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James J. White

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# Abuse Prevention 2005

James J. White<sup>1</sup>

## I. INTRODUCTION

The 2005 amendments to the Bankruptcy Code (BAPCPA<sup>2</sup> or Act) that became effective in October of 2005 had an unusually long and difficult gestation. The legislation was conceived and even passed by Congress once during the Clinton administration. After President Clinton's pocket veto, the Act did not again reach a President's desk until President George W. Bush signed the Act into law on April 20, 2005, during the first year of his second term.

The Act was conceived by institutional unsecured consumer creditors as the antidote to the rapidly rising number of consumer bankruptcies that followed the enactment of the new Code in 1978. In the first year of the Code of 1978 there were about 250,000 bankruptcies;<sup>3</sup> by 2004 that number was more than 1.5 million.<sup>4</sup> The principal advocates of BAPCPA were the issuers of credit cards. Other consumer lenders, such as the credit unions, joined the card issuers, but consumer creditors who lent only against valuable security such as cars and homes were unenthusiastic.

At first the political support for the Act in the House of Representatives was bipartisan.<sup>5</sup> There was never significant Democratic support in the Senate and, as the legislation lingered in Congress, Democratic support in both houses melted away. In 2005 the Act passed the Senate by a 74 to 25 vote<sup>6</sup> and the House by a 302 to 126 vote.<sup>7</sup>

The political division (Democrats favored the debtors' case and Republicans favored the creditors' case) echoed a similar intellectual division among bankruptcy scholars and within the bar. The position of scholars and lawyers on the need for change in the 1978 law, or, differently, whether there

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1. Robert A. Sullivan Professor of Law, University of Michigan Law School.

2. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.).

3. Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U. L. REV. 1463, 1464 (2005).

4. *Id.*

5. See generally Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 485 (2005).

6. The Senate roll call vote is available at <http://www.senate.gov> (follow "Votes" hyperlink; then follow "2005 (109th 1st)" hyperlink; then follow vote "00044" hyperlink).

7. The House roll call vote is available at <http://clerk.house.gov/evs/2005/roll108.xml> (S. 256 passed the House with a vote of 302 to 126 (all Republicans and 73 Democrats)).

is “abuse” of the bankruptcy law, depends on one’s view of the causes of the rise in bankruptcy filings.<sup>8</sup> For example, that difference in view explains the disagreement between Professor Warren,<sup>9</sup> the liberal leader of the majority of the National Bankruptcy Review Commission, and Judge Edith Jones,<sup>10</sup> the conservative leader of the minority in that Commission. Professor Warren would not ascribe the rise in filings to debtors’ abuse of the system, but only to appropriate use; Judge Jones would argue that many of the million and a half bankrupts were using the bankruptcy law in ways that were not justified and not contemplated by the drafters of the 1978 law.

The conventional model of consumer bankruptcy assumes a debtor who will file only when some event beyond his control, such as a large health expense, divorce, or loss of a job, drives him over the edge. Of course the consumer can choose to skate nearer the edge, and if he does, a smaller puff of wind will push him over than if he were more cautious. To conform strictly to this benign model, defenders of the status quo must claim that the wind is rising and that more consumers are going into bankruptcy because of increased health care costs, greater job loss and the like. One willing to relax the model a little might defend the consumer’s willingness to skate near the edge by blaming creditors, particularly credit card companies or gambling emporiums, for encouraging consumers to take on excessive debt.<sup>11</sup>

Opponents of BAPCPA generally embrace the conventional model. They argue that health care costs are rising, that job loss is widespread and that other economic shocks explain the rise in filings.<sup>12</sup>

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8. See generally Zywicki, *supra* note 3 (providing an analysis of the traditional model as compared to the alternative model as an explanation for rising bankruptcy filings).

9.

The sharp rise in bankruptcies . . . cannot be attributed primarily to a group of “well-off” debtors who have decided that filing bankruptcy is somehow easier than paying the monthly bills. While some debtors in bankruptcy no doubt file for reasons that are illegitimate, most families come to the bankruptcy courts as they have for many years - seeking relief from debts they have virtually no hope of repaying.

REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION 83 (Oct. 20, 1997), available at <http://govinfo.library.unt.edu/nbrcreport/05acons.pdf>.

10. Jensen, *supra* note 5, at 496 (“[M]ost bankruptcy is availed, nowadays, by the middle class. And most — many — bankruptcies, now, are filed by people who are income-earning when they file. The increase in medical expenses, divorce, and losses of jobs simply cannot explain the increase that we face today. I think gambling is involved. I think there is a decreased social stigma.”) (quoting NATIONAL BANKRUPTCY REVIEW COMMISSION REPORT: HEARING BEFORE THE SUBCOMM. ON COMMERCIAL AND ADMINISTRATIVE LAW OF THE H. COMM. ON THE JUDICIARY, 105th Cong. 2-3, at 33 (1997) (statement of Hon. Edith H. Jones)).

11. Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L.J. 1079, 1083 (1998).

