

# BANKRUPTCY ABUSE: AN EMPIRICAL STUDY OF CONSUMER EXEMPTIONS CASES<sup>\*</sup>

Bernard Trujillo<sup>\*\*</sup>

## Abstract

On April 20, 2005, the President of the United States signed a sweeping legislative overhaul of the consumer bankruptcy system. The bankruptcy reform legislation is based on an empirical assertion: that sophisticated debtors with the means to re-pay their debts were instead filing for bankruptcy and acquiring a discharge, thereby abusing the bankruptcy system.

This Article presents the results of an empirical study of bankruptcy court doctrine in consumer exemptions proceedings over a twenty-year period. The findings suggest a serious empirical flaw in the premise of the bankruptcy reform legislation. The study shows that the bankruptcy system minimizes abuse by valuing property exemptions to decrease the amount of the discharge for sophisticated debtors and increase the amount of the discharge for unsophisticated debtors. The data show that the presence of sophistication reduces a debtor's chance of success in an exemptions proceeding by as much as **87.8%**. Courts systematically value exemptions to impose costs on the "can-pay" debtor. This pattern of abuse minimization emerged endogenously, without the prompting of hierarchical, exogenous forces such as Congressional or appellate court directives.

These findings suggest that Congress has misunderstood the complex nature of the bankruptcy system, misdiagnosed the problem of consumer credit, and applied the wrong remedy. The Article concludes with a preliminary attempt to re-focus analysis of debt regulation around a "no-fault" .

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**BANKRUPTCY ABUSE:**  
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# **BANKRUPTCY ABUSE:**

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### **INTRODUCTION: THE RHETORIC OF ABUSE**

We all know the story about middle class consumers. Here is a group that spends too much on fancy cars, restaurant meals, and bottled water. And when they have stretched it too thin for too long they waltz into bankruptcy court and wipe their debts away. Over-consumption, followed by bankruptcy abuse: This is the one-two punch that irresponsible consumers have been laying on the rest of us, and Congress finally acted to put a stop to it.

So the story goes. The data, however, go in a different direction. This Article reports the results of an empirical study of bankruptcy court doctrine in consumer exemptions proceedings over a twenty-year period. The results of this study challenge a key assumption of the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) and suggest that the bankruptcy system has been effectively minimizing potential abuse.

Enacted on April 20, 2005, BAPCPA works the most significant changes in the

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\*\* Assistant Professor, University of Wisconsin Law School. A.B., Princeton University, 1988; J.D., Yale Law School, 1992. Thanks to Peter Carstensen, Bill Clune, Marc Galanter, Tracey George, Bob Lawless, Lynn LoPucki, Stewart Macaulay, Clint Sprott, Martin Shapiro, Bill Whitford, and participants in a panel at the Law & Society Association’s 2005 annual meeting. The empirical work in this article was funded by grants from the National Conference of Bankruptcy Judges, the American Bankruptcy Institute, and the University of Wisconsin at Madison Graduate School. I gratefully acknowledge the research assistance of Mike Morgalla and Jay Kronenwetter, the statistical assistance of David Merrill and Menesh Patel, and the coding assistance of Cari Weber, Erik Guenther, and Lance Mueller. Special thanks to Victoria Trujillo.

U.S. bankruptcy system in over a quarter of a century. BAPCPA is grounded on the claim that consumers strategically abuse the bankruptcy system by discharging debts that they are capable of paying. Congressional rhetoric summarizes the conceptual underpinnings of BAPCPA. Witness a press release from Sen. Orrin Hatch on the day BAPCPA passed the Senate:

“This bill is about fairness and accountability. Bankruptcy claims have skyrocketed since the last major bankruptcy reform bill in 1978. We all know about the abuses of the system. Well, that is about to change for the better. This bill may not lead to a severe reduction in the number of bankruptcies, but I do believe that it will reduce the number of fraudulent and abusive filings....”<sup>1</sup>

On the day BAPCPA became law, Sen. Hatch continued, “The underlying idea is simple – if you can pay, then you should pay. Too many people have abused the system in the past, and everyone else had to shoulder their debt for them.”<sup>2</sup> The same day, Senate Majority Leader Bill Frist opined,

“The bankruptcy reform bill marks a major step towards eliminating abuses in our court system and ensures that those who have the means will repay their debts. These reforms will lower the burden on all Americans who are currently paying the price for these abuses in the form of higher interest rates, higher down payments and higher costs of goods and services. I’m proud of this victory for personal responsibility and fairness.”<sup>3</sup>

Behind this rhetoric of abuse is an empirical assertion: the population of debtors filing for bankruptcy had changed in the past several years, and the bankruptcy system had failed to keep up with the changes. The legislation assumes that debtors have become more sophisticated, more practiced at taking strategic action. Debtors with “the

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<sup>1</sup> Press Release, “Bankruptcy Reform Passes Senate”, March 10, 2005. Website of Senator Orrin Hatch, [http://hatch.senate.gov/index.cfm?FuseAction=PressReleases.View&PressRelease\\_id=1303](http://hatch.senate.gov/index.cfm?FuseAction=PressReleases.View&PressRelease_id=1303)

<sup>2</sup> Press Release, “Bankruptcy Reform Signed Into Law”, April 20, 2005. Website of Senator Orrin Hatch, [http://hatch.senate.gov/index.cfm?FuseAction=PressReleases.View&PressRelease\\_id1327](http://hatch.senate.gov/index.cfm?FuseAction=PressReleases.View&PressRelease_id1327)

<sup>3</sup> Press Release, “Frist Applauds Signing of Bankruptcy Bill”, April 20, 2005. Website of Sen. Bill Frist, [http://frist.senate.gov/index.cfm?FuseAction=PressReleases.Detail&PressRelease\\_id=1914&Month=4&Year=2005](http://frist.senate.gov/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=1914&Month=4&Year=2005)

means [to] repay their debts” (using the language of Majority Leader Frist) were instead choosing to file for bankruptcy and shift their costs to the general population of credit consumers. The bankruptcy system, according to the legislative imagination, failed to adjust to this new population of scheming debtors and guilelessly awarded a discharge to all debtors who asked for one. Because the bankruptcy system had failed to organize itself on this important matter of abuse-prevention, Congress would have to step in and exogenously re-order the bankruptcy system to minimize abuse.

Against Congress’ vision of the consumer bankruptcy system as a simple discharge machine, this Article offers a counter-description: bankruptcy is a complex, adaptive system that demonstrates patterns of self-organization according to a complex dynamics.<sup>4</sup> Patterns emerged in this complex system that effectively regulate potential abuse of the discharge.

Part I of this Article reviews the arguments regarding debtors’ alleged abuse of the bankruptcy discharge and BAPCPA’s attempt at remedy. Part II frames an empirical test of the “abuse” hypothesis and Part III presents the results of an empirical study measuring the bankruptcy system’s control of potential abuse. This Article concludes with a preliminary attempt to re-cast the project of debt regulation as a “no-fault” system.

