

Testimony of  
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"The Worsening Foreclosure Crisis:  
Is It Time to Reconsider Bankruptcy Reform?"

Hearing before the Senate Committee on the Judiciary  
Subcommittee on Administrative Oversight and the Courts  
Thursday, July 23, 2009  
Dirksen Senate Office Building, Room 226 (10:00 a.m.)

Chairman Whitehouse, Ranking Member Sessions, and distinguished members of the Subcommittee, thank you kindly for inviting me to address bankruptcy reform in light of the worsening foreclosure crisis. I will share with you my experience of foreclosure in bankruptcy from the perspective not of an academician, but of a "country-lawyer" practitioner in the trenches. In my general trial and transaction practice, I represent consumers and creditors in Chapter 7 and Chapter 13 bankruptcy cases.

Before 2006, it was common in Chapter 7 and 13 cases to advise financially overwhelmed debtor clients to surrender late-model cars and trucks. Since 2006, it has become common for debtors instead to surrender the house. What is different now?

Since the bursting of the residential real estate asset bubble, my debtor clients owe more on their mortgages than their home is worth on the open market. Many of my clients are unaware that their home is financially "underwater." They have sought the protection of the bankruptcy court to avoid repossession of a car or because they are behind on their mortgage payments. My clients usually express their wish to retain their home. I find myself explaining that their home is a financial albatross around their necks, that it is a liability, not an asset. I inform Chapter 7 clients that I will not sign a reaffirmation agreement to ratify a debt on under-valued collateral. Such conversations usually are long, tense, and uncomfortable for all involved. It is not uncommon to repeat such a conversation two, three, or four times in office visits or over the phone before reality sets in that the debtors cannot keep house and hearth together. What brings my consumer clients to such a financially uncomfortable impasse? It has almost never been because of the interest rate on their home loan.

I see individuals compelled to file bankruptcy petitions because of medical catastrophe, or because one or both spouses is laid off from a job or has become employed with reduced compensation after having lost a job. Upon further scrutiny of my clients' financial organization, I typically have found that individuals spent way too much and saved way too little. They bought houses, timeshares, and cars they could not afford. It is not uncommon to see my bankruptcy

clients drive up to my building in a newer vehicle than I own. I see consumers having adopted a self-defeating, self-perpetuating mind-set of viewing spending through the lens of the monthly payment, rather than with an eye to the long term. I pray that the Congress will not be so short-sighted. My clients often wish to retain all their collateralized purchases despite their inability to pay for all of them and to service their credit card debt as well.

My observation is that consumers have gone way overboard in borrowing for consumption. Americans would benefit from viewing borrowing money as a financial vehicle for businesses that plan to make a profit on the borrowed money. Americans would be wise to save more, to spend less, to establish a reserve of six months of income, and to buy cars for cash.

Would cramdown of residential real estate loans benefit my debtor clients? Of course it would. Any reduction of the cost of any collateralized debt would benefit my debtor clients. Not only would cramdown be beneficial, it would create a cottage industry within consumer bankruptcy practice of encouraging everyone earning under their median state income with an "underwater" residential loan to file bankruptcy expressly for the purpose of cramming down the loan. If cramming down a car loan older than 210 days would be moderately beneficial to a consumer debtor, cramming down a residential real estate loan would be so greatly beneficial to debtors that any residential loan underwater by more than \$5,000.00 would benefit from a Chapter 13 bankruptcy. Under such a law, I imagine that consumer bankruptcy practice would thrive like never before. Legislating cramdown of residential real estate would create a veritable "license to steal" from mortgagees. The question this raises for the Congress is whether or not this would be beneficial for the American economy.

Finally, which consumer debtors would benefit from residential real estate loan cramdown?

Ironically, the higher the income of the debtor, the more able would be the debtor to benefit from cramdown. Again, I return to my observation that debtors become unable to pay their mortgages primarily because of job loss, sometimes due to medical catastrophe. Chapter 13 plans seem to benefit those mainly who have experienced a temporary setback in income due to job loss or medical catastrophe, not those who have been laid off permanently. Those consumers with residential mortgages and steady employment whose only financial weakness is the loss in value of the market value of their home would be the cohort who I believe would benefit the most from mortgage cramdown.