12. See generally Elizabeth Warren, *The Growing Threat to Middle Class Families*, 69 BROOK. L. REV. 401 (2004).

The opposing model of current consumer bankruptcy behavior says that the frequency and severity of the economic shocks are not greater than they formerly were: the wind is not rising. Critics maintain that the increase in filings is attributable to the disappearance of shame and to the new generosity of the bankruptcy law that came with, and as a result of, the Code of 1978.<sup>13</sup> Using earlier rates of filing, proponents of BAPCPA characterize many recent filings as “abusive” because, according to proponents, filers have not been pushed into bankruptcy by an unexpected gust of wind. Instead, the filers have jumped in. According to the critics, a choice to file by a consumer in 2004 is an abuse if a hardier consumer in similar economic circumstances in 1975 would have suffered his fate without filing.

Critics of the conventional model note several points. First, they point out that, whereas the current rise in filings came while the economy was healthy and interest rates were low, earlier bankruptcy booms occurred when the economy was depressed. Second, they acknowledge that debt as a percentage of income is higher now than previously, but they argue that the percentage of consumers’ income necessary to service the new debt is not larger than it was in the 1970’s. This is because much of the consumer debt is long term and at lower rates than comparable consumer debt in earlier periods. They also challenge the assertions that consumers now have more health care debt or that job loss and divorce are growing.<sup>14</sup>

Congress adopted the critics’ view of the bankruptcy world; the title of the Act — Bankruptcy Abuse Prevention — proclaims Congress’s belief that many of the people filing bankruptcy were drinking from a cup that was not intended for them. Today I do not debate the empirical question (what is the cause of the increase in bankruptcy filings?) nor do I address the buried moral question (who deserves the protection of bankruptcy law?). Rather, I speculate about the consequences of BAPCPA and about the reasons it will achieve or fail to achieve the goals of its sponsors. Along the way I hope to learn something about how law changes, or fails to change behavior.

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13. Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1 (1987).

14. See Zywicki, *supra* note 3, at 1540

([T]he rising consumer bankruptcy filing rate over the past several years is not the result of increasing economic distress, but, rather, from the result of an increasing propensity for American households to file bankruptcy in response to economic problems. . . . Problems of unemployment, divorce, health, and indebtedness have been a part of the human condition since human societies have existed. The underlying problems are not therefore what is novel. Rather, it is the increasing willingness of individuals to use bankruptcy as a response to those underlying problems.).

See also Glenn B. Canner & Charles A. Luckett, *Payment of Household Debts*, 77 FED. RES. BULL. 218, 222-23 (1991).

## II. THE BANKRUPTCY ORGANISM

Predicting the consequences of the enactment of a law like BAPCPA is especially difficult because it must affect an exceedingly complex organism. That organism is made up of debtors, debtors' lawyers, non-lawyer "petition preparers" panel trustees (for Chapter 7 cases), Chapter 13 trustees, the U.S. trustee, creditors and their lawyers and, of course, bankruptcy judges. Each of these parts of the organism has its own incentives and each of those incentives will be affected in somewhat different ways by the Act. In its own way, I suspect that every part of the organism except for creditors is an enemy of BAPCPA.

The principal target of the Act was the debtor. The most widely discussed goal of the creditors was to force many out of Chapter 7 and into Chapter 13. A set of less vocal creditors must also have hoped that the changes in Chapter 7 and Chapter 13 would dissuade many debtors from filing in any chapter.

Under the Act the debtor has a new set of duties that will make Chapter 7 a less welcoming place. The debtor must produce documents that were not always required before. He must produce at least one, and sometimes more than one, tax return.<sup>15</sup> He must present pay stubs from wages paid during the 60 days before the filing.<sup>16</sup> Failure to file the tax information, pay stub and other information required by 707(a)(1) within 45 days after the filing causes "automatic" dismissal of the case.<sup>17</sup> The debtor must submit to a "briefing" concerning credit counseling as a condition to his right to file<sup>18</sup> (and must complete an "instructional course concerning personal financial management" as a condition to his right to a discharge).<sup>19</sup>

The debtor's lawyer, as a professional whose bread comes from bankruptcy, is even better informed and at least as interested in the law as the debtor. Several parts of the Act speak directly to the debtor's lawyer. Making the lawyer's signature a certification that he has done a "reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion" and that he has "determined that the petition, pleading, or written motion . . . is well grounded in fact"<sup>20</sup> has already attracted the attention of debtors' lawyers. And, of course, lawyers have not missed the invitation in Section 707 (b) to creditors and trustees to ask for civil sanctions.<sup>21</sup>

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15. 11 U.S.C. § 521(f) (Supp. V 2005).

16. *Id.* § 521(a)(1)(B)(iv).

17. *Id.* § 521(i)(1).

18. *Id.* § 109(h).

19. *Id.* § 727(a)(11).

20. *Id.* § 707(b)(4)(C).

21. Jennifer Emens-Butler, *Bankruptcy Reform: Gather 'Round Children, Yes, the Sky is Falling*, 31 VER. B. J. 26, 29 (2005).