## **I. THE ABUSE HYPOTHESIS**

Analysis of consumer bankruptcy tends to begin with the question: What explains the sharp increase in bankruptcy filings? Filings rose from 200,000 in 1978 (the date of

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<sup>4</sup> See Bernard Trujillo, *Self-Organizing Legal Systems: Precedent and Variation in Bankruptcy*, 2004 UTAH L. REV. 483 (2004); Bernard Trujillo, *Patterns in a Complex System: An Empirical Study of Valuation in Business Bankruptcy Cases*, 53 UCLA L. REV. --- (forthcoming, Dec. 2005).

the last major revision of the U.S. bankruptcy laws) to 1.6 million in 2004.<sup>5</sup> Two schools have arisen to explain this spike. One school argues that changes in *borrower* behavior explain the rise in bankruptcies. The other school looks to changes in *lender* behavior.

The “borrower behavior” school argues that recent years have seen an increase in the dual phenomena of over-consumption and bankruptcy abuse. Middle class consumers, on this view, spend beyond their means and otherwise court financial ruin. When ruin comes, these consumers choose to file bankruptcy rather than cut their expenses or take on a second (or third) job.<sup>6</sup>

The “lender behavior” school argues that the real sea-change in consumer credit has been on the lenders’ side. The past several years have seen an unprecedented amount of innovation in the types of consumer credit instruments available, and in the distribution of those instruments to consumers who previously had very limited access to the credit markets. The obvious example is the credit card, an instrument whose surge in distribution correlates strongly with a subsequent surge in bankruptcy filings.<sup>7</sup> But other forms of innovation in consumer credit instruments and distribution also abound.<sup>8</sup>

This Article will return to the arguments of the “lender behavior” school.<sup>9</sup> I

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<sup>5</sup> Timothy Egan, *Debtors in Rush to Bankruptcy as Change Nears*, NEW YORK TIMES August 21, 2005. The article projects that the filings could reach 1.8 million for 2005.

<sup>6</sup> See Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, NORTHWESTERN L. REV. (forthcoming, 2005); Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, WASH. & LEE L. REV. (forthcoming, 2005); Edith H. Jones & Todd J. Zywicki, *It's Time For Means-Testing*, 1999 BYU L. REV. 177 (1999).

<sup>7</sup> See Ronald J. Mann, *Credit Cards, Consumer Credit, and Bankruptcy*, (2005 draft, available on SSRN). Mann’s excellent study uses data from five nations (Australia, Canada, Japan, UK and US) and finds a strong correlation between credit card debt and, lagging by 1-2 years, bankruptcies. See also Robert M. Lawless, *The Relationship between Nonbusiness Bankruptcy Filings and Various Basic Measures of Consumer Debt* (2002 e-article) (showing bankruptcy filings are higher for revolving consumer credit instruments (e.g. credit cards) than for total consumer credit). See generally, Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249 (1997).

<sup>8</sup> An important recent arena for such consumer credit innovation is the home-loan market. See e.g. Edmund L. Andrews, *A Hands-Off Policy on Mortgage Loans*, NEW YORK TIMES, July 15, 2005.

<sup>9</sup> See *infra* TAN 45-46 (considering a “no-fault” approach to debt regulation).

believe it is crucial to consider what role is appropriate to government in regulating a lending environment characterized by profuse innovation of, and broad access to, consumer credit instruments.

For now, it is sufficient to observe that BAPCPA is almost entirely animated by blame-the-borrower logic. The most heralded change that BAPCPA makes to the Bankruptcy Code (the “Code”) is the imposition of a new “means-test.”<sup>10</sup> Convinced that the bankruptcy system failed to separate debtors with means from debtors without means, Congress added a new sub-section of byzantine proportions to section 707 of the Code.<sup>11</sup> This “means-test” is designed to perform a gate-keeping function – identifying debtors who can repay and barring their access to a chapter 7 discharge.<sup>12</sup>

The “borrower behavior” school has thus fared well in the halls of Congress. But how do the claims of that school withstand empirical analysis? The charge that debtors court financial ruin via over-consumption, the first prong of the “borrower behavior” story, is withering beneath the light of empirical scrutiny. Work by Elizabeth Warren and her colleagues has shown that charges of over-consumption have little basis in fact.<sup>13</sup>

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<sup>10</sup> For discussions of earlier versions of the means-test, see Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 48 (2001); Jean Braucher & Mooney, *Means Measurement Rather Than Means-Testing: Using the Tax System to Collect from Can Pay Consumer Debtors After Bankruptcy*, 22 AM. BANKR. INST. J. 6 (2003); Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission’s Proposals as a Starting Point*, 6 AM. BANKR. INST. L. REV. 1 (1998).

<sup>11</sup> The gist of the new 707(b)(2) is to establish a chapter 7 debtor’s monthly income and subtract a set of allowed deductions. If the amount remaining exceeds \$166.66, the statute creates a rebuttable presumption that the debtor’s petition for a chapter 7 discharge constitutes “abuse.” The debtor’s case (unless the presumption is overcome) will be then be dismissed or converted to a chapter 13. A debtor whose income is below the median income for the state in which the petition is filed is carved out of the means-test. See 707(b)(2) of the Code, as amended April 20, 2005. See generally Eugene R. Wedoff, *Major Consumer Bankruptcy Effects of 2005 Reform Legislation*, available at [www.abiworld.org/pdfs/s256/mainpoints6.pdf](http://www.abiworld.org/pdfs/s256/mainpoints6.pdf)

<sup>12</sup> Prior to BAPCPA, a consumer debtor could elect to file for either a liquidation under chapter 7 or a debt reorganization (which requires monthly payments of debts over a 3 to 5 year period) under chapter 13. After BAPCPA, debtors who are found to have the means to repay will be denied access to chapter 7, either forcing them into a chapter 13 repayment plan or forcing them out of bankruptcy.

<sup>13</sup> Elizabeth Warren, *The Over-Consumption Myth and Other Tales of Economics, Law, and Morality*, 82 WASH. U. L. Q. 1485 (2004); ELIZABETH WARREN & AMELIA WARREN TYAGI, THE TWO-INCOME TRAP:

How fares the second prong of the blame-the-borrower story? Are debtors abusing bankruptcy by discharging debts they could repay? Prior studies have explored the existence of abuse by looking to the central characteristics of the debtor population. If debtors who could pay their debts (“Can-Pays” in the vernacular of the literature) were filing for bankruptcy, then there was abuse of the discharge.<sup>14</sup> If debtors who could not pay their debts were filing for bankruptcy, then there was no abuse of the discharge.<sup>15</sup>

This approach of establishing abuse by elaborating debtor characteristics tends to assume a straight line from filing to discharge: if “can’t-pay” debtors are filing, then the system serves the public interest; if “can-pay” debtors are filing, then the system is being abused. But this straight-line approach ignores the complexity of the bankruptcy system itself.<sup>16</sup>

The bankruptcy system is an intermediating institution standing between the debtor and the discharge. This system is “complex”, in a sense of that term that is borrowed from the “complexity science” methodologies common in physics and the natural sciences. A complex system manifests a non-linearity, or a disproportion between

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WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE BROKE (2003); David U. Himmelstein, Elizabeth Warren, Deborah Thorne, & Steffie Woolhandler, *MarketWatch: Illness and Injury as Contributors to Bankruptcy*, HEALTH AFFAIRS, February 2005; Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1 (2004).

