competent evidence of liability for the debt and the actual amount of the debt owed. The practice of most unsecured claimants in bankruptcy amounts to little more than that. Affidavits and Proofs of Claim are signed not by persons with any actual knowledge of the account activity at all, but instead based on a slice of data from a database.

The only way that debtors and their counsel, and the courts, can evaluate the correctness of the claim is to obtain the documentation on which the claim is based.

While the Rule is a good first step toward the goal of ensuring that the proper creditor is allowed a claim in the proper amount, an additional statement from the creditor or holder of the account will not solve the underlying problem. It does not provide enough information to evaluate the claim, even if the written agreement is also provided.

Some commenters have pointed to the fact that large numbers or percentages of unsecured claims go unchallenged as evidence that the system is working fine as it is. But, I think they read too much into historical results.

Many, many consumer debtors have little stake in challenging unsecured claims filed in their cases. In the vast majority of consumer cases, there will not be enough money available to satisfy all of the unsecured claimants. Debtors are, rightly, more concerned about the loss of their non-exempt property or the amount they will have to pay to obtain the discharge of the portion that they cannot afford to pay. Consequently, whether any one unsecured creditor gets paid more or less than another unsecured creditor is rarely a concern.

Similarly, trustees have little at stake in discovering whether claims are accurate or not. They get paid their percentage regardless. Indeed, in many cases, Trustees are better off financially in a particular case if the unsecured creditors pool is larger. Our Chapter 13 Trustees do not typically object to unsecured claims unless the claim is unfiled. I have never seen a Chapter 7 Trustee in the rare asset case object to an unsecured claim based on documentation.

Other creditors do have a stake, as disallowing some claims may allow the suriving claims to get paid more. But, I have yet to see a creditor in a consumer case undertake to object to another creditor's claim.

So, it should be no surprise to find that the vast majority of filed unsecured claims are not challenged and are allowed. However, that indicates nothing about their validity.

Nevertheless, the amount of unsecured claims does sometimes make the difference in whether a debtor can confirm a feasible Chapter 13 plan and, thereby, perhaps preserve his home, or not. Inflated, inadequately documented claims jeopardize consummation of the plan in these instances.

Rather than requiring that all unsecured creditors always provide a single statement that is of little help, I would suggest reinforcing the rule that all claimants must provide a copy of the writing on which the claim is based and that failure to do so removes the prima facia validity of the claim. Then, I would add a provision that states that the claimant, upon written request of any party in interest, must provide to that party all of the following documents: the complete written agreement (to the extent not already filed) documenting the claim, up to four years worth of statements or similar records showing the charging of fees and interest on the account, and if the claim is asserted by someone other than the original creditor, all agreements, assignments, or other writings that evidence the transfer of the debt or claim from the originating creditor to the claimant. Failure to provide the documentation within a reasonable time, such as 30 days after the request, would result in disallowance of the claim upon notice and hearing. All of this is documentation that would be discoverable in claims allowance litigation but could be obtained without the necessity of commencing a 2004 exam or an objection to claim.

Some commenters have suggested that providing a summary statement from creditor's records should be sufficient. Unfortunately, this information does not tell anyone whether the amount claimed is correct. It only repeats the same information that probably was provided to the debtor pre-petition or that was passed along on a spreadsheet from a previous purported creditor to the claimant. If the problem with the claim is that the claim amount is wrong, a far more detailed analysis will be required.

I also would like to write generally to support the comments of the National Association of Consumer Bankruptcy Attorneys, of which I am a member. I also support the comments of the Honorable Marvin Isgur as presenting workable, practical resolutions to the mortgage claim and discharge issues that plague Chapter 13 and the mortgage servicing industry.

Very truly yours,

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