According to Section 110, “bankruptcy petition preparer[s]” are neither lawyers nor persons who work under lawyers’ supervision; Section 110 describes them as persons who “prepare[] for compensation a document for filing.”<sup>22</sup> Presumably these persons occupy the bottom rung in the bankruptcy organism’s hierarchy. In its revised form, Section 110 is an extended admonition to these persons to eschew the practice of law, despite the fact that they are doing what a debtor’s lawyer might otherwise do. I suggest below that petition preparers might benefit from the Act; work that formerly went to lawyers may now come to them as the less expensive source of a filing.

Fulfilling the other new requirements that the Act imposes on the debtor will mostly fall on the lawyer’s shoulders. For example the debtor’s lawyer will have to buy a new software program or otherwise figure out how to determine whether his client qualifies for Chapter 7. And the lawyer will have to shepherd his client through the credit counseling briefing that must precede the filing<sup>23</sup> and, probably, guide him through the financial management course that is a condition to discharge.<sup>24</sup>

The U.S. Trustee, an office created by the 1978 Code to relieve judges of most of their administrative duties,<sup>25</sup> has just begun to find its footing. Never a part of the comfortable network made up of lawyers for creditors and debtors and of the panel trustees, the U.S. Trustee nominally owes his allegiance to the Justice Department, not to the local judges or to the local bar. My impression is that various U.S. Trustees have carved different niches in different places and that their behavior has been a function of the personality and idiosyncrasies of the person holding the office in a particular district. BAPCPA takes several steps toward making the U.S. Trustee into the local sheriff whose badge comes from Washington. Whether the people in Washington can make the U.S. Trustees kick ass and take names remains to be seen.

Even though the Chapter 7 trustees (trustees that are chosen for each Chapter 7 case from a panel of standing trustees) are critical players, they are rarely addressed by name in the Act (*e.g.*, 521(e)(2), (i)(4)). That omission is misleading, for these trustees are included in the generic “part[ies] in interest,”<sup>26</sup> and they are the cops on the beat who must confirm that the debtor and his lawyer have made the proper disclosures and that the debtor’s lawyer has correctly determined the debtor’s eligibility for Chapter 7. Presumably the

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22. 11 U.S.C. § 110(a)(1) (Supp. V 2005).

23. *Id.* § 109(h)(1).

24. *Id.* § 727(a)(11).

25. *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 827 (1st Cir. 1990) (“The legislative history of the statute indicates that the office of U.S. Trustee was created by Congress for the express purpose of taking on many of the ministerial and administrative duties previously borne by bankruptcy judges . . .”).

26. 11 U.S.C. § 707(b)(1) (Supp. V 2005) (granting any “party in interest” the power to make a motion to dismiss the case without debtor’s permission or convert it to Chapter 13).

trustees — in addition to the debtors' lawyers — will feel any heat that comes from audits that will first be performed in 2007.<sup>27</sup> These trustees have one year appointments from the U.S. Trustee. Trustees are routinely reappointed, but the U.S. Trustee's power to decline to reappoint gives the sheriff some power to make the trustees conform to his wishes in their administration of Chapter 7 cases. If, for example, the audits in a particular district show that certain trustees routinely turn up more assets than others, that might be a basis to deny reappointment to those who have not hunted as diligently as others for undisclosed assets.<sup>28</sup>

Creditors, particularly unsecured creditors, have the most to gain from an aggressive application of BAPCPA. Unsecured consumer creditors, particularly credit card issuers, built the fire under Congress that passed the reform. If many of the consumers who now file in Chapter 7 could be shunted into Chapter 13, unsecured consumer creditors would benefit in two ways. First, they would benefit from the three or five years of payments from the debtor. Second, they would benefit from the fact that the imposing barriers to the completion of a Chapter 13 might cause many to abandon bankruptcy altogether.

But creditors' motivation to use their new powers to challenge the debtor is muted. First, every creditor who procures a dismissal, a conversion, or a sanction against a debtor's lawyer is doing not only his own work but also the work of every other creditor of this debtor. No creditor owns as much as half of the credit card market<sup>29</sup> and none is likely to dominate other unsecured consumer lending in any market, so any debtor with significant debts will owe money to more than one institutional creditor. Second, since the failures of debtors and debtors' lawyers are likely to be ad hoc and varied, such peccadilloes cannot be cured by a few precedents; to change the behavior of debtors and debtors' lawyers will require persistent attention and repeated and costly court appearances. I wonder how many creditors have the stamina to pay persistent attention to these issues, particularly when much of the payoff will go to others.

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27. 28 U.S.C. § 586(f) (Supp. V 2005). It is currently unclear what the result of the audits will be, and to what actors in the organism the audits will be directed. It remains to be seen whether the audits will seek to discover when assets are discovered by some trustees and not by others, or whether the audits will merely seek to ensure that the proper paperwork has been filed. If the latter proves true, the audits will likely not have much impact.

