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Options in Consumer Bankruptcy: An American Perspective

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Options in Consumer Bankruptcy: An American Perspective

Abstract

In both the United States and Canada, a rapid increase in personal bankruptcies has led to demands for stricter laws to force more repayment by consumer debtors. Canada has already taken this step, while the United States may soon do so in response to the counterfactual claim that the problem is debtors with means using bankruptcy as "a method of financial planning." The author suggests that the real problem in both countries, however, is an increase in the ranks of the over-indebted. Bankruptcy is a symptom, signalling to creditors the need to reform themselves. The author concludes that if creditors persist in aggressive marketing to high-risk debtors, effective legal and social reforms should include better disclosure, financial education in secondary schools and, perhaps, even direct regulation of risky creditor practices.

OPTIONS IN CONSUMER BANKRUPTCY: AN AMERICAN PERSPECTIVE®

BY JEAN BRAUCHER*

In both the United States and Canada, a rapid increase in personal bankruptcies has led to demands for stricter laws to force more repayment by consumer debtors. Canada has already taken this step, while the United States may soon do so in response to the counterfactual claim that the problem is debtors with means using bankruptcy as "a method of financial planning." The author suggests that the real problem in both countries, however, is an increase in the ranks of the over-indebted. Bankruptcy is a symptom, signalling to creditors the need to reform themselves. The author concludes that if creditors persist in aggressive marketing to high-risk debtors, effective legal and social reforms should include better disclosure, financial education in secondary schools and, perhaps, even direct regulation of risky creditor practices.

A la fois aux Etats-Unis et au Canada, une augmentation rapide dans le nombre de faillites personnelles a conduit aux demandes pour des lois plus sévères pour forcer les consommateurs débiteurs de rembourser. Le Canada a déjà fait un pas dans ce sens, tandis que les Etats-Unis pourraient bientôt faire de même afin de répondre à la demande en opposant le fait que le problème vient des débiteurs ayant des moyens, qui utilisent la faillite comme «une méthode de planning financier». L'auteure suggère que le problème dans les deux pays est, pourtant, une augmentation dans les rangs des débiteurs surendettés. La faillite est un symptôme indiquant aux créanciers la nécessité de se réformer. L'auteure en conclut que si les créanciers persistent dans un marketing agressif aux débiteurs à hauts risques, des réformes légales et sociales effectives devraient inclure une meilleure divulgation, une éducation financière dans les écoles secondaires et, peut-être, même un règlement des pratiques hasardeuses des créanciers.

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I. INTRODUCTION

The economics and politics of consumer bankruptcy in the United States and Canada are in many ways remarkably similar. In both countries, there has been a rapid rise in the number of bankruptcy cases.¹ The increase in each country is not due to the use of bankruptcy by better-off debtors than in the past.² Rather, because of the expansion of consumer credit in both countries, more people are overextended.³ In both countries, the increase in filings has been accompanied by political pressure to change the law to require more repayment. In Canada, the political pressure has produced more restrictive consumer bankruptcy legislation, while in the United States, Congress failed to complete work in 1998 on bills to cut back on consumers' access to bankruptcy, but similar legislation was introduced again in 1999.⁴

¹ For the twelve-month period ending 30 September 1998, personal filings in the United States increased 5.8 per cent over the previous year, to a total of 1,389,839: see American Bankruptcy Institute, "Bankruptcies Break Another Record During 12 Month Period Ending September 30" (23 November 1998), online: American Bankruptcy Institute <<http://www.abiworld.org/release/98thirdquarterfilings.html>> (date accessed: 16 July 1999) (web site of the American Bankruptcy Institute, which maintains a statistics file). Personal filings in the United States have more than tripled since 1985: see United States Bureau of the Census, *Statistical Abstract of the United States 1998*, 118th ed. (U.S. Government Printing Office, 1998) at 555, Table No. 881. In Canada, the number of consumer bankruptcies also increased more than threefold between 1985 and 1995: see J.S. Ziegel, "Canadian Perspectives on the Challenges of Consumer Bankruptcies" (1997) 20 J. Consumer Pol'y 199 at 200-01 [hereinafter "Canadian Perspectives"].

² See National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years, Final Report* (Washington, D.C.: U.S. Government Printing Office, 1997) at 82-83, n. 124, online: National Bankruptcy Review Commission <<http://www.nbrc.gov/reportcont.html>> (accessed: 16 July 1999) [hereinafter *NBRC Report*]. The National Bankruptcy Review Commission (NBRC) found that a review of the available statistical evidence suggests that American debtors in bankruptcy in the 1990s are in as much or more financial trouble as debtors in the early 1980s. In Canada, the incomes (adjusted for inflation) of Canadian debtors in bankruptcy were a little lower in 1997 than twenty years earlier, while debtors' assets, although still low, increased slightly: see S. Schwartz, "The Empirical Dimensions of Consumer Bankruptcy: Results From a Survey of Canadian Bankrupts" (1999) 37 Osgoode Hall L.J. 83

³ American consumer debt grew nearly 700 per cent between 1977 and 1997: see *NBRC Report*, supra note 2 at 84. See also T. Craddock, "International Consumer Insolvency Statistics" (Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context, Faculty of Law, University of Toronto, 21-22 August 1998) [unpublished], which revealed that American and Canadian consumer credit more than tripled from 1982 to 1997.