<sup>14</sup> Ernst & Young, *Chapter 7 Bankruptcy Petitioners’ Repayment Ability Under H.R. 833: The National Perspective*, 7 Am. Bankr. Inst. L. Rev. 79 (1999) (study, funded by VISA and Mastercard, finding that many chapter 7 debtors have the ability to pay back some of their debts).

<sup>15</sup> Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 Am. Bankr. Inst. L. Rev. 27 (1999) (disputing the Vias/Mastercard study by finding that only 3.6% of debtors are “Can-Pays”); Theresa Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991*, 68 AM. BANKR. L.J. 121 (1994) (using micro-data gathered from case files to establish that debtors in 1991 are even less well off than in 1981 – contradicting the argument that the increase in bankruptcy filings is due to abuse as the result of bankruptcy losing its “stigma”); Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L.J. 1079 (1998) (data show that more debt, not more abuse, explains the rise in filings).

<sup>16</sup> By the bankruptcy system, I mean that group of locally organized semi-autonomous groups involving bankruptcy bench, bar, trustee’s office, commercial actors, potential clients. For more on this institutional description of the bankruptcy system see Trujillo, *Self-Organizing Legal Systems* at 520-22.

inputs and outputs. Because of this non-linear character, complex systems are difficult to regulate exogenously (i.e. from the outside) and exogenous attempts at regulation often have unpredictable results.<sup>17</sup> Perhaps contrary to our expectations, non-linearities in a complex system tend to generate patterns rather than random behavior. These patterns (or “attractors” in the language of dynamical systems) are thus said to be a product of self-organizing dynamics.<sup>18</sup>

The general approach of my research has been to study bankruptcy using the methodological tools made available by complexity science.<sup>19</sup> I am interested in measuring quantitatively those patterns that emerge in legal content at bankruptcy’s trial court level.<sup>20</sup> As I have noted elsewhere, bankruptcy provides an excellent field for the study of self-organizing dynamics because institutional conditions limit exogenous ordering.<sup>21</sup> BAPCPA to one side, Congressional ordering of bankruptcy law is relatively infrequent. And institutional elements combined with practical concerns have made the usual mechanisms of appellate court control relatively under-utilized in the bankruptcy context.<sup>22</sup>

The present Article applies complex systems research methods to explore whether debtors abuse the bankruptcy system. Rather than focusing on the demographic characteristics of the debtor population, this study asks whether patterns for controlling

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<sup>17</sup> Sally Falk Moore, *Law and Social Change: The Semi-Autonomous Social Field as an Appropriate Subject of Study*, 7 LAW & SOC’Y REV. 719 (1973).

<sup>18</sup> PER BAK, *HOW NATURE WORKS: THE SCIENCE OF SELF-ORGANIZED CRITICALITY* (1996); JULIEN CLINTON SPROTT, *CHAOS AND TIME-SERIES ANALYSIS* (2003). My work on business cramdowns valuations is an example of a study that traces patterns wrought by a complex self-organizing legal system. Trujillo, *Patterns*, UCLA L. REV. (forthcoming Dec. 2005).

<sup>19</sup> Trujillo, *Self-Organizing Legal Systems*, 2004 UTAH L. REV. 483 (2004); Trujillo, *Patterns in a Complex System*, 53 UCLA L. REV. --- (forthcoming Dec. 2005).

<sup>20</sup> UCLA, spot cite and parenthetical

<sup>21</sup> Trujillo, *Self-Organizing Legal Systems*, at 492-98; UCLA spot cite

<sup>22</sup> *But see* sec. 1233 of BAPCPA, authorizing direct appeals from bankruptcy court to Courts of Appeals. It will be important to observe how this direct appeals provision is used in the future, and how it might affect the dynamics of the bankruptcy system.

abuse have emerged among bankruptcy courts.

As we will see in Part III, substantial patterns have emerged in the property exemption phase of consumer chapter 7 cases that act effectively to minimize abuse. Through a dynamics of self-organization, the bankruptcy system has developed important, if unheralded, gate-keeping procedures. The existence and efficacy of these procedures substantially undercuts the logic of BAPCPA and the blame-the-borrower school of bankruptcy policy analysts.

To paraphrase the late, great Johnnie Cochran: “If they lose, it’s not abuse!” The data show that, where “can-pay” debtors do file for bankruptcy, a funny thing happens on the way to the discharge: sophisticated debtors “lose”, at the level of exemptions valuation, in great proportions. Before laying out the data, Part II of this Article will present an empirically testable frame to the hypothesis that sophisticated debtors abuse the bankruptcy system.

## **II. TESTING THE ABUSE HYPOTHESIS**

This part lays out a matrix for how we might put the abuse argument to the empirical test. First, I will specify the notion of “abuse” in a way that can be measured. Then I will examine the law, procedure, and policy surrounding property exemptions in chapter 7 consumer bankruptcies. Finally, I will offer a testable      howing how bankruptcy courts’ valuation of exemption claims acts as a control parameter that allows the system to monitor and minimize the amount of potential abuse. This part will conclude with some predictions of what we would see if the abuse hypothesis was true.

## A. Defining Abuse Quantitatively

Consumer debtors file for bankruptcy in order to acquire the state-provided “good” we call the discharge.<sup>23</sup> It is perhaps useful to regard the discharge as a sort of public resource that is managed by the state for public benefit. As with all public resources, the state can manage the discharge in a way that redounds to the social good, or in a way that damages the social good by spending a public resource to line private pockets. A municipality can spend a fund of public money on a waterworks project that benefits the community. Or it can invest that fund in a program of graft (perhaps unbeknownst to the public officials managing the money) that amounts to a social cost.

We understand every dollar that is discharged in a consumer chapter 7 case to be either a social benefit or a social cost. Discharging a dollar owed by a debtor who cannot repay is a social benefit – this is the “fresh start” policy that animates consumer bankruptcy law. Discharging a dollar owed by a debtor who can repay is a social cost – it is an instance of a public good being distributed for private gain only.

We can thus quantify “abuse” as the number of *7 discharged can-pay dollars* – that is, debt discharged in a chapter 7 liquidation by a consumer who could have repaid the debt if she had executed a plan of repayment under chapter 13 or restructured her debt obligations outside of bankruptcy. Bankruptcy abuse, by this definition, is every dollar of discharge that constitutes a social cost. It follows that the proper use of bankruptcy is every dollar of discharge that constitutes a social benefit.

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<sup>23</sup> A debt is discharged when it becomes legally uncollectible after the bankruptcy case is terminated.

## B. Exemptions in Consumer Bankruptcy

A central part of every consumer 7 bankruptcy is the law's specification of what among the debtor's property shall be declared exempt and thus held beyond the reach of the creditors. How much the debtor benefits from the discharge, and thus whether it will benefit the debtor to proceed with the liquidation at all, will often depend on the outcome of the exemptions phase of the case.