28. Hon. Steven W. Rhodes, *An Empirical Study of Consumer Bankruptcy Papers*, 73 AM. BANKR. L.J. 653, 678 (1999); see also Hon. Steven W. Rhodes, *A Preview of "Demonstrating a Serious Problem with Undisclosed Assets in Chapter 7 Cases,"* 2002 No. 5 NORTON BANKR. L. ADVISER 1 (2002).

29. Fouad H. Nader, *The Credit Card Industry: Background Paper No. 15*, at 5 (2005), [http://www.upu.int/news\\_centre/2005/en/paper\\_2005-08-15\\_pitney-bowes15\\_en.pdf](http://www.upu.int/news_centre/2005/en/paper_2005-08-15_pitney-bowes15_en.pdf) (last visited Oct. 18, 2006).

Even among consumer creditors interests diverge. If one of the goals of BAPCPA is to make bankruptcy as a whole more costly and unpleasant (and, as a result, reduce the number of filings), that goal is undermined by the creditors who are prepared to make new loans to debtors immediately after they exit bankruptcy court.

Even within the bankruptcy process, creditors' interests diverge. For example, a secured creditor may be happy to have his debtor in Chapter 7 where he can get a reaffirmation, not in Chapter 13 where the debtor may be able to strip down the creditor's lien.

The judges are only indirectly affected by BAPCPA, but in the end they may have the most important role in determining its impact on the bankruptcy organism. To the extent that creditors or trustees are moved to challenge debtors by motions to dismiss and by motions for sanctions against their lawyers, judges' rulings on those motions might have a long-lived impact on the administration of consumer bankruptcies. In a jurisdiction where judges routinely dismiss cases and where painful sanctions are given, debtors' lawyers will quickly learn. And in jurisdictions where that does not happen, debtors' lawyers will learn even more quickly.<sup>30</sup>

Except for the creditors and debtors, every person identified above depends on bankruptcy for his living. The judges and U.S. Trustee earn a fixed income that is not directly dependent on the number and kind of bankruptcy cases.<sup>31</sup> But the debtors' lawyers, the Chapter 7 and Chapter 13 trustees and even the creditors' lawyers earn an income that is tied to the number of bankruptcy cases. The trustees take a percentage of the assets in the estates that they administer and earn a flat \$60 for each no asset Chapter 7 case.<sup>32</sup> Typical debtors' lawyers charge a flat fee that is paid in advance. Creditors' lawyers individually negotiate fees that might be assessed by the hour or by the case or on some other basis. So more cases means more pay for almost all of the lawyers and for all of the trustees. To reduce bankruptcy to zero is against the economic interest of every one of these persons except for the creditors. To reduce bankruptcy at all is contrary to the economic interests of the lawyers and trustees.

I predict that, covertly or openly, every member of the bankruptcy organism (save creditors) will resist BAPCPA's efforts to reduce the total number of consumer cases and to move cases from Chapter 7 to Chapter 13. But whether his true motives for resistance are ulterior or arise from a sincere disagreement with the substance of BAPCPA, none will justify his opposition by reference to his own economic interests; each will pay tribute to the debtor's needs.

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30. For an examination of the lawyer's obligations under BAPCPA see *infra* Section IV.

31. 28 U.S.C. § 154(a) (Supp. V 2005).

32. 11 U.S.C. § 330(b) (2000)



## III. SUBSTANTIVE CHANGES

To give a basis for speculating on the effect of BAPCPA, I summarize the substantive and procedural changes brought by the Act.<sup>33</sup> Dividing the provisions of BAPCPA into substantive and procedural categories is necessarily arbitrary; I do it because I think it helps one to understand how the various provisions of the Act might affect the bankruptcy organism.

The principal substantive change was to exclude debtors with a specified level of free cash flow from Chapter 7. This exclusion is accomplished by making a filing presumptively abusive (and so dismissible) under Section 707 if the debtor's free cash exceeds the specified amount. Much has already been written about how to compute a debtor's "monthly income" so as to determine whether that income, less chargeable expenses, will exceed \$6,000 (or in some cases another number between 6,000 and 10,000) over five years.<sup>34</sup> How to compute those numbers, I leave to others.

One provision inhibits repeat filing;<sup>35</sup> another deprives short term repeat filers of the benefit that they hope to enjoy.<sup>36</sup> Whereas under BAPCPA no one who has been discharged in a Chapter 7 case may file again in Chapter 7 until eight years have passed from the first filing,<sup>37</sup> the former law allowed refiling after only six years. Other provisions generally extend the times between filings for other combinations involving Chapter 7 and Chapter 13.<sup>38</sup> Debtors who file to enjoy the immediate benefits of the stay but who allow their cases to be dismissed will now be cut off from the stay after 30 days on the second filing within a year, and will not get the benefit of the stay at all if they file a third time during one year.<sup>39</sup>

Two provisions strengthen the bar to discharge debt incurred shortly before bankruptcy. Debt incurred within ninety days of filing of more than \$500, and cash advance loans for more than \$750 within 70 days are now

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33. I refer only to changes applicable to consumer bankruptcy. I ignore the handful of important changes to Chapter 11.