⁴ For a discussion of Canadian bankruptcy legislative reform, see J.D. Honsberger, Q.C., "Philosophy and Design of Modern Fresh Start Policies: The Evolution of Canada's Legislative Policy" (1999) 37 Osgoode Hall L.J. 171; and J.S. Ziegel, "The Philosophy and Design of Contemporary Consumer Bankruptcy Systems: A Canada-United States Comparison" (1999) 37 Osgoode Hall L.J. 205 [hereinafter "Consumer Bankruptcy Systems"]. See also Part II, below, concerning the proposed legislative reforms in the United States Congress.

Despite some differences in the law of consumer bankruptcy in the two countries,⁵ there are also important similarities. Both countries have two main options, but in practice these options often involve both some repayment and some discharge of debt.⁶ Also, the two main options in each country have many variations in the details of how they may be used. As a result, the consumer bankruptcy systems of both countries are much too complex for consumer debtors to understand. At least in the United States, this puts debtors at the mercy of the judgement, and sometimes the prejudices and whims, of the professionals they consult—their own lawyers.⁷ In addition, the bankruptcy professionals who advise consumers in both countries (usually lawyers in the United States and trustees in Canada) play multiple, conflicted roles. Despite differences in the formal legal definition of professional roles in the two countries, in practice, the roles may be quite similar, with professionals generally both showing allegiance to the integrity of the system, and looking out for the interests of the debtors they serve.

Before returning to the comparison of the roles of professionals in the two systems in Part VI, this article first describes the political climate concerning consumer bankruptcy in the United States in Part II, and briefly explains the operation of the American system in Part III. Part IV analyzes the competing critiques of that system, and Part V discusses the counselling and education of debtors in the United States.

⁵ See note 4, *supra*. Under Canadian law, consumer debtors' surplus income, if any, must be paid to creditors during the pendency of a straight bankruptcy case, while in the United States, Chapter 7 debtors are not required to commit surplus income to debt repayment. In practice, however, the differences in how bankruptcy law is used may be small because, in Canada, many debtors have no surplus income and, in the United States, many Chapter 7 debtors do make some payments to creditors out of post-petition income under reaffirmation agreements or more informal arrangements. Also, American debtors with substantial surplus income, after expenses, risk a "substantial abuse" challenge if they file under Chapter 7 rather than Chapter 13, which requires a repayment plan: see Part III, below.

⁶ See Part III, below, for a discussion of the options under United States bankruptcy law. In practice, in the United States, under both Chapter 7 and Chapter 13, debtors typically discharge some debt and, probably in most cases of both types, debtors repay some debt. In Canada, both straight bankruptcy and consumer proposals involve some discharge of debt, and both can involve some debt repayment: see Honsberger, *supra* note 4; and "Consumer Bankruptcy Systems," *supra* note 4.

⁷ See J. Braucher, "Counseling Consumer Debtors to Make Their Own Informed Choices—A Question of Professional Responsibility" (1997) 5 Am. Bankr. Inst. L. Rev. 165 [hereinafter "Counseling Consumer Debtors"]. In the United States, consumer debtors typically have lawyers. This is much less common in Canada, and debtors there get their advice from trustees in bankruptcy, who are usually chartered accountants. See Part VI, below, for a comparison of the roles of professionals in the two countries.

II. THE POLITICS OF CONSUMER BANKRUPTCY IN THE UNITED STATES

Consumer creditors mounted a sustained attack on the American consumer bankruptcy system in the 105th Congress (in session from January 1997 to December 1998), and after running out of time and momentum in the fall of 1998, renewed their efforts in the 106th Congress in 1999.⁸ During this campaign, segments of the consumer credit industry and supportive politicians condensed their argument to a sound bite—in essence: bankruptcy is being used as “a method of financial planning”⁹ by those with the means to pay their debts but no shame.

The facts did not seem to matter to those who made this argument. Never mind that the available evidence, carefully sifted by the National Bankruptcy Review Commission (NBRC) at the direction of Congress, is that American debtors who file in bankruptcy now are as bad or worse off financially than those who filed in the early 1980s, when the number of people filing was about one-third of what it is today.¹⁰ No doubt occasional abusers slip through the checks in the system, but the costs of rooting them out would be huge.