Exemptions are a creature of state debt collections law and federal bankruptcy law. Exemptions statutes protect certain types of property (e.g. the family Bible, a burial plot) and types of property in certain amounts (e.g. \$1,200 worth of car, \$7,500 worth of tools-of-the-debtor's-trade), holding the exempt property beyond the reach of debt collection. The logic behind exemptions law is that every person is entitled to some stuff, no matter how much debt they pile up.

A chapter 7 petition authorizes the trustee<sup>24</sup> to seize and liquidate the debtor's non-exempt assets and distribute the proceeds (if any) to the creditors. Statutory exemptions thus maximize the value of the discharge to the debtor by preventing the seizure of property. Procedurally, the debtor submits a list of property she claims as exempt, along with valuations of each item. The trustee reviews the list. If the trustee objects to a particular exemption (and if the debtor and trustee cannot settle the matter) then the exemption will be adjudicated by the bankruptcy court.

Imagine a consumer who has a lot of debts and a 1995 Dodge Neon. The consumer wants to lose the debts and keep the Neon. Prior to BAPCPA, she had the option of filing (without submitting to a means-test) a chapter 7 petition and a schedule

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<sup>24</sup> A chapter 7 trustee is an administrative officer of the bankruptcy court whose job is to administer the assets of the mass of chapter 7 consumer bankruptcies.

claiming the Neon as exempt property. Suppose the governing exemption statute allows debtors to exempt \$1,200 worth of car. The debtor would list the Neon's value at, say, \$1,000. If the trustee does not object, the debtor keeps the Neon and gets the discharge.

Now suppose that the car is a 2005 Mercedes convertible with quad DVD players, self-cleaning ashtrays, and fuzzy dice. The statutory exemption amount is still \$1,200. Any attempt by the debtor to exempt this car at or below the statutory amount will surely fetch an objection from the trustee and potentially an adjudicated valuation by the court.

A debtor can "lose" at the exemptions valuation proceeding in at least two ways. First, the judge may deny the exemption and authorize the trustee to seize the asset and sell it. In the Mercedes example, the trustee would seize the car and sell it, give \$1,200 to the debtor and the balance to the creditors.<sup>25</sup> Second, the judge may allow the exemption, but at a higher value than listed by the debtor. If the found value of the asset is higher than the exemption amount, the debtor is forced to make a payment to the trustee in order to avoid seizure. In either case, the debtor is forced to pay more for the discharge, and the creditors realize the gain.

The administration of exemptions is a significant component in determining whether the discharge produces a social gain or a social cost. It is thus important to specify how exemptions are implemented in the bankruptcy system. Earlier studies that have accounted for property exemptions tend to treat the exemption as if it were a non-adjusting variable that could only be raised or lowered exogenously.<sup>26</sup> The present study

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<sup>25</sup> This calculation assumes that there is no security interest in the car. Alternatively, assume a lien in the car securing a debt of \$20,000 and a liquidation price of \$30,000. After liquidation, the trustee would distribute the first \$20,000 to the secured party, the next \$1,200 to the debtor in satisfaction of the exemption amount, and the balance to the creditors.

<sup>26</sup> See Barry Adler, Ben Polak, and Alan Schwartz, *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEG. STUD. 585, 608-09 (2000): "...when the borrower has assets to protect, he will work harder to avoid bankruptcy. Consequently, raising the personal exemption level would reduce ex ante

approaches exemptions in the context of their implementation by bankruptcy system actors.

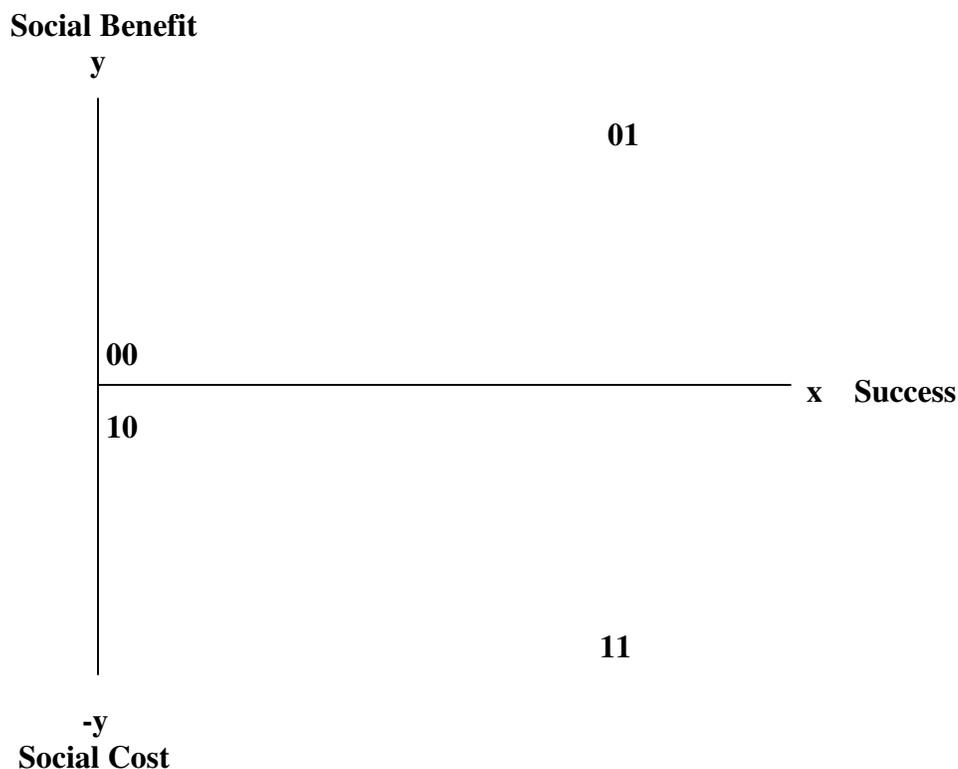
### C. A of Exemptions Valuation as a Control on Abuse

I have argued that the bankruptcy system uses exemptions valuation to calibrate the amount of the discharge, thus controlling abuse. Using the language of dynamical systems, we can say that the exemptions valuation acts as a “control parameter” on the amount of potential abuse. The relationship between the control parameter and abuse is represented in Figure 1.

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efficiency. On the other hand, lowering the exemption level reduces the amount of wage insurance that the bankruptcy system provides.” This passage well-frames the tradeoffs. But it mistakenly treats the exemptions value as a flat, non-adjusting variable. When we see how exemptions are administered by bankruptcy-qua-complex system, we see the exemption value adjust to maximize benefits (more “wage insurance” for the can’t-pays) and minimize costs (less “inefficiency,” i.e. less social costs lost to the can-pays). As we will see in Part III, exemptions values, as deployed by bankruptcy system actors, are elastic and correlated to debtor status: taking a high value to diminish the value of the discharge for can-pays, and taking a low value to increase the value of the discharge for can’t-pays. *See also* Richard Hynes, Anup Malani, and Eric Posner, *The Political Economy of Property Exemption Laws*, 47 J. LAW & ECON. 19 (2004) (establishing that an inference from exemption amounts to filing rates is unconvincing). The research limitations identified by Hynes, Malani, and Posner may be overcome in the context of a “field experiment” that studies exemptions, as it were, in the field of their actual implementation. *See generally* Glenn W. Harrison & John A. List, *Field Experiments*, 42 J. ECON. LIT. 1009 (2004). The present study perhaps moves us in the direction of such a “field experiment.”