34. Michael Barnett, *Analysis of Consumer Provisions of BAPCPA*, <http://www.hillsboroughbankruptcy.com/1017checklist.htm#MeansTest> (last visited Oct. 18, 2006).

35. 11 U.S.C. § 727(a)(8) (Supp. V 2005).

36. *Id.* § 362(c)(3)-(4).

37. *Id.* § 727(a)(8).

38. Debtors who have previously filed a Chapter 7 case must wait eight years before filing Chapter 7 again, *id.* § 727(a)(8), and four years before filing under Chapter 13, *id.* § 1328(f)(1). Debtors who have filed a Chapter 13 case must wait six years before filing a Chapter 7 case (unless they have paid one hundred percent of allowed unsecured claims, or seventy percent of such claims, and it is deemed the debtor's best efforts), *id.* § 727(a)(9), and two years before filing a Chapter 13 case, *id.* § 1328(f)(2).

39. *Id.* § 362(c)(3)-(4).

presumed to be not dischargeable.<sup>40</sup> In the first case the reach back period is extended from 60 to 90 days, and in the second it is extended from 60 to 70. In the first case the threshold was lowered to \$500 from \$1,225, and in the second from \$1,225 to \$750.

The stay no longer protects the debtor from eviction from his apartment if the lessor has obtained a “judgment for possession” before the case was filed.<sup>41</sup>

Section 506(a)(2) directs the use of the retail value — not wholesale or value that might be realized on repossession — to measure the value of a secured creditor’s interest in consumer collateral. This provision will affect the amount that a consumer would have to pay to redeem his collateral under Section 722 and it will require that a debtor in Chapter 13 pay full retail value to a secured creditor whose lien is being stripped down. Assume, for example, that a debtor has given a security interest in his car for a debt of \$25,000, and that the car has a retail value of \$20,000 and a wholesale value of \$14,000. To redeem the car the debtor will have to come up with \$20,000, and in Chapter 13 he will be permitted to treat only \$5,000, not \$11,000, of his \$25,000 debt as unsecured.<sup>42</sup>

Under Section 521(a)(6) a secured creditor may repossess and sell personal property collateral unless within 45 days after the Section 341 meeting the debtor redeems it under Section 722 or reaffirms the debt. If the value of the collateral exceeds the amount of the creditor’s claim, the creditor may choose to repossess. The burden is on the debtor and his lawyer (or on the trustee if he is interested) to move the court to keep the collateral in the estate. Since reaffirmation is often the secured creditor’s best hope of recovery, few are likely to rush to repossess as long as reaffirmation is possible.

Chapter 13 is tougher on debtors under the Act in at least three ways. First, more Chapter 13 cases will have to extend for five years now than in the past.<sup>43</sup> Second, debtors may not strip down purchase money security interest on cars if the security interest was created within 910 days of the filing. There is a similar prohibition on strip downs on other collateral as to security granted within one year of the filing.<sup>44</sup> Third, the Act does away with the

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40. *Id.* § 523(a)(2)(C).

41. *Id.* §§ 362(b)(22), (l).

42. 11 U.S.C. § 506(a)(2) (Supp. V 2005) essentially codifies the decision of the Supreme Court in *Associates. Commercial Corp. v. Rash*, 520 U.S. 953, 955-956 (1997) (stating that the correct value that a debtor must pay to retain possession under a Chapter 13 plan is the replacement value of the collateral); *Cf. In re Cole*, 252 B.R. 66, 68 (Bankr. E.D. Va. 1999) (allowing the use of the purchase price of the car as the cramdown value when the car was purchased within two and a half months of the filing).

43. 11 U.S.C. § 1322(d).

44. *Id.* § 1325(a)(5), (9). It is not clear from the text of the statute whether the one year term is limited to purchase money loans.

super discharge.<sup>45</sup> Formerly some debtors were enticed to Chapter 13 by the offer of a more generous discharge than was available in Chapter 7. For example, a debt incurred after the debtor had formed an intention to file may not be discharged in Chapter 7 because it was procured by actual fraud or by false pretenses and is so excepted from the Chapter 7 discharge by Section 523(a)(2). Under the Act the fraud exception will apply equally in Chapter 13 cases.

Below I return to the question of what impact this small bag of substantive changes is likely to have on the bankruptcy organism. All but the diversion of debtors from Chapter 7 into Chapter 13 seem like pretty small potatoes, but it is too soon to be sure.

#### IV. PROCESS AND PROCEDURE CHANGES

There are many new hurdles for the debtor. The debtor must get the Section 342(b) notice from his lawyer or from the clerk. This notice tells about the forms of bankruptcy and warns of the dire consequences that can come to one who conceals assets or otherwise misrepresents his finances in his bankruptcy filing. The debtor must have a credit counseling “briefing” to be eligible to file and must complete a “personal financial management course” to be eligible for a discharge in Chapter 7. Section 521 requires a recent pay stub and a tax return. That Section also obliges disclosure of monthly income and explanation of how it was calculated together with a statement of anticipated increases in income.