A slightly more nuanced version of the attack is that there are too many filings under Chapter 7 of the *Bankruptcy Code*, in which debtors can get a discharge without the necessity of repayment, and not enough in Chapter 13, in which a repayment plan is required.¹¹ This

⁸ No major legislation was enacted in 1998, but very similar legislation was introduced again in 1999. It was unclear at mid-summer 1999 whether a compromise could be reached with the Clinton Administration. One of the reasons the proposed legislation was not enacted in 1998 was that it encountered opposition from the Clinton Administration, which criticized the “rigid and arbitrary means test to determine whether a debtor could file for discharge of most debts under Chapter 7 or would be required to establish a repayment plan under Chapter 13 rules”: see Executive Office of the President, Office of Management and Budget, *Statement of Administration Policy* (10 June 1998), online: American Bankruptcy Institute <http://www.abiworld.org/legis/bills/whsap_hr3150.html> (date accessed: 5 August 1999) at 1. Although the Administration also expressed support for “bankruptcy reform that requires responsibility of debtors who have the ability to repay a portion of their debts” under an approach giving greater discretion to the bankruptcy courts (*ibid.*), the credit industry apparently decided against compromise.

⁹ See Rep. G.W. Gekas (a Pennsylvania Republican who is chairman of the United States House Judiciary Subcommittee on Commercial and Administrative Law Bankruptcy Reform Act of 1998), News Release (3 February 1998), online: <<http://www.house.gov/gekas>> (date accessed: 16 July 1999).

¹⁰ See NBRC Report, *supra* note 2 at iv. The NBRC was established by Congress in 1994 to review the bankruptcy system.

¹¹ See 11 U.S.C., ch. 7, 13 (1998) [hereinafter *Bankruptcy Code*].

argument leads to a supposed “solution”: make access to Chapter 7 more difficult. The proposers of this approach are untroubled by the fact that, under current law, debtors fail to complete well over one-half of Chapter 13 repayment plans.¹² Late in 1998, after the end of all legislative business other than presidential impeachment, a study by Creighton University law professors Marianne Culhane and Michaela White found that only 3.6 per cent of Chapter 7 filers could afford to repay as much as 20 per cent of their unsecured debts in a five-year Chapter 13 plan under the means-testing approach of the bill that the House of Representatives passed in June 1998.¹³ The costs to the bankruptcy system of applying means testing, and the costs to debtors of dealing with a more complex system, must be balanced against the potential returns to creditors from getting more from a small number of debtors.

There are problems with the American consumer bankruptcy system, which are discussed in Part IV, below, but they are not the ones asserted by the supporters of the recent bills. Unfortunately, there may not be time or the political courage to reframe the debate. Redefinition of the problem, from “there are too many people filing in bankruptcy,” to “there are too many overextended debtors,” tends to lead to cultural criticism of a sort that mainstream politicians avoid. They do not want to say that too many Americans are living at the outer boundaries of their means, with an insufficient cushion from personal savings or social safety-net programs, making them vulnerable to default if they suffer job loss, family breakup, or illness.

Nor do many want to point accusingly at creditors making large profits by facilitating this culture of immediate gratification in the midst

¹² See W.C. Whitford, “The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy” (1994) 68 *Am. Bankr. L.J.* 397 at 410.

¹³ See M.B. Culhane & M.M. White, “Means-Testing For Chapter 7 Debtors: Repayment Capacity Untapped?” (1998), online: American Bankruptcy Institute <<http://www.abiworld.org/research/creightonstudy.html>> (dated accessed: 16 July 1999). Culhane and White used a sample of 150 cases from each of seven bankruptcy districts, for a total of 1,050 cases. They applied the means testing proposed in the *Bankruptcy Reform Act of 1998*, H.R. 3150, 105th Cong. (1998) [hereinafter “H.R. 3150”], as passed by the United States House of Representatives on 10 June 1998 (but never enacted). Under that version of H.R. 3150, debtors with an annual gross income of less than the national median and those with less than \$50 per month in net income (income in excess of allowed living expenses and after payment of secured and priority debts) would not be excluded from Chapter 7. For those of median or greater income and \$50 or more of net monthly income, the test for Chapter 7 eligibility was whether the debtor could repay 20 per cent of unsecured debt in a five-year Chapter 13 plan; if so, the bill would have denied Chapter 7 relief, leaving Chapter 13 as the only option. Culhane and White found that only 3.55 per cent of their sample would be excluded from Chapter 7 under the three-part means test of H.R. 3150.

of financial insecurity. The consumer credit industry has poured money into lobbying on the basis of its counterfactual claim that the problem is debtors with means who have no shame, and into campaign contributions to sympathetic members of Congress.¹⁴ A candid definition of the problem requires recognition that, in the absence of more of a social safety net, the only way to reduce over-indebtedness is for individuals to save more and borrow less, which would mean reduced volume for the consumer credit industry and reduced consumption, with attendant ripple effects in the economy. On the other hand, more savings would result in more comfortable retirements, and the United States is a long way from having to worry about under-consumption and over-saving—problems some see in Japan, for example, and blame in part for the economic problems there.

In the United States, consumer credit has grown dramatically, and this has been accomplished by expansion into high-risk sectors.¹⁵ The consumer credit industry continues to expand risky lending, while, at the same time, it seeks to limit access to bankruptcy relief. If the industry and its supporters in Congress succeed in this objective, far from addressing the underlying problem of over-indebtedness, they are likely to make it worse by encouraging yet more high-risk credit.