**Figure 1**



The y axis represents the social benefit and social cost of the discharge. The x axis, labeled “success,” represents the degree to which the debtor was successful at the exemptions valuation proceeding. The four points on the graph can be summarized as:

<u>Can-Pay</u>	<u>Successful</u>	
0	1	Social Benefit
0	0	Missed opportunity
1	0	Dodged a bullet
1	1	Social Cost

A debtor represented as “01” is a “can’t-pay” who was successful in her exemption valuation hearing. We can offer this situation as the proper use of bankruptcy, in that it distributes the public resource of the discharge in a way that redounds to the public good.

A debtor represented as “00” is a “can’t pay” who was unsuccessful in her exemption valuation hearing. More value directed to this person’s discharge would have been a social benefit, but the bankruptcy system missed that opportunity. A debtor represented as “10” is a “can pay” who was unsuccessful at the exemption hearing. Any value flowing to this debtor would constitute a social cost, but the system minimized the amount of that cost. Finally, a debtor denoted as “11” is a “can pay” who wins at the exemption hearing. This is abuse – a debtor who can pay getting the maximum value for her discharge.

Suppose that Figure 1 is a “miniature ” course, and each of the four plotted points is a hole. The ground is sloped that that any ball dropped onto the course will ultimately find its way into a hole. Imagine that we stand on a platform above the course and dump 1,000 balls. We then count how many balls were collected in each of the four holes. Suppose we repeat this experiment 1,000 times, and then calculate the results.

If the abuse hypothesis of BAPCPA and the blame-the-borrower school were correct, we would see either no pattern at all (i.e. a random distribution of how many balls were collected by each hole, indicating that the bankruptcy system was exerting no order over debtors’ application for discharges) or we would see a pattern favoring hole “11” (i.e. that can-pay debtors are maximizing value from the discharge and the system is being abused).

Neither of these predictions is supported by the data. Instead, we see patterns favoring hole “01” (maximized social benefit) and hole “10” (minimized social cost). The system sorts debtors, and it sorts them to maximize social benefits and minimize social costs associated with the discharge.

### III. STUDY RESULTS AND INTERPRETATIONS

Part II argued that bankruptcy courts' valuation of exemptions is a key component in the process of monitoring and controlling debtors' alleged abuse of the discharge. Measuring exemptions data, therefore, is critical to understanding what, if anything, courts are doing about abuse.

This Part presents the results of an empirical study of bankruptcy court valuations in consumer exemptions proceedings. The question of this study: What have bankruptcy court opinions signaled<sup>27</sup> about sophisticated debtors' chances of success?

If the "abuse" argument were true, we would expect to see no correlation between sophistication and success, indicating that courts were expending no particular effort to rein in debtors' attempted abuse, or even a positive correlation indicating that that sophisticated debtors were maximizing the value of their discharge at the exemptions hearing. In fact, we see a strong negative correlation between debtors' sophistication and their success. The data show that the presence of sophistication reduces a debtor's chance of success by as much as 87.8%. Courts seem to have systematically valued exemptions to smack the "can-pay" debtor.

More generally, these data offer some support for a claim that the bankruptcy legal system, through a dynamics of self-organization, adjusts to monitor and minimize abuse by sophisticated debtors. If the premise of the BAPCPA was that Congress had to

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<sup>27</sup> See Trujillo, PATTERNS n-n, UCLA L. REV. (forthcoming Dec. 2005) (discussing the "communications effects" of a published bankruptcy court opinion). These data (published bankruptcy court cases) are appropriate to the research question because the published opinion stands as a signal *par excellence* to the other members of the trial court network (including trustee, bar, and potential debtor population) regarding the likely disposition of future disputes. This *ex officio* signaling affects the administrative behavior of the trustee's office, the counseling behavior of the bar, and the filing behavior of the debtor population.

step in because the bankruptcy system was not acting to control abuse, that premise is disproved by these data. The BRA may turn out to be a clumsy exogenous attempt to achieve what the Br system was already accomplishing to in a more complex fashion.<sup>28</sup>

### A. Study design

The data for this Article are drawn from reported opinions of U.S. Bankruptcy Courts in consumer exemptions proceedings that contain a judicial valuation of at least one asset. The database consists of 540 observations drawn from 394 published opinions reported in the Westlaw computer database.<sup>29</sup> These cases were decided in three periods of three years each: 1980-1982, 1988-1990, and 1995-1997.<sup>30</sup> Law students, working

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<sup>28</sup> Sally Falk Moore, *Law and Social Change: The Semi-Autonomous Social Field as an Appropriate Subject of Study*, 7 LAW & SOC'Y REV. 719 (1973).

<sup>29</sup> The Westlaw search terms used to acquire the cases were “DA(AFT 1979 & BEF 1983) & SY,DI (51K2761 51K2771 51K2772 51K2773 51K2774 51K2775 51K2776 51K2777 51K2778 51K2779 51K2780 51K2781 51K2782 51K2793 163K31 163K32 163K33 163K34 163K35 163K36 163K37 163K39 163K40 163K41 163K42 163K43 163K44 163K45 163K47 163K48 163K49 163K50 163K52)”, “DA(AFT 1987 & BEF 1991) & SY,DI (51K2761 51K2771 51K2772 51K2773 51K2774 51K2775 51K2776 51K2777 51K2778 51K2779 51K2780 51K2781 51K2782 51K2793 163K31 163K32 163K33 163K34 163K35 163K36 163K37 163K39 163K40 163K41 163K42 163K43 163K44 163K45 163K47 163K48 163K49 163K50 163K52),” and “DA(AFT 1994 & BEF 1998) & SY,DI (51K2761 51K2771 51K2772 51K2773 51K2774 51K2775 51K2776 51K2777 51K2778 51K2779 51K2780 51K2781 51K2782 51K2793 163K31 163K32 163K33 163K34 163K35 163K36 163K37 163K39 163K40 163K41 163K42 163K43 163K44 163K45 163K47 163K48 163K49 163K50 163K52)” in the library “fbkr-bct”. Opinions of Bankruptcy Appellate Panels were disregarded, leaving only opinions of Bankruptcy Courts. This term yields a list of 709 cases; 194 cases for the period 1980-1982, 260 cases for the period 1988-1990, and 255 cases for the period 1995-1997. This list generated 540 observations, reported in 394 cases. Observations consist of a reported valuation of an asset by a court. Where a single case reported valuations of multiple assets, each asset was coded as a separate observation. The earliest observation in the database is from January 14, 1980. The latest observation is from December 22, 1997. The database contains consumer exemptions cases only, and is not designed to capture any “substantial abuse” cases under old section 707(b) of the Code. The findings (i.e. that sophisticated debtors are unsuccessful) is strengthened because the correlation arises in pure exemptions cases. If the database had included cases where the abuse issue was already framed, we would expect to see more observations correlating sophistication with a lack of success.