In Chapter 13 the debtor must file four years of tax returns<sup>46</sup> and annual meetings and disclosures.

In truth, all of the debtor’s duties become the duties of his lawyer. It will be the lawyer who arranges for the credit briefing and for the personal finance course. The lawyer will prepare the documents and hound the debtor for his tax returns. But the Act puts more weight on the lawyer’s shoulders by making his signature a “certification” of his “reasonable investigation” that would allow him to determine that the claims put forward and the statements made are “well grounded in fact.”<sup>47</sup>

A troublesome rite for a debtor’s lawyer is the condition to certain debtor’s reaffirmations that his lawyer “certify” that the reaffirmation does not “impose an undue hardship on the debtor” or his dependents. This requirement comes from the existing Code, but the Act raises the ante. Now the lawyer must give his opinion that “the debtor is able to make the payment” in any case where there is a “presumption of undue hardship” because of the

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45. *Id.* § 1328(a)(2).

46. *Id.* § 1308.

47. *Id.* § 707(b)(4).

debtor's low income.<sup>48</sup> Is the lawyer now the guarantor of the debtor's promise? Does the lawyer have liability if his opinion is wrong or given without adequate investigation or consideration of the debtor's finances?

The act contemplates audits of one out of 250 filings.<sup>49</sup> Since this requirement does not take effect until sometime in 2007, it is hard to tell exactly what the audits will disclose, and, more important, no one knows how the Attorney General and the U.S. Trustees will use the audit results. Will they disclose substandard work by some Chapter 7 trustees and cause those trustees to lose their jobs? Perhaps. Will they disclose patterns of understatement of debtors' income by some lawyers and bring sanctions down on them? Perhaps. Or will they be co-opted by the bankruptcy organism and so become just another irritating bureaucratic detail? Perhaps.

Here is a formidable array of new procedural requirements. It is the nature of process rules that they have great potential to change the organism to which they apply and that their effect is covert and hard to predict. I speculate about the consequences of these procedures below.

## V. THE CONSEQUENCES

Put yourself in the position of a consumer creditor in 1994.<sup>50</sup> Assume that you believed that the rise in bankruptcies was attributable to the decline in bankruptcy shame and that abuses such as the taking on of more debt in anticipation of bankruptcy and the hiding of assets were widespread. Because of those beliefs you feel morally justified in doing almost anything that will make consumer bankruptcy less widely available.

What would you do? You would expect a friendly Congress, but you would know that the bankruptcy organism, including bankruptcy scholars and powerful members of Congress like Senator Kennedy, would oppose you.

Some of the most efficacious solutions to your problems would have to be dismissed out of hand. For example, requiring a red "b" to be tattooed on a debtor's forehead as a condition to a discharge would more than reinvigorate bankruptcy shame, but the anathema associated with the similar public humiliation of Hester Prynne would make that simple solution unpalatable even if it were thought morally defensible.

In the same category would be the solution that was practiced several times during the 19<sup>th</sup> century to abolish bankruptcy.<sup>51</sup> But the continuous

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48. *Id.* § 524(k)(5)(B) ("If a presumption of undue hardship has been established with respect to such agreement, such certification shall state that in the opinion of the attorney, the debtor is able to make the payment.").

49. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 603(a)(2)(B), 119 Stat. 23, 122.

50. Jensen, *supra* note 5, at 486 (beginnings of BAPCPA traced to the National Bankruptcy Review Commission in 1994).

51. Todd J. Zywicki, *Legal History: The Past, Present, and Future of Bankruptcy Law in America*, 101 MICH. L. REV. 2016, 2017-18 (2003) (reviewing DAVID

existence of some form of consumer bankruptcy law since 1898 would make that solution too radical. And even the most strident critics of the current law might concede that a non-trivial number of the 1.5 million filers deserved the protection of a bankruptcy law.

With that you might have had to retreat to the position that appears to have been taken by those advocating BAPCPA. Ostensibly the advocates of BAPCPA had two uncontroversial goals. The first was to force persons who had the means to do so to make three or five years of payments to their creditors. The second was to limit well-understood specific abuses such as repeat filing and incurring new debt on the eve of bankruptcy. To have any hope of achieving those goals in the face of an unwelcoming bankruptcy organism, you would need a third change in the law: the imposition of the process and procedural rights described above.

Understanding the inability of a handful of new substantive rules to achieve your goal, you might mount a more general but more subtle attack on the bankruptcy process. By raising the cost in hundreds of little ways, you might make bankruptcy unpalatable to many who currently take bankruptcy. Put more pejoratively, you might then be tempted to sabotage, to fling your shoes into the bankruptcy machinery, in the hope of slowing it down. And even if the bankruptcy organism and its friends in Congress could block overt substantive changes in the law, they might not be able to recognize the impact of or to resist changes that parade as benign process and procedural improvements. Nor would you be obliged to admit that the true reason for advocating these bureaucratic changes was to degrade the machinery of bankruptcy; these rules could be justified as palliatives for acknowledged ills of the system.

