The Shape of Things to Come: What is the Recipe for Success in Consumer Bankruptcy?
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Glimpse of the Future

Do you like what you see?
Are you *really* happy with the current consumer bankruptcy system?
Problems with The Current System

- It is Really Complicated
- It is not really uniform
- It does not really rehabilitate
- Outcomes are unpredictable
Problems with The Current System

- It has become expensive for Debtors
- It has become expensive for Creditors – Hidden Costs

GAO, *Dollar Costs Associated with BAPCPA* (2008)

Both found: about 50% increase in attorney fees for chapter 7 (on average nationally) under the 2005 law
Lupica found lower increase for chapter 13:
- 18% for dismissed cases
- 24% for discharged cases
(Looking at average chapter 13 attorneys fees received, not just “no look” fees permitted in theory)

Huge local variations in fees and in expectations of attorneys

Qualitative data: Burden of paperwork, document gathering, counseling and education, legal labyrinths
- Stanley & Girth (1971)
- Neustadter (1986)
- Braucher (1993)
## Huge Variation in Chapter 13 Use

(early 2007 – time period of sample; Harvard CBP)

### Districts with Lowest Chapter 13 Ratio

<table>
<thead>
<tr>
<th>District</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>ND Iowa</td>
<td>8.4%</td>
</tr>
<tr>
<td>North Dakota</td>
<td>11.0%</td>
</tr>
<tr>
<td>ND, West Va.</td>
<td>11.1%</td>
</tr>
<tr>
<td>SD, West Va.</td>
<td>11.1%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>12.5%</td>
</tr>
<tr>
<td>ND, Okla.</td>
<td>14.3%</td>
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</table>

### Districts with Highest Chapter 13 Ratio

<table>
<thead>
<tr>
<th>District</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Carolina</td>
<td>65.5%</td>
</tr>
<tr>
<td>MD, Alabama</td>
<td>70.8%</td>
</tr>
<tr>
<td>WD, Louisiana</td>
<td>71.8%</td>
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<tr>
<td>SD, Alabama</td>
<td>72.4%</td>
</tr>
<tr>
<td>WD, Tenn.</td>
<td>74.8%</td>
</tr>
<tr>
<td>SD, Georgia</td>
<td>77.8%</td>
</tr>
</tbody>
</table>

National average ≈ 39%
<table>
<thead>
<tr>
<th></th>
<th>Chapter 7s</th>
<th></th>
<th>Chapter 13s</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Nevada</td>
<td>6.82</td>
<td>Tennessee</td>
</tr>
<tr>
<td>2</td>
<td>Michigan</td>
<td>5.11</td>
<td>Alabama</td>
</tr>
<tr>
<td>3</td>
<td>Indiana</td>
<td>4.72</td>
<td>Georgia</td>
</tr>
<tr>
<td>4</td>
<td>Colorado</td>
<td>4.65</td>
<td>Louisiana</td>
</tr>
<tr>
<td>5</td>
<td>California</td>
<td>4.18</td>
<td>Arkansas</td>
</tr>
<tr>
<td>6</td>
<td>Arizona</td>
<td>4.17</td>
<td>Nevada</td>
</tr>
<tr>
<td>7</td>
<td>Ohio</td>
<td>4.14</td>
<td>Mississippi</td>
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<tr>
<td>8</td>
<td>Illinois</td>
<td>4.01</td>
<td>Utah</td>
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<tr>
<td>9</td>
<td>Idaho</td>
<td>3.97</td>
<td>Indiana</td>
</tr>
<tr>
<td>10</td>
<td>Kentucky</td>
<td>3.93</td>
<td>Illinois</td>
</tr>
</tbody>
</table>
• Personal attitudes of the judges and trustees

• Personal attitudes of the United States Trustee

• Different process – e.g. homestead exemptions, state opt out, etc.
• How long it takes to administer an asset
chapter 7 – not prompt

• Creditors in the same class are not
treated the same
  ◦ Special treatment of The Used Car Lot
  ◦ Special treatment of The Retirement Loan

• There is no certainty of outcome in a case
based upon its venue
A significant number of debtors do not receive a discharge

- The educational ticket out
- The DSO certificate
- The “I am not an Enron crook” certificate
- Failure to complete a chapter 13 plan
• Reaffirmations in chapter 7
• Exceptions to discharge
• Failure rate in chapter 13
Chapter 7—Discharge to some extent overstates success

- over a third (by their own account) are worse off or the same a year after discharge in chapter 7

Chapter 13 cases—Discharge in about a third

Chapter 13 discharge rate to some extent understates success (no-discharge cases used to cure arrearages, strip liens, give time to move)

Big result: holding on to a home, at least for a while

- 81% of homeowners at filing still owned
- But 60% of those still owning home were delinquent, and half of the delinquent already faced foreclosure.
Also: 83% of dropouts said filing was very or somewhat good decision
  ◦ only 17% thought filing was a bad decision

Overall picture: temporary relief
The cost to deliver a dollar in an asset chapter 7 is about 70 cents.
The debtors pay for the no asset cases.
The court system costs - $656 Million.
The UST system costs - $250 Million?
The Chapter 13 trustee system costs $337 Million (21% of u/s distributions)

Debtors attorneys in 13s cost $708 Million

The Panel Trustees cost $234 Million
Of 100 Chapter 13 cases filed:

- 14 will convert
- 57 will dismiss
- Only 28 will complete the plan.