<sup>30</sup> Of the 540 observations, 486 (exactly 90%) occurred in the context of a Chapter 7 filed by a consumer debtor. 42 observations (7.78%) occurred in Chapter 13 cases, 8 observations (1.48%) occurred in Chapter 11 cases, and 4 observations (0.74%) occurred in Chapter 12 cases. All of these cases, including the “plan” bankruptcy cases in Chapters 11, 12, and 13, involved debtors who claimed personal exemptions and sought a judicial valuation. Typically the point of the valuation was to allow the exemption. Occasionally, the point of the valuation was to specify whether and how much of a lien may be avoided under 522(f). In

closely with me, coded each observation according to a coding instrument.<sup>31</sup> Following the initial coding, a substantial portion of the observations was re-coded by a different law student to test for reliability.<sup>32</sup>

An important limitation of this database is the fact that the observations are drawn entirely from published cases.<sup>33</sup> These observations are evidence of what the bankruptcy courts' are signaling about the likely disposition of future disputes. They are not evidence of debtors' post-discharge economic status. All codes in the database proceed from opinions written by judges, thus everything in the database is filtered through the judge's interpretation. These are not unvarnished facts, but the facts that the judge chose to write about in the way she chose to write about them.

Additional limitations of the database include the possibility that the computer search failed to identify relevant cases, that Westlaw misclassified some relevant cases, and that the coding process registered some "false negatives" (i.e. failing to classify an item as an "observation" despite the presence of a reported judicial valuation). Finally, these data comprise only three samples of three years each from the period after the enactment of the Bankruptcy Code through about 1998. Thus, while this database

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the "plan" cases, the exemption hearing was often used to exempt an asset (or a portion of the asset) from the estate in order to clarify payments under the plan.

<sup>31</sup> See *infra* Appendix (describing how reader can access a copy of the Coding Instrument). See generally HERBERT JACOB, USING PUBLISHED DATA: ERRORS AND REMEDIES (1984, vol. 42, Sage series on Quantitative Applications in the Social Sciences) (discussing methodology generally applicable to this study); ROBERT PHILLIP WEBER, BASIC CONTENT ANALYSIS (1990, vol. 49, Sage series on Quantitative Applications in the Social Sciences) (same).

<sup>32</sup> See Appendix, (presenting reliability statistics). An Appendix containing documents important for the replication of this study shall be maintained on the author's website. Please contact the author at [brtrujil@wisc.edu](mailto:brtrujil@wisc.edu) for more information. Appendix shall include: (i) Reliability statistics; (ii) the logistic regression used to generate Figure 10; (iii) the caselist; (iv) the Coding Instrument; and (v) the database. See generally PAUL E. SPECTOR, SUMMATED RATING SCALE CONSTRUCTION: AN INTRODUCTION, 65-67 (1992).

<sup>33</sup> An alternative term for "published" cases would be "available" cases. These cases all appear in the Westlaw electronic database. It is possible that some of them did not appear in print in the Westlaw published BANKRUPTCY REPORTER.

provides a broad sample of roughly 20 years of bankruptcy doctrine, the data are still only a sample of a larger population.

I will present some of the general features of the database, and then explain the major variables used for the statistical .

### B. General Characteristics of the Database

Figure 2 presents the distribution of cases by year during the sample periods.

**Figure 2**  
Frequency of Cases by Year

Year	Frequency	Percentage
1980	32	5.93
1981	43	7.96
1982	39	7.22
1988	67	12.41
1989	76	14.07
1990	79	14.63
1995	65	12.04
1996	56	10.37
1997	83	15.37
TOTAL	540	100.00

3 periods of 3 years each  
 1980, 1981, 1982  
 1988, 1989, 1990  
 1995, 1996, 1997

Figure 3 shows the distribution of observations, based on whether the debtor was a couple or, if single, the debtor's gender.

**Figure 3**

Frequency of Debtor by Couple and Gender

Gender	Frequency	Percentage
Male	186	34.44
Female	77	14.26
<u>Couple</u>	<u>277</u>	<u>51.30</u>
TOTAL	540	100.00

The observations are roughly evenly divided between single filers (263) and couples (277). For the sample periods, male single filers outnumber female single filers by more than two-to-one.

Figure 4 shows the types of assets that were adjudicated in the exemptions proceedings.

**Figure 4**  
Frequency of Asset Type

Type of Asset	Frequency	Percentage
Cash	311	57.59
Personal Transportation		
Vehicle	30	5.56
Homestead, non-mobile	81	15.00
Homestead, mobile	3	0.56
Tools of the Trade:		
Motor Vehicle	7	1.30
Farm Equipment	21	3.89
Farm Produce	2	0.37
Farm Real Estate	1	0.19
Non-Farm Real Estate	2	0.37
Non-Farm Blue Collar	7	1.30
Non-Farm White Collar	6	1.11
Farm Animals	2	0.37
Household Goods:		
Guns	7	1.30
Mobile Home (Not Homestead)	1	0.19
Jewelry	11	2.04
Clothing	2	0.37
Furniture	4	0.74
Other	41	7.59
Motor Boat	1	0.19
<b>TOTAL</b>	<b>540</b>	<b>100.00</b>

### C. Variables

Our dependent variable (that is, the thing we are trying to explain) is the debtor's success in the exemption proceeding. We define success in two ways: narrowly and broadly.

Success, narrowly defined, occurred when the debtor won the adjudicated exemption, and failure occurred when the court denied the debtor that exemption.<sup>34</sup>

Figure 5 presents the frequency of debtor success, narrowly defined.

**Figure 5**  
Frequency of Debtor Success, Narrowly Defined

Success	Frequency	Percentage
Debtor denied exemption (Failure)	157	39.95
Debtor takes exemption (Success)	236	60.05
TOTAL	393	100.00

We also define debtor success more broadly to include all observations of the narrow definition, plus 128 instances where the debtor won the exception, but the court limited the amount of the exemption, typically because the court adjudicated a limit imposed by another statute (e.g. limits on worker’s compensation, or amount exemptible in community property; adjudicates how much of an income tax refund is exemptible based on filing data).<sup>35</sup> Figure 6 presents the frequency of debtor success, broadly defined.

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<sup>34</sup> There were 393 observations of debtor success, narrowly defined. These include 9 observations of success in 522(f) adjudications, where the debtor was found to have a right to an exemption and allowed to avoid a lien to the extent that it impaired that exemption. *See* Code 522(f).

<sup>35</sup> Limiting an exemption in this way is not an operation of the “control parameter” in the way we have defined it. *See supra* Part II.