III. OPTIONS UNDER AMERICAN BANKRUPTCY LAW

To understand the real problems in the American consumer bankruptcy system and how the current political attack fails to take note of them, it is necessary to appreciate the complexity of the system in action. Textbook descriptions of the options under the *Bankruptcy Code* refer to Chapter 7 by its statutory caption as the “Liquidation” chapter.¹⁶ Chapter 7 provides for liquidation of non-exempt property and frees post-petition income from dischargeable claims. A few states have over-generous exemptions,¹⁷ but, for the most part, debtors with any

¹⁴ See K.Q. Seelye, “House to Vote Today on Legislation for Bankruptcy Overhaul” *The New York Times* (10 June 1998) A18.

¹⁵ For a review of the growth in high-risk credit sectors, including loans to those with default histories, to low-income and young people, and to those who have just received bankruptcy discharges, see *NBRC Report*, *supra* note 2 at 91-94.

¹⁶ *Supra* note 11, ch. 7.

¹⁷ For example, three states, Florida, Texas, and Iowa, have homestead exemptions that are unlimited by value: see Fla. Const. art. X, § 4 (1998); Tex. Const. art XVI, §§ 50-51 (1997); Fla. Stat. ch. 222.01-222.30 (1997); Iowa Code § 561.16 (1992); and Tex. Prop. Code § 41.001 (1997).

significant assets would lose them in Chapter 7. These debtors with assets have an incentive (as well as the means) to avoid bankruptcy. In more than 90 per cent of cases, however, no liquidation occurs because the debtor has no assets in excess of exemptions.¹⁸ Thus, Chapter 7 is more accurately thought of as the “fresh start” chapter.

There is some inaccuracy in this alternative description too, because many Chapter 7 debtors continue to pay some debts after filing. Chapter 7 debtors frequently retain collateral through secured creditors’ acquiescence in repayment of the loan amount or by reaffirming the debt.¹⁹ Many debtors also reaffirm unsecured or undersecured debts, thus undercutting their fresh starts.²⁰ Also, debtors sometimes voluntarily pay one or more debts after discharge. Sometimes this “voluntary” repayment is a result of questionable creditor practices, such as offering a small amount of new credit to debtors who repay discharged debt.²¹ When all these forms of repayment are combined, it appears likely a majority of Chapter 7 debtors repay some debt.

Although many Chapter 7 debtors do use post-petition income to pay dischargeable claims, they are not required by law to do so. However, under the “substantial abuse” test of section 707(b) of the *Bankruptcy Code*, debtors with the ability to pay a significant portion of their debts can be excluded from Chapter 7, leaving Chapter 13 as their only bankruptcy option. There is considerable variation in how the “substantial abuse” test is applied by different courts,²² but across districts, challenges on this basis are rare because few debtors in Chapter

¹⁸ See J. Braucher, “Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission’s Proposals as a Starting Point” (1998) 6 *Am. Bankr. Inst. L. Rev.* 1 at 2, n. 6 [hereinafter “Increasing Uniformity in Consumer Bankruptcy”].

¹⁹ In a study of reaffirmation practices in twelve districts, the General Accounting Office found that in eight of them, more than 50 per cent of debtors stated an intention to reaffirm: see United States General Accounting Office, *Personal Bankruptcy: The Credit Research Center Report on Debtors’ Ability to Pay* (1998), online: <<http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.21&filename=gg98047.txt&directory=/diskb/wais/data/gao>> (date accessed: 16 July 1999).

²⁰ See *NBRC Report*, *supra* note 2 at 152-56.

²¹ See K. Gross, “Perceptions and Misperceptions of Reaffirmation Agreements” (1997) 102 *Com. L.J.* 339 at 349-51.

²² See W.R. Wells, J.M. Kurtz & R.J. Calhoun, “The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality” (1991) 39 *Clev. St. L. Rev.* 15.

7 have significant excess income once they budget realistically for their expenses.²³

Chapter 13, captioned “Adjustment of Debts of an Individual with Regular Income,” requires a debtor to propose a plan of repayment out of post-petition income and to complete it in order to get a discharge.²⁴ There are two main reasons Chapter 13 often does not involve much debt repayment. One is the high non-completion rate of over 60 per cent.²⁵ In addition, in some districts, many Chapter 13 debtors who have minimal disposable income are able to obtain confirmation of low percentage plans, in which they commit to repay, for example, only 10 per cent of unsecured indebtedness.²⁶ Creditors do not get to vote on confirmation of Chapter 13 plans; rather, debtors must meet three main statutory tests. First, Chapter 13 debtors must pay unsecured creditors their liquidation share,²⁷ but this is typically zero because most debtors who file in Chapter 13 would have had no asset cases in Chapter 7. A notable aspect of the American consumer bankruptcy system is that the large majority of debtors in the two chapters are in similarly grim financial circumstances; Chapter 13 debtors are not better off financially.²⁸

Chapter 13 debtors’ plans must also meet two other conditions: the “good faith” test,²⁹ and the requirement that “disposable income,” after “reasonable” expenses, be paid to creditors for at least three years.³⁰ There is much variety in how bankruptcy judges and Chapter 13

²³ See J. Braucher, “Lawyers and Consumer Bankruptcy: One Code, Many Cultures” (1993) 67 Am. Bankr. L.J. 501 at 536-37 [hereinafter “Lawyers and Consumer Bankruptcy”].