Not all completing plans will get a discharge.
Calculation of income based on different interpretations of the Means Test

- Tax refunds
- Unemployment Income
- Contributions to the household
• 15% of all debtors – all chapters – will receive no discharge as a result of their entry into the system.

• Only 10% of all debtors receive a chapter 13 discharge.
The enactment of the 2005 law has NOT:

- resulted in an increase of chapter 13 cases
- increased the chapter 13 discharge rate
- increased the distribution rate to unsecured creditors.
• Percentage of cases that are in chapter 13 is down
• Total receipts are flat
• The total distributions are flat
• The total payments to unsecured creditors are flat
Chapter 13 trustees are at risk of becoming little more than mortgage servicers or mortgage rescue agents.

- Mortgages 10 years ago -15%
- Today mortgages – 30%
- Mortgages count for entire growth in chapter 13
• 10 years ago Houses and Cars were 30% of chapter 13 distributions

• Today, Houses and Cars are 50% of chapter 13 distributions
Race Disparity in Chapter Choice


- Good way to think about the problems in the system in general—complexity and resulting unfairness
Evidence on Race Disparity in Use of Chapter 13

- National data
- Vignette study
- Probable lack of intention by attorneys, trustees

Complexity allows race disparity to occur without actors in the system realizing. Probably many other more subtle disparities.
Percentage of Debtors Filing Chpt 13 by Race (Harvard CBP data)

African-Americans (N = 511)  54.6%
All other races (N = 1,754)  28.2%

Chi-square = 122.40*
* -- statistically significant at 5% level
Independent variable of interest: African-American debtor(s)

Controls:

- Percent 13’s in district
- Income (ln)
- Priority debt (ln)
- Credit card debt/total debt
- Occupational prestige score
- Female head of household
- Prior bankruptcy
- Total assets (ln)
- Foreclosure reason for bkr.
- Represented by attorney
- Number of dependents
- Home owner
- Total debt (ln)
- Secured debt/total debt
- Bachelor’s degree or higher
- Live with spouse or partner

More likely to file chapter 13 and statistically significant (5%)

Less likely to file chapter 13 and statistically significant (5%)
Study 2: Vignette to Attorneys

- Experimental vignette study with balanced facts on 7/13 choice

- Random selection of 594 consumer bankruptcy attorneys
  - Response rate = 44.0%
• Race as first variation:
  - L & R who attend a church
  - Latisha & Reggie who attend the Bethel A.M.E. Church
  - Todd & Allison who attend the United Methodist Church

• The other variation: stated preference for chapter 7 or 13 or no preference stated

• All financial facts exactly the same; survey variations randomly assigned to attorneys
Percentage of Attorneys Recommending Chapter 13

African American: 47%
No Race Identified: 36%
White: 32%

chi-square = 9.93
p = 0.042
• Harvard study of real cases controlled for financial factors such as homeownership, income, assets and also local legal culture

• African Americans’ plans call for marginally more repayment to unsecured creditors and result in discharge at a much lower rate

• Vignette study used same financial facts, yet attorney recommendations were racially disparate
Groups
- National random sample of consumer bankruptcy attorneys
- All chapter 13 trustees

“For each group below, please estimate the percentage of bankruptcies in that group that were filed as chapter 13s . . .”
Lawless and Cohen sent all chapter 13 trustees listed on the NACTT website (201 total) surveys like those sent to attorneys (asking about chapter 13 usage by various groups)

Very low response rate

Due to low number of responses, caution advised, but there was a similar pattern to that of attorneys:
- Trustees overestimated use of chapter 13 by whites and underestimated its use by African-Americans
- Also overestimated use by homeowners and underestimated use by those with a prior bankruptcy
• That attorneys and chapter 13 trustees substantially underestimate usage of chapter 13 by African Americans suggests they are not deliberately creating the disparity

• Implicit (unintentional) bias is more likely at work

• Chapter 13 use overestimated among the stereotypically more responsible—whites, homeowners; underestimated among African Americans and those with a prior case
What to Do?

- Conversation, reflection among bankruptcy professionals
  - Continuing legal education
  - NACBA, ABI, NACTT

- Collection of demographic data on bankruptcy forms to confirm race disparity (or not)

- Adds to conversation about chapter 13 more generally

- Reducing complexity would make unjustified disparities more apparent; increase fairness

- “Choice” in the system is not necessarily debtor choice but rather choice driven by professionals
Let’s Build a Better System

What *Should* a Consumer Bankruptcy System Contain
The forms should not be so complicated that it takes a specialist to fill them out.

