**BANKRUPTCY BY THE NUMBERS**

## One Hand Clapping: What We Know, and Still Need to Know, About Consumer Cases

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Lamenting the lack of objective information about the realities of consumer bankruptcy has a track record that goes back at least three decades, when David Stanley and Marjorie Girth introduced their landmark study of cases under the Bankruptcy Act in 1967 with the observation that "bankruptcy has received only sporadic attention from scholars and is ignored by the news media except when some movie star or business tycoon appears in bankruptcy court."[1]

Thirty years later the Final Report of the National Bankruptcy Commission expressed the same concern even more vividly: "In short, the bankruptcy system operates behind a veil of darkness created by the lack of reliable data about its operations. The lack of information about 'what is going on' in the bankruptcy system leads to a distrust of its results–-a belief by some that creditors, debtors and professionals within the system are all somehow taking advantage of one another and the public at large, and that the system suffers from widespread fraud, abuse and inefficiency."[2]

In this column I emphasize four points concerning the state of our ignorance about consumer bankruptcies.

1) There is a growing consensus, based on good data, about some basic financial attributes of consumers in chapter 7. At the same time, there are continuing vigorous disputes about other characteristics of these debtors.

2) Our knowledge of chapter 13 debtors is even more

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[1]David T. Stanley and Marjorie Girth, *Bankruptcy: Problem, Process, Reform.* Brookings Institution,1971. At 1.

[2]*Bankruptcy: The Next Twenty Years.* National Bankruptcy Review Commission Final Report. October 20, 1997. At 924.

fragmentary. There are several reasons for this, but none is so major that it prevents the development of thorough nationwide profiles of chapter 13 cases that can be used, along with chapter 7 data, to illuminate the grounds on which policy can be debated.

3) Comparisons of debtors participating in chapter 7 and chapter 13 cases are particularly important right now. The means-testing provisions of the final Conference Report on H.R. 3150, the Bankruptcy Reform Act of 1998, could move a very large number of would-be chapter 7 filers into chapter 13.[3]

4) All public and private entities that have key data to contribute to developing clear pictures of the two consumer bankruptcy environments should act in concert to build an information resource that is agreed upon by all as accurate and germane to informing policy discussions.

**Consensus and Dispute about Chapter 7 Debtors.**

There is rough consensus about the income distribution of relatively recent chapter 7 filers. Thus, the authors of the ABI-supported study of approximately 2,000 cases could bring their agreement *on this variable* to within a couple of percentage points of the results reported by Ernst & Young in a study supported by VISA.[4] Other studies over similar populations are likewise in general agreement about the income distribution of chapter 7 debtors.

This common ground is important because legislative

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[3]See Flynn, Ed, and Gordon Bermant, *Measuring Means-Testing: It's All in the Words.* 17 A.B.I.J. 1,30-31 (September, 1998).

[4] Culhane, Marianne B., and Michaela M. White, *Means-Testing for Chapter 7 Debtors: Repayment Capacity Untapped?* American Bankruptcy Institute, 1998; Neubig, Tom, and Fritz Scheuren, *Chapter 7 Bankruptcy Petitioners' Ability to Repay: The National Perspective, 1997.* Ernst and Young, LLP (March, 1998); *see Chapter 7 Debtors Unable to Repay Debts, Study Reveals; Creditors' Study Refuted. 10* BNA Bankruptcy Law Reporter 1192 (December 3, 1998).

proposals for means-testing have so far all begun with comparisons of debtor gross income with national median incomes. Other areas of agreement are likely to be found regarding amounts of secured, priority, and unsecured debt, that is, values that are available directly from schedules provided at or near the time of filing.[5]

At this time, there is little agreement about the "bottom line" of current means-testing proposals: that is, how much would general unsecured creditors recover if some debtors were required to file for five-year chapter 13 repayment plans instead of filing for chapter 7 liquidation? Maximum estimates are five to eight times greater than minimum estimates. Much of the difference between the bottom lines arises from differences between judgment calls that the authors had to make in order to run the numbers as called for by the legislation.

This sort of disagreement is not inevitable. If all the participants in this research shared their data and described their calculations completely, arguments about apparent factual discrepancies could more quickly be replaced by debates over competing policy positions.

**Understanding Chapter 13 Debtors and Cases**

Information aggregated to a national level about the course and contents of chapter 13 cases has not been as readily accessible as chapter 7 data. Once a plan has been confirmed, the court records do not track the course of the debtor's progress until the plan is completed or there is a problem that comes to the court's attention, (e.g., motions to modify, convert, or dismiss). Hence, there is no court-based national compilation of the course of debtors' progress through chapter 13. All of the important information does exist in the offices of the chapter 13 trustees, but not all of it is aggregated to a single location.

Finally, the information about chapter 13 collected by the U.S. Trustees is not organized in terms of individual case files, which is an essential feature of the database required to support policy analysis.

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[5] There is of course the separate question of how accurate the scheduled values are.

These circumstances arose naturally and appropriately out of the different needs of the entities managing the chapter 13 environment. Until recently, there has not been a pressing need to know how the environment operates in great detail: now there is.

**The Consequences of a New Policy**

The intended effect of means-testing is to channel some debtors into chapter 13 instead of chapter 7 for the purpose of returning more money to general unsecured creditors than the creditors would otherwise receive. Bottom-line assessments of the benefits of this move depend in part on assumptions about the actual effectiveness of chapter 13 as a collection device. Among the solid facts now in hand are the amounts returned annually to creditors from chapter 13 plans. For calendar year 1997, for example, these were $1.34 billion to secured creditors, $289 million to priority creditors, and $466 million to the general unsecured creditors[6].

We also need to know follow-up facts such as: What proportion of the debts owing under the plans during the year did the collected amounts represent? How does the success vary across different financial profiles of debtors and the particular characteristics of chapter 13 plans?[7]

Answers to such questions can assist the development of rational, empirically based policy choices for implementing means tests or other need-based statutory amendments. Without them, our knowledge of chapter 7 debtors and fragmentary understanding of chapter 13 outcomes is like one hand clapping: unfulfilled potential for a positive outcome.

**What Can Be Done?**

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[6] Information supplied by the Executive Office for U.S. Trustees. The figures do not include cases from North Carolina and Alabama, which account for approximately 10% of all chapter 13 filings, though not necessarily 10% of collections.

[7] To mention just two relevant plan characteristics: Were ongoing mortgage payments handled inside or outside of the plan? How do these proportions of actual payback relate to the proposed length of the plan?

The prescription for progress is easy to state and probably quite difficult to achieve-the public and private entities with major stakes in consumer bankruptcy policy should cooperate to develop a national database and a set of protocols for testing major questions about the likely outcomes of chapter 13 administration under means testing plans with known parameters.

There is now and likely always will be a divergence of goals between the creditor community and debtor advocates. However, this divergence need not extend to the question of what are the facts to gather about current debtors, and what questions should be asked about how legislative changes may affect the pool of debtors and their demonstrated abilities to repay their debts.

Obtaining sound answers to such questions is in the collective best interest.