²⁴ See *Bankruptcy Code*, *supra* note 11, ch. 13.

²⁵ See *NBRC Report*, *supra* note 2 at 90, which reported a 32 per cent completion rate in Chapter 13. See also Whitford, *supra* note 12 at 410-11, concerning high failure rates of repayment plans in all regions of the United States.

²⁶ See “Lawyers and Consumer Bankruptcy,” *supra* note 23 at 532, for a discussion of the routine confirmation of 10 per cent plans in Dayton, Ohio, and 25-33 per cent plans in Austin, Texas.

²⁷ See *Bankruptcy Code*, *supra* note 11, § 1325(a)(4).

²⁸ See T.A. Sullivan, E. Warren & J.L. Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Debt in America* (New York: Oxford University Press, 1989) at 239-40: the authors found that the great majority of debtors in bankruptcy have about the same debt-to-income ratio whether they are in Chapter 7 or Chapter 13; the *Bankruptcy Code* does not sort debtors by their capacity to repay.

²⁹ See *Bankruptcy Code*, *supra* note 11, § 1325(a)(3).

³⁰ *Ibid.* § 1325(b).

standing trustees³¹ apply these tests, leading to many high repayment plans in some districts (usually with higher than normal failure rates) and many low repayment plans in other districts.³²

Another factor in the debt repayment picture in Chapter 13 is “cramdown” of secured debt. Home mortgage debt must be repaid in full in Chapter 13,³³ but other secured loans need only be paid at collateral value,³⁴ with payment typically over the length of the plan.³⁵ If the debtor instead reaffirmed the secured debt in Chapter 7, this would mean repayment of the full loan.

In light of how Chapter 7 and Chapter 13 are actually used, it is not clear that the average Chapter 13 debtor repays much more debt than the average Chapter 7 debtor, or that Chapter 13 debtors are generally acting in a more morally upright way than Chapter 7 debtors. To be sure, some Chapter 13 debtors complete 100 per cent repayment plans (although even these plans do not usually provide for payment of interest on unsecured debts). However, Chapter 7 debtors often repay some debt and Chapter 13 debtors often repay little, either because their plans are for low percentages or because they fail to complete their plans. Some Chapter 13 debtors use that option primarily to hold on to collateral when creditors will not let them reaffirm or continue paying informally in Chapter 7.

An idea embraced by the NBRC is that Chapter 13 debtors should get a better credit rating than Chapter 7 debtors, presumably leading to quicker and better access to credit in the future.³⁶ It is difficult to see how this recommendation could be implemented, however, because it flies in the face of market realities. Creditors are now generally much quicker to lend to a debtor who filed in Chapter 7 than in Chapter 13, and there are good reasons for this phenomenon. Chapter 7 debtors who do not reaffirm their debts no longer carry large debt loads, making them better able to handle new credit. Also, a Chapter 7 debtor cannot

³¹ The roles of trustees in Chapter 7 and Chapter 13 are discussed in Part VI, below. Debtors in both chapters are usually represented by lawyers, and trustees play an oversight role.

³² See “Lawyers and Consumer Bankruptcy,” *supra* note 23 at 531-34.

³³ See *Bankruptcy Code*, *supra* note 11, § 1322(b)(2).

³⁴ *Ibid.* § 506(a). For a discussion of the ambiguity of the United States Supreme Court’s analysis of how to measure collateral value, see J. Braucher, “Getting It for You Wholesale: Making Sense of Bankruptcy Valuation of Collateral After *Rash*” (1998) 102 Dick. L. Rev. 763.

³⁵ See *Bankruptcy Code*, *supra* note 11, § 1325(a)(5).

³⁶ See *NBRC Report*, *supra* note 2 at 291-93.

file in that chapter again for six years after discharge.³⁷ Chapter 13 debtors, in contrast, must commit all disposable income for at least three years,³⁸ and are at high risk to convert to Chapter 7 during that time, discharging outstanding debts, including those incurred during the pendency of their Chapter 13 cases.³⁹ Many Chapter 7 debtors get new credit shortly after discharge,⁴⁰ before a Chapter 13 debtor could complete a three- or five-year repayment plan to get a discharge.