**Figure 6**  
Frequency of Debtor Success, Broadly Defined

Success	Frequency	Percentage
Debtor denied exemption (Failure)	157	30.13
Debtor takes exemption OR debtor takes the exemption but is limited in amount (Success)	364	69.87
TOTAL	521	100.00

Our explanatory variables (or “independent variables”) include whether the debtor is filing singly or jointly, what kind of asset is the subject matter of the exemption (e.g. a cash instrument such as a bank account or annuity, a home, a car, tools, etc.), what party initiated the proceeding (the trustee, the debtor, or a creditor), and the debtor’s “sophistication.” An observation was coded as “debtor sophisticated” only if there was clear evidence in the opinion that the debtor possessed the means to exit the usual high-volume track of bankruptcy administration, and instead had utilized attorney services and financial planners to execute a tailor-made strategy for maximizing post-discharge personal wealth.<sup>36</sup> An observation was coded as “debtor unsophisticated” only if there

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<sup>36</sup> See e.g., Heitkamp v. Dyke, 99 B.R. 343 (Bankr. S.D. Tex., 1989) (“The debtor, Marshall James Dyke, M.D., filed for relief under Chapter 7 on October 1, 1987. The debtor is the sole shareholder and director of a professional association known as the Conroe Ear, Nose and Throat Clinic. The debtor has sought to prevent the trustee, on behalf of the estate's creditors, from reaching the debtor's interest in a pension plan titled the Conroe Ear, Nose and Throat Clinic, P.A., Pension Plan and Trust (Pension Plan). The debtor is the sole trustee of the Pension Plan, and his interest in it, which is 95 percent vested, amounts to \$1,170,000.”).

was clear evidence in the opinion that the debtor lacked the means to maximize strategically her gains from the discharge.<sup>37</sup>

Figure 7 shows the distribution of debtors coded as sophisticated and unsophisticated.

**Figure 7**  
Debtor Sophistication

Sophistication	Frequency	Percentage
Clearly Sophisticated	92	17.04
Clearly Unsophisticated	51	9.44
Data did not support assigning a code	397	73.52
<b>TOTAL</b>	<b>540</b>	<b>100.00</b>

We are especially interested in the statistical relationship between the debtor’s sophistication and success. Figures 8 and 9 show the relationship between sophistication and success for the data observed in the sample. The Figures include simple tests for significance, showing a statistically significant relationship between Sophistication and a lack of Success.<sup>38</sup>

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<sup>37</sup> See e.g., In re Thompson, 103 B.R. 205 (Bankr. W.D. Missouri, 1989) (“Debtor has a high school degree through G.E.D., suffers from a blood disease (Porphyria Cutanea Tardia) which is congenital and has no known cure, owns nothing but a partially paid for pickup truck, minimal household furnishings and clothing, and has no substantial prospects for an increase in income except what he receives as a result of union negotiated contracts with his employer. Debtor presently makes \$13.47 per hour, has no insurance with substantial cash value, no annuities and only the anticipation of social security benefits plus income from the fund at the time of retirement.”).

<sup>38</sup> These simple bi-variate analyses are confirmed in the multi-variate analysis of Figure 10.

**Figure 8**

Debtor Success (Broadly Defined) by Sophistication

<b>Debtor Sophistication</b>	<b>Debtor Success (Broadly Defined)</b>		<b>TOTAL</b>
	No	Yes	
Not Sophisticated	8 (17.39)	38 (82.61)	46 (100.00)
Sophisticated	40 (44.44)	50 (55.56)	90 (100.00)
<b>TOTAL</b>	<b>48 (35.29)</b>	<b>88 (64.71)</b>	<b>136 (100.00)</b>

Note: row percentages in parentheses  
Pearson  $\chi^2(1) = 9.7555$  Pr = 0.002

**Figure 9**

Debtor Success (Narrowly Defined) by Sophistication

<b>Debtor Sophistication</b>	<b>Debtor Success (Narrowly Defined)</b>		<b>TOTAL</b>
	No	Yes	
Not Sophisticated	8 (21.05)	30 (78.95)	38 (100.00)
Sophisticated	40 (52.63)	36 (47.37)	76 (100.00)
<b>TOTAL</b>	<b>48 (42.11)</b>	<b>66 (57.89)</b>	<b>114 (100.00)</b>

Note: row percentages in parentheses  
Pearson  $\chi^2(1) = 10.3636$  Pr = 0.001

D. Regressions and Interpretations of Results

We use a logistic regression for a binary dependent variable (success = 0 or 1). The details of the are presented in the Appendix. Figure 10 reports the results of two regressions, one the broad definition of success and one for the narrow definition of success.<sup>39</sup>

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<sup>39</sup> Figure 10 includes Cash as one of the independent variables but, because of multicollinearity effects, does not contain Home (n = 15). Regressions containing Home are maintained on authors website. See

**Figure 10**  
Results: Binary Logit of Success

<i>Variable</i>	<i>Debtor Success, Broadly Defined</i>	<i>Debtor Success Narrowly Defined</i>
Sophistication	-1.810 (0.534) ** [0.164]	-2.104 (0.600) ** [0.122]
Creditor, Entity	-0.787 (0.754) [0.455]	-0.476 (0.806) [0.621]
Creditor, Nonentity	0.849 (1.276) [2.338]	-0.831 (1.513) [0.436]
Trustee initiated	-0.766 (0.790) [0.465]	-0.663 (0.870) [0.515]
Debtor Initiated	0.024 (0.837) [1.024]	-0.999 (0.876) [0.368]
Debtor is a couple	-1.178 (0.450) ** [0.308]	-1.530 (0.532) * [0.216]
Tools	-0.381 (0.937) [0.683]	0.223 (0.968) [1.250]
Vehicle	-3.968 (1.459) [0.019]	
Cash	-1.277 (0.665) [0.279]	-1.269 (0.714) [0.281]
Log Likelihood	-69.745203	-58.450987
BIC	-450.408	-335.452
Pseudo-R <sup>2</sup>	0.1659	0.1736
Observations	131	106

Standard error in parentheses; Odds ratios in brackets

Appendix re: documents maintained on author's website. The standard error for Vehicle suggests that the result for that independent variable is not reliable.

In this , we see an odds ratio<sup>40</sup> for Sophistication is 0.164 (broad success) and 0.122 (narrow success). This means that the presence of Sophistication reduced the chance of broad success by 83.6%, and reduces the chance of narrow success by 87.8%. This result is significant at the one percent level.

We also see that when the debtor is a couple, the chances of Success are reduced by 69.2% (broad) and 78.4% (narrow), and this result is also significant at the one percent level.

### E. Discussion

We find that the presence of sophistication drastically reduces the chance of success, and the presence of unsophistication dramatically increases the chances of success. This finding undermines the empirical basis of BAPCPA, and suggests that the bankruptcy system has developed patterns to control abuse of the discharge.