Every new procedural burden in the law has a monetary or non-monetary cost. If a lawyer could previously complete a simple Chapter 7 in ten hours but it now takes twenty, his charge will go up. If a lawyer and his client could formerly cut a few corners in the Chapter 7 documents without fear of incurring legal liability, but are now faced with possible legal liability, the lawyer's fee will rise. And finding tax returns and pay stubs and giving up the assets that might be disclosed by those documents make the process more costly for the debtor.

So if you were a clever proponent of BAPCPA, you would welcome all of the substantive changes that you could get, but you might find your main course in the added costs associated with the process and procedure changes. At the margins these added costs will deter at least some consumers from filing.

Depending upon how they are applied, they could raise the costs enough to deter large numbers. Clearly debtors are responsive to the costs and benefits of bankruptcy, and clearly there is some cost that would deter thousands

or hundreds of thousands of potential debtors. It is indisputable that even honest, hardworking souls brought to bankruptcy by unbidden external shocks to their finances make hard-headed calculations in deciding whether to take bankruptcy. That the number of filings went from a normal 60,000 to an abnormal 5,000,000 for the two weeks prior to the October 17 deadline<sup>52</sup> proves that debtors understand and respond to the costs and benefits buried in the bankruptcy law.<sup>53</sup>

So the questions: how much will BAPCPA raise the cost of bankruptcy, and how many potential filers will that cost deter?

To assess the direct costs (the debtor's lawyer's fee, the cost of the credit briefing, the cost of the finance course and the additional filing fee) I interviewed half a dozen lawyers who represent debtors in Chapter 7. My respondents were unanimous in concluding that the cost of consumer Chapter 7's will rise significantly. They cited the cost of the credit briefing (around \$50)<sup>54</sup> and the financial management course (\$50 or more), and the increase in filing fees (\$245 up from \$155).<sup>55</sup> All of them now charge a fee that is fifty to eighty percent higher than they charged under the old law.<sup>56</sup> Most of my respondents are charging from \$1,200 to \$2,000 for a Chapter 7 case.<sup>57</sup> A case that might have cost a debtor \$1,000 or slightly more, will now cost nearly \$2,000.<sup>58</sup>

One of my respondents told me that a typical debtor would have to come to his office three times before the filing, not one time as was common under the old law. The first visit would be to explain the Section 342 disclosures and to begin collecting information. The second might be to get additional information and to arrange the counseling briefing, commonly done by telephone in the lawyer's office. Last, the lawyer himself will have to verify the information given by the debtor and check the debtor for his tax return and pay stub. The lawyer will also have to do the mandated factual investigation. Several of my respondents are getting credit reports, doing lien searches, and

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52. Liz Pulliam Weston, *Bankruptcy Law Backfires on Credit Card Issuers*, MSN MONEY, <http://moneycentral.msn.com/content/Banking/bankruptcyguide/-P135860.asp> (last visited Oct. 19, 2006).

53. Of course, some filings are stimulated by lawyers who report the coming changes to their clients, and this may have influenced the data.

54. 11 U.S.C. § 111(d)(1)(E) (Supp. V 2005). The statutory language requires only that if credit counselors charge a fee, the fee must be reasonable.

55. Filing fees were initially raised to \$220, 28 U.S.C. § 1930 (a)(1)(A) (Supp. V 2005), but were recently raised even further, to \$245. *Id.*

56. At the time of article submission, Congress is considering raising filing fees an additional \$40. Rob Larimer, *Bankruptcy May Soon be Unaffordable*, COLORADO SPRINGS BUS. J. (Aug. 4, 2006), <http://www.thepbj.com/story.cfm?ID=9558> (last visited Oct. 18, 2006).

57. These figures are not precise for several reasons. Some respondents had no fixed fee; they set their fees only after they determined what a case might entail. Some respondents included the filing fee in their fee, but most did not.

checking other public records to determine if the client is listed as the owner of real property. Trustees will demand that debtors' lawyers follow up on anything — such as the source of rental income — that might be disclosed by the tax return.

Will anyone be deterred by an additional direct cost of \$1,000? My respondents differed. One has found “no resistance” to the increase; his clients understand that the new law takes more lawyer time and effort. Another respondent has had potential clients disappear after they were told of the fees during their first phone call. Both responses are anecdotal and neither is a satisfactory basis for predicting the effect of the direct cost increase. That my first respondent's clients were not repelled by the fee does not tell about others who never came to his office because they knew of the fees, and my second respondent's callers may have gone to another lawyer, or they may eventually return to him.

My respondents identified at least two sets of debtors who would have filed under the old law but who are likely to be deterred by the new costs. First are those who do not have the means or the will to scrape together the \$1,200 to \$1,800 that has to be paid up front. Since debtor's lawyers are probably debt relief agencies who are explicitly prohibited from advising a debtor “to incur more debt” in contemplation of filing,<sup>59</sup> none of my respondents is willing to advance “credit” to clients by filing before the fee has been paid: all require that their entire fee be paid before filing.