IV. COMPETING CRITIQUES

The empirically-based overview of the options in the American consumer bankruptcy system provided in Part III, above, leads to a much different critique than that driving the so-called reform legislation introduced in Congress in 1997, and again in 1999. Rather than debtors with ability to repay but no shame escaping their debts, there are two obvious, related problems with the American bankruptcy system: (1) the two chapters lack distinct characters, making the system much too complex for debtors to understand, and leaving debtors vulnerable to manipulation by their own lawyers; and (2) Chapter 13 plans, particularly high-percentage repayment plans, are oversold in some areas and by some lawyers who find it easier to get more clients and higher fees that way, leading to great unfairness both within and across bankruptcy districts.⁴¹ Some bankruptcy judges and Chapter 13 trustees use their discretion to push for unrealistically high repayment, and they reward lawyers who cooperate by approving much higher fees, financed through the plan, than debtors typically pay in Chapter 7.⁴² As a result, some debtors get a quick discharge in Chapter 7, while similarly situated debtors struggle and usually fail to complete their Chapter 13 plans. In addition, some Chapter 7 debtors undercut their fresh starts by

³⁷ See *Bankruptcy Code*, *supra* note 11, § 727(a)(8).

³⁸ *Ibid.* § 1325(b)(1)(B).

³⁹ *Ibid.* §§ 1307, 727(b), 301.

⁴⁰ For a discussion of creditors' practice of soliciting debtors for new credit shortly after discharge, see *NBRC Report*, *supra* note 2 at 94.

⁴¹ See "Lawyers and Consumer Bankruptcy," *supra* note 23 at 545-51. See also American Bankruptcy Institute, *National Report on Professional Compensation in Bankruptcy Cases*, online: American Bankruptcy Institute <<http://www.abiworld.org>> (date accessed: 5 August 1999), which reported that attorneys' fees in Chapter 13 are routinely higher than in Chapter 7, based on a 1991 national sampling which found a mean Chapter 7 fee of \$637, and a mean Chapter 13 fee of \$820.

⁴² See "Counseling Consumer Debtors," *supra* note 7 at 196.

reaffirming unsecured debts. This saves lawyers the trouble of litigating against creditors who threaten to raise confirmation challenges unless debtors reaffirm obligations to them.

The reporter for the NBRC, Elizabeth Warren, tried to get the Commission to address the complexity and inequity problems in the current system with her "Basic Bankruptcy" proposal. Her proposal, in short, involved having one bankruptcy option, essentially like Chapter 7, with additional voluntary repayment features to hold on to collateral or to pay all debts.⁴³ Instead, the Commission adopted a set of piecemeal proposals that would result in some increased fairness, but would not address at all the fundamental problem of excess complexity.⁴⁴

To date, Congress has not focused seriously on the Commission's proposals.⁴⁵ Instead it has taken up credit industry proposals to restrict access to Chapter 7, accepting the definition of the problem that there are too many people filing who could repay a significant portion of their debts. In the 105th Congress, the House of Representatives bill would have used a bright-line "means test" formula at the outset of the process, while the Senate bill would have made it easier to challenge Chapter 7 filings as abusive and, for the first time, would have given creditors the power to bring these challenges.⁴⁶ Either of these proposals, if enacted, would likely increase the cost of legal services for consumer debtors, and the costs of administration of the consumer bankruptcy system. This would presumably be reflected in higher attorneys' fees and bankruptcy filing fees, and result in less use of bankruptcy by the worst off, who would be priced out of the system. These additional hurdles to gain access to bankruptcy also would likely encourage more risky extensions of credit. Fewer debtors would get relief from collection and some would

⁴³ See "Basic Bankruptcy Concept for Consumer Bankruptcy" *Consumer Bankruptcy News* (12 September 1996) 1 at 4-6.

⁴⁴ See "Increasing Uniformity in Consumer Bankruptcy," *supra* note 18 at 17-23. For a leading consumer advocate's critique of the NBRC's recommendations, see G. Klein, "Consumer Bankruptcy in the Balance: The National Bankruptcy Review Commission's Recommendations Tilt Toward Creditors" (1997) 5 *Am. Bankr. Inst. L. Rev.* 293.

⁴⁵ The Commission was authorized by the *Bankruptcy Reform Act of 1994*, H.R. 5116, 103d Cong. § 602 (1994), and its membership was determined prior to the 1994 congressional elections, which resulted in a change in power from a Democratic to a Republican majority. As a result, a commission created when the Democrats controlled the House reported to a House controlled by the Republicans.

⁴⁶ See H.R. 3150, *supra* note 13; and *Consumer Bankruptcy Reform Act of 1997*, S. 1301, 105th Cong. (1997) [hereinafter "S. 1301"]. The bankruptcy reform bills introduced in 1999 both contained means tests: see *Bankruptcy Reform Act of 1999*, H.R. 833, 106th Cong. (1999); and *Bankruptcy Reform Act of 1999*, S. 625, 106th Cong. (1999).

pay more as a result, but it is far from clear that the net result would be less total bad-debt loss because of the likely increase in debt volume. Debtors without access to bankruptcy do not necessarily pay their debts, and some bankruptcy losses would just be converted to non-bankruptcy default losses. In short, the proposed legislation might reduce the bad-debt loss percentage of creditors by squeezing consumer debtors a little harder, but at the cost of more overextended consumers, particularly at the low end of the economic scale.