The finding is open to one important criticism: It is possible that there are unmeasured observations where sophisticated debtors were successful (and unmeasured observations where unsophisticated debtors were unsuccessful). Put another way, it is possible that judges only mentioned the debtors' high sophistication when the judges were prepared to find against the debtor, and that there are cases where the judge found in favor of sophisticated debtors, but chose not to mention anything about the debtors'

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<sup>40</sup> An "odds ratio" of 1 means the independent variable has no effect on the dependent variable. An odds ratio of "2" means the presence of the independent variable doubles the likelihood of the presence of the dependent variable. An odds ratio of 0.5 means the presence of the independent variable halves the chances that the dependent variable will occur.

sophistication. This is a problem in measurement known as “unmeasured heterogeneity.”<sup>41</sup>

To ameliorate this potential problem, we need to produce evidence suggesting that the unmeasured observations did not behave in the opposite manner from the observations that we did measure. Figures 11 and 12 show that, when comparing the group that we were able to code with those that we were unable to code, there is no difference in success (narrow and broad).

**Figure 11**  
Success (Broadly Defined) by Whether Sophistication was Coded

<b>Success</b>			
<b>Sophistication</b>	<b>Failure</b>	<b>Success</b>	<b>Total</b>
<b>Not Coded</b>	109 (28.31%)	276 (71.69%)	385
<b>Coded</b>	48 (35.29%)	88 (64.71%)	136
<b>Total</b>	157	364	

$X^2 = 2.3273$   
Pr = 0.127

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<sup>41</sup> See generally, James W. Vaupel & Anatoli I. Yashin, *Heterogeneity’s Ruses: Some Surprising Effects of Selection on Population Dynamics*, 39 AM. STATISTICIAN 176 (1985).

**Figure 12**  
Success (Narrowly Defined) by Whether Sophistication was Coded

<b>Success</b>			
<b>Sophistication</b>	<b>Failure</b>	<b>Success</b>	<b>Total</b>
<b>Not Coded</b>	109 (39.07%)	170 (60.93%)	279
<b>Coded</b>	48 (42.11%)	66 (57.89%)	114
<b>Total</b>	157	236	

$X^2 = 0.3112$

$Pr = 0.577$

Specifically, Figures 11 and 12 show that the uncoded observations are not statistically significantly different from the coded observations. The distribution of values in the Success variable was roughly the same across both coded and uncoded observations.<sup>42</sup> This is at least partial evidence that the observations that we did not measure did not behave differently from the observations that we did measure.<sup>43</sup>

The other significant finding is the correlation between couples-as-debtors and failure at the exemption proceeding. We find that single filers stand a significantly greater chance of succeeding in an exemptions claim than joint filers. This is true despite the fact that singles tend to be more sophisticated, as is shown in Figure 13.

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<sup>42</sup> Thanks to Peter Carstensen and Bob Lawless for help on this point.

<sup>43</sup> We can offer an educated guess that the observations we did not measure were most likely the “typical” cases of debtor with no particular sophistication receiving the discharge as a matter of administration. Such cases are unremarkable and unremarked upon, and so never rose to the level of adjudication that would put them in our database.

**Figure 13**  
Sophistication by Debtor Filing Status

<b>Debtor Filing Status</b>	<b>Sophistication</b>		<b>Total</b>
	<b>Not Sophisticated</b>	<b>Sophisticated</b>	
<b>Debtor is not Couple</b>	20 (25.97%)	57 (74.03%)	77
<b>Debtor is Couple</b>	31 (46.97%)	35 (53.05%)	66
<b>Total</b>	51	92	143

$X^2 = 6.8277^{**}$   
Pr = 0.009

We see that, if the debtor is a couple, their chances of being sophisticated are about 50/50. But if the debtor is single, the chance of being sophisticated goes up to 74/26. So the finding that couples are unsuccessful is not just a necessary corollary to the finding that sophisticates are unsuccessful.<sup>44</sup>

More generally, the data offer preliminary support for the claim that the bankruptcy legal system has self-organized to maximize the social benefit of the discharge and to minimize the social cost. Put another way, the system developed patterns to control abuse, contrary to the empirical assertions of BAPCPA and its proponents.

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<sup>44</sup> More work must be done to specify the potential correlation between couples and failure. One preliminary theory for why judges might be harder on couples than singles is demographic: there is some sociological evidence that marriage acts as a risk-spreading device and that unmarried consumers are thus in greater need of receiving the support of a social safety net in the form of the discharge. *But see* Warren and Tyagi (arguing that two-income couples double their risk of failure caused by job loss).

## **CONCLUSION: TOWARD A “NO-FAULT” APPROACH TO DEBT REGULATION**

There appears to be no empirical support for the claim that bankruptcy abuse explains increased filing rates. What, then, explains the dramatic rise in bankruptcies? If blame-the-borrower does not work, how about blame-the-lender?

The not-so-secret dirty little secret of the bankruptcy reform legislation is that it has been motivated by something weightier and more fundamental than Congress’ yearning for a more financially responsible middle class. The largely unspoken premise of BAPCPA was that bankruptcy, because it bars collection efforts on discharged debts, had made too expensive the lenders’ project of market expansion. Lenders want to expand the lending market. They want to lend more money through more instruments to more borrowers. And they want to shift the risks of this market expansion away from themselves.

I would like, for the moment, to put to one side what is obviously lenders’ self interest in this project of market expansion and cost shifting. Instead, I would like to offer a bare assertion: suppose there is something structural about the consumer credit phenomena that we have observed in the last several years. Innovations in, and access to, consumer credit have undergone a rapid evolution. It seems unlikely that these forms will simply fade into the shadows, leaving society and economy as once it was. Rather than hankering after an imagined equilibrium, it is a more pressing task for lawyers and regulators to measure and comprehend the far-from-equilibrium system we possess.

I would like to close by suggesting two arguments by analogy: health care and

accidents. David Cutler's recent work<sup>45</sup> traces a progression of comprehending health care as a structural change in the U.S. economy. Analyses of health care (and consumer credit) conventionally begin with the observation that we are consuming much more of it than we used to. Suggested remedies often involve some form of rationing – force providers to bear more risks, price more consumers out of the market. Cutler's "Aha!" moment came when he realized that perhaps the U.S. economy is consuming the right amount of health care, even if that amount is much more than it was even a short time ago. The task for regulators then becomes adapting old institutions to new phenomena, rather than trimming the consumption of health care to pre-surge levels.

Guido Calabresi's classic *Costs of Accidents* begins with the understanding that horse and buggy accidents law is insufficient to the task of regulating a complex system characterized by a new transportation form called the automobile.<sup>46</sup> In the system in which we live, accidents happen so frequently as to utterly overwhelm a case-by case, who's-at-fault method of cost settlement. Calabresi's work beckoned us to look beyond the point-to-point linearities and turn to a system-wide investigation of patterns recurrent in the mass of data, patterns that can be regulated and controlled. Thirty-five years after *Costs of Accidents*, our institutions have changed but our habits of mind remain the same.

New technologies of transportation, new forms of consumable services and finance pass through a system, dominating it, re-characterizing it. And the first job of the regulator is to see what is there.

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<sup>45</sup> DAVID M. CUTLER, *YOUR MONEY OR YOUR LIFE* (2004).

<sup>46</sup> GUIDO CALABRESI, *THE COSTS OF ACCIDENTS* (1970).