Second are consumers with limited debt. For example, one of my respondents has represented consumer debtors who have only \$10,000 or \$15,000 of debt. Some of these may find it unwise to spend \$2,000 to get rid of a \$10,000 debt, especially when that discharge brings an eight-year exclusion from Chapter 7.

When these new direct costs are added to the indirect costs of threatened lawyer liability they might interfere with the operation of firms that are pejoratively called bankruptcy “mills”; these firms charge low fees and, I presume, give comparatively generic, non-individualized service. If their generic practice is no longer acceptable to the Chapter 7 trustees as fulfilling the obligation to do “reasonable investigation,”<sup>60</sup> the mills could be forced to adopt the practices of more thorough lawyers; following that practice could remove their price advantage. The disappearance of the mills would surely reduce the number of filings. Additionally, the disappearance of advertising commonly done by large volume firms might independently reduce the number of filings yet further.

My respondents believed that the Act would cause some reduction in the number of lawyers doing Chapter 7 cases. One termed the new complexity a barrier to the entry of new lawyers. Several stated that persons doing only occasional bankruptcies were getting out of that practice, and most thought

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59. 11 U.S.C. § 526(a)(4) (Supp. V 2005).

60. *Id.* § 707(b)(4)(C).

that *pro bono* bankruptcies by non-specialists were a thing of the past. If lawyers leave the Chapter 7 practice and are not replaced, that alone will reduce the competition among lawyers, and, in the long run, raise the cost of Chapter 7's.

Some of the prospective debtors that defect from lawyers will find their way to the "petition preparers," the untouchables of the bankruptcy organism. Under Section 110 these poor wretches must tell the client that they are not lawyers and may not give legal advice. The Section even bars them from advising the debtor whether to file in 7 or 11 or 13.<sup>61</sup> One of the long-term consequences of BAPCPA may be a shift of business from lawyers to "petition preparers." Such a shift will be welcomed neither by the lawyers who will lose clients nor by trustees or judges, both of who will have to deal with more unrepresented debtors floundering around in the system.

Notwithstanding the wishful thinking of many in the bankruptcy organism, some number of cases will be shunted from 7 to 13. My respondents, Panglosses all, thought the number to be diverted would be tiny, 3% or less. They may be right, but it is too soon to know. If the creditors make a concentrated effort in court and with the trustees to require stern and diligent administration of Section 707, they might establish rigorous practices that would require trustees to examine cases much more closely than they have been examined in the past. Even under benign administration some groups will produce a large percentage of Chapter 13 cases. Consider, for example, the UAW workers who are represented by the legal plans sponsored by the auto manufacturers. Many, if not most, of the workers who are not retired will have enough income to be presumptively excluded from Chapter 7.

Whether the Chapter 7 process is tightened up will depend on the acts of the U.S. Trustees. If they use their power over the Chapter 7 trustees to make those trustees look closely at the means calculations and search diligently for hidden assets, Chapter 7 will become known as a less receptive place than it was formerly, and the direct and indirect costs both for the debtor (in the form of assets that must be forked over and in the unpleasantness of harsh, public oral examination) and for the lawyer (in the form of sanctions and added work to find and recover assets) will rise.

A factor of large potential and even larger uncertainty is the audits that are to commence in 2007. As I suggest above, these may disclose that some trustees are diligent and thorough and that others are not. If the audits show that, and if the U.S. Trustee refuses to reappoint the less diligent, it would stiffen the backbone of the Chapter 7 trustees. If the audits reveal deficiencies

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61. Exactly how such a person can prepare a bankruptcy petition without making an occasional legal judgment is not clear to me. I suspect that a long-term consequence of the new admonitions and prohibitions found in Section 110 is increased warfare between the bar and the petition preparers. As lawyers' fees rise and preparers' business swells, the lawyers will have larger incentives to use the new weapons in Section 110 to charge the preparers with the unauthorized practice of law and with violation of the restrictions in Section 110.



in certain debtors' lawyers and bring some kind of sanctions down on those lawyers, the audits could have even larger influence. Since I do not know what the auditors will be looking for, how deeply they will dig, nor how the data will be used, it is impossible to know the audits' impact.

Could BAPCPA change consumers' willingness to take on debt? Maybe. If bankruptcy becomes known among laymen as an unpleasant and costly antidote to excessive debt, the amount of debt that rational debtors will undertake might decline.<sup>62</sup> Contrary to the belief of some of the consumer advocates who regard their charges as helpless ships on a stormy sea, I think even imprudent consumers might be deterred from taking on too much debt by debt's remote consequences. In fact the smiling debtors, who appear in the press and on TV while they are cutting up their credit cards, are unintentionally expressing appreciation for those consequences. Of course, BAPCPA could not cause a decline in debtors' appetite for debt until word of bankruptcy's new costs spreads among laymen, so one should not expect to see prompt reduction in borrowing. Newfound thrift is hardly