When the problem is redefined as too many overextended debtors, pending legislation seems likely to make it worse. The large number of filings should be seen as a symptom of the problem. It could also be considered evidence of the need for a safety valve. A case could even be made for easier access to bankruptcy and more filings to stimulate reform of creditor practices. On the other hand, bankruptcy is not a pleasant experience. Direct regulation of risky lending practices would be more humane. There have been suggestions by members of Congress that some new direct regulation is needed but, so far, proposals have only taken the form of new disclosure requirements.⁴⁷

V. COUNSELLING AND EDUCATION

Currently, American debtor counselling and education programs are directed at debtors already in trouble, which is much too late. For many years, consumer credit counselling under the auspices of private agencies has provided an alternative to bankruptcy for many debtors. A range of non-profit and for-profit agencies in the United States provide the service of arranging workouts.⁴⁸ Many debtors are able to use these agencies to enter into voluntary arrangements with creditors to stretch out payments. The agencies depend on cooperation and, in some cases, funding from creditors, so of necessity they stress creditor interests. These agencies often do not permit forgiveness of either principal or

⁴⁷ See section 209 of the *Consumer Bankruptcy Reform Act of 1998* (Engrossed Senate Amendment), H.R. 3150, 105th Cong. (1998), which would have required credit card issuers to disclose in billing statements the number of months it would take to pay off the current balance if the consumer paid only the required minimum monthly payment.

⁴⁸ For further discussion of the services provided by consumer credit counselling agencies, see "Lawyers and Consumer Bankruptcy," *supra* note 23 at 524-25. According to the Consumer Federation of America, 1.4 million Americans sought credit counselling from an agency in 1998: see American Bankruptcy Institute, *Credit Counseling Charges Increase* (29 July 1999), online: American Bankruptcy Institute <<http://www.abiworld.org/headlines/todayshhead.html>> (date accessed: 5 August 1999).

interest, and they limit the number of years for workouts they arrange; as a result, many debtors are too overextended to be able to participate in these agencies' plans.⁴⁹ Some counselling agencies will refer debtors who do not qualify for their services to bankruptcy lawyers, but others do not.⁵⁰ Counselling agencies often do not tell debtors about bankruptcy options or may even misrepresent the consequences of bankruptcy.⁵¹ Lawyers are more likely to provide disinterested advice, although some serve their own financial interests at the expense of clients.⁵²

Consumer credit counselling agencies and lawyers sometimes provide education on future financial planning, but this is not a consistent practice.⁵³ Some Chapter 13 trustees have long-run debtor education programs.⁵⁴ There have been proposals for more extensive debtor education programs, including mandatory education in financial management as a condition of discharge in either Chapter 7 or Chapter 13.⁵⁵ In the past few years, widely varying new programs have been developed by Chapter 13 trustees. Some of these programs emphasize avoiding credit in the future and the importance of saving, but others focus on getting renewed access to credit—a questionable emphasis. While education for some is better than nothing, rather than focusing on people who have already filed in bankruptcy, it would appear to be much more sensible to put education about personal financial management and planning into the curricula of secondary schools, which currently is not a common practice in the United States.

VI. ROLES OF PROFESSIONALS

There are some initially striking differences in the roles played by professionals in the consumer bankruptcy systems in the United States and Canada. In the United States, most consumer cases involve

⁴⁹ See "Lawyers and Consumer Bankruptcy," *supra* note 23 at 524-25.

⁵⁰ *Ibid.*

⁵¹ Consumer advocates told the NBRCC that credit counselling agencies sometimes give consumers misinformation to scare them away from bankruptcy.

⁵² See "Counseling Consumer Debtors," *supra* note 7 at 174-77.

⁵³ See "Lawyers and Consumer Bankruptcy," *supra* note 23 at 568-69.

⁵⁴ See *ibid.* at 557, for a discussion of a mandatory four-and-one-half hour school program for Chapter 13 debtors within six months of filing, which is run by the Chapter 13 trustee in San Antonio, Texas. A similar program operates in Columbus, Ohio.

⁵⁵ See S. 1301, *supra* note 46, § 321.

both a lawyer, for the debtor, and a trustee, who serves as fiduciary for the creditors. Most American consumer debtors have lawyers, although some file *pro se* without any professional advice. Lawyers are fiduciaries of their clients and are supposed to be advocates for their interests. In the United States, every case has a trustee, but the trustees do not typically provide advice to the debtor. In Chapter 7, a panel trustee presides at the first meeting of creditors and is authorized to investigate the financial affairs of the debtor and to liquidate non-exempt property.⁵⁶ The Chapter 7 panel trustee is paid on the basis of assets distributed;⁵⁷ in the more than 90 per cent of cases that are “no asset” cases, the trustee gets \$60 a piece and has little incentive to put much effort into oversight.⁵⁸ In Chapter 13, a standing trustee reviews the debtor’s petition and payment plan, and can raise challenges under the statutory tests.⁵⁹ Chapter 13 standing trustees are paid a percentage of plan distributions in the range of 6 per cent.⁶⁰ In practice, Chapter 7 panel trustees play a very limited role, while the standing Chapter 13 trustees are powerful, well-paid officials who play a role in every Chapter 13 proceeding in their area, and can significantly affect the local legal culture.⁶¹ Some Chapter 13 trustees promote high-percentage plans, while others are more accepting of little repayment as all that is realistic.⁶²