The rules should not be so cumbersome that only the insiders know how it works.

People considering bankruptcy should clearly understand what it takes and what is the result.
• Unnecessary transactional costs should be eliminated

• An easier, less complicated system will reduce the need for litigation and judicial supervision and lower attorneys’ fees

• A more transparent system will reduce the need for the gatekeeper
It Should be Uniform

- People in the same situation should be treated the same
- As debtors
- As creditors
  - Cars, houses, furniture, appliances – is there a compelling public policy reason to treat them differently?
  - Used car lots, hospitals, accident victims, involuntary creditors – is there a compelling public policy reason to treat them differently?
The big choices for a debtor – Do I keep my house? Do I keep my car?

Eliminate the choices of process only – What chapter do I file under? – These are lawyer choices, anyway

It is the outcome that matters
The Single Chapter System
Cheap, but rough justice

vs.

More expensive, individualized justice
Design Issues

- Eligibility
- Surplus income contribution
- Should debtors be able to keep collateral? If so, how?
• Keeping assets—uniform federal exemptions?

• The role of trustees

• Would lawyers for debtors be necessary in a simple system?
• Everyone can file consumer bankruptcy

• No more “family farmer, family fisherman, wage earner, debt limits”

• The need for regular income would be gone.
• Asset Liquidation
  ◦ Unencumbered nonexempt assets
  ◦ Trustee liquidates or Debtor purchases from the trustee

• Future Income
Future Income

- **Assumption**: Bankruptcy system is not legitimate unless there is a component that requires the commitment of future income – the only issue is how much.

- **75th Percentile (by state and family size)**
  - 0 - $50K above 75th Percentile – 10%
  - $50K – $100K above 75th Percentile – 20%
  - Above $100K above 75th Percentile – 30%

- **Three Years**
• Should it be trustee implemented? Why?

• Payroll deduction order

• Annual review

• Based on gross income only – not expenses
  ◦ Intended to be significantly more generous system than the current system
  ◦ By setting high, allows debtors to improve during the process

• Very few debtors are affected
- Redemption
- Restructure
- Ride through
- Surrender

Secured Debt
Based on forced sale value (trade in for cars) reduced by a fixed 10% to account for costs of liquidation

Unsuccessful creditor challenge to value results in award of attorneys’ fees

Lump sum

For PMSI within 180 days, only options are surrender or ride through
• All property except principal residences (subject to special rules)

• New secured obligation equal to the replacement value, paid over up to 5 years at *Till* interest rates

• Paid through a trustee
• Presumption that any restructured mortgage payment which exceeds 38% of income is an undue hardship
  ◦ Debtor must overcome presumption to restructure

• APOR interest (Average Prime Offer Rate plus 100 points) if the loan to value ratio is no greater than 80%

• Higher interest for higher LTV
• May choose to maintain payments and cure defaults (as under existing law)

• Cram down on Mortgage option to pay fair market value over up to 30 years from date of loan

• Equity recapture of 50% experienced within a year of the principal reduction
• This would allow debtor to deal with cosigned debts

• Debtor may keep up the payments post bankruptcy without personal liability
• Front end for all debtors except for actual fraud, prior discharge within 5 years
All obligations would be subject to discharge except:

- Fraud
- Taxes
- Spousal and Child support
- Willful injury to person
- Student Loans (???)
• No opt out available for the states – States may add to the federal exemptions but may not take the federal exemptions away

• Federal wild card should be adjusted

• Current look back for exemptions is impractical

• Federal Homestead Exemption should be $250,000

• Collusive involuntary – state exemptions only
• If a debtor fails to comply with the restructured obligation, the secured creditor has retained its rights to pursue the collateral

• Debtor does not lose a discharge if debtor fails to pay secured debt

• If Debtor does not pay the dividend, trustee may pursue the debtor to collect this forever
The unpaid dividend is subsequently nondischargeable

- There is a stay

- Discharge might be revoked in cases of fraud
• Appointed by UST but without involvement by UST in individual cases

• Trustee will administer nonexempt assets and contributions of income

• Should Trustees administer all non-ride through secured obligations and justify lien release?
First thing we do, let’s kill all the lawyers.”

- Henry VI, Part Two
- There is a robust debate about whether this was
  - A lawyer joke
  - A defense of lawyers, given that the speaker was Dick the Butcher, a low and evil character but also a comic one
- Lawyers like the latter complicated explanation, but the evidence of other Shakespeare plays (Hamlet) is against us
• Littwin (2010), The Affordability Paradox

• Australian comparison: most debtors don’t have a lawyer in bankruptcy

• But the government trustees are not that vigorous about questioning creditors’ claims

So Simple That Lawyers Become Unnecessary?
More likely: simplification would return us to lower fees, and attorneys would have to make it up in volume.
• Congress and Mr. President, over to you.

• Thank you!

Conclusion