Canadian debtors must have a trustee, who is usually an accountant by training and to whom the debtor pays a fee. Most consumer debtors do not retain lawyers, in order to avoid payment of dual fees.⁶³ Although the Canadian professional who advises the debtor is called a trustee, these professionals advertise their services to debtors,

⁵⁶ See *Bankruptcy Code*, *supra* note 11, §§ 341, 704. The panel trustee is appointed by the United States trustee for the district: see 28 U.S.C. § 586 (1998) [hereinafter “Judiciary and Judicial Procedure”]. The United States trustees are appointed by the United States Attorney General and are salaried: see *ibid.* §§ 585, 587. Panel trustees are lawyers and accountants who are engaged for each case.

⁵⁷ See *Bankruptcy Code*, *supra* note 11, § 326.

⁵⁸ *Ibid.* § 330(b).

⁵⁹ *Ibid.* § 1302. See also “Judiciary and Judicial Procedure,” *supra* note 56, § 586.

⁶⁰ The statutory percentage cap of 10 per cent is rarely reached because the high volume in filings in recent years has meant that the statutory maximum cap equals about 6 per cent of distributions: see *Bankruptcy Code*, *supra* note 11, § 586(e).

⁶¹ See “Lawyers and Consumer Protection,” *supra* note 23 at 556-61.

⁶² *Ibid.*

⁶³ See “Consumer Bankruptcy Systems,” *supra* note 4 at 214.

who then come to consult them.⁶⁴ Thus, in practice—if not in name—debtors are clients of Canadian trustees and get advice from them, although the trustees owe allegiance to creditors and to the integrity of the system. This raises a potential conflict of interest problem.⁶⁵ Another aspect of the Canadian system is that debtors undergo mandatory financial counselling as a condition of discharge.⁶⁶ The accountant-trustees typically provide this service, although they are not comfortable with this role and do not believe that counselling is very effective.⁶⁷

American debtors typically retain lawyers, but some American lawyers worry about the political acceptability of the system and do not push their clients' interests too hard.⁶⁸ Lawyers are even more powerfully influenced by two interrelated factors: their own financial interests, and the local legal culture. Lawyers for consumer debtors typically charge small fixed fees.⁶⁹ Debtors cannot afford by-the-hour services. This leads some lawyers to avoid conflict with creditors, judges, and Chapter 13 standing trustees.⁷⁰ They may routinely go along with reaffirmation of unsecured debts in Chapter 7 and with high percentage plans in Chapter 13, and put most clients into Chapter 13, where fees are higher and payment of fees through the plan gives the lawyers the services of the standing Chapter 13 trustee as a collection agent. As a result, some lawyers serve creditors' interests as much as their clients' interests. The complexity and resulting lack of uniformity in American bankruptcy law produces some inequity; complexity also obscures dubious professional practices. Despite differences in the roles of professionals in the United States and Canada, multiple and conflicting allegiances appear to be features of both systems.

VII. CONCLUSION

Canada has already taken the step of tightening up on consumer use of bankruptcy, creating more pressure for repayment. The United

⁶⁴ *Ibid.* at 214-15.

⁶⁵ *Ibid.* at 215.

⁶⁶ See *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 157.1, as am. by *An Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27, s. 58.

⁶⁷ See "Canadian Perspectives," *supra* note 1 at 213, Table III.

⁶⁸ See "Lawyers and Consumer Bankruptcy," *supra* note 23 at 568.

⁶⁹ See note 41, *supra*.

⁷⁰ See "Counseling Consumer Debtors," *supra* note 7 at 177-79.

States has so far escaped this result, but creditor interests have continued their campaign in Congress. There is also some political resistance, making it hard to predict what will happen. While the consumer credit industry wants new bankruptcy restrictions, and is prepared to put massive resources into lobbying and campaign contributions to attain that goal, the political reality that underlies the resistance is the common understanding in the United States that credit is not just easy, but is aggressively hawked to even the most risky debtors. Americans are well aware of how easy it is to get in trouble with debt.⁷¹

⁷¹ For example, in the week before Christmas in 1998, with American consumers busily increasing their credit card balances, National Public Radio featured a story about a mentally retarded man who made \$8,000 a year and who had run up \$17,000 on credit cards under sales pressure from telemarketers: see J. Russel, "Mentally Retarded & Credit" *National Public Radio: All Things Considered* (22 December 1998), audio transcript available online: National Public Radio <<http://search.npr.org/cf/cmn/cmnpd01fm.cfm?PrgDate=12/22/98&PrgID=2>> (date accessed: 16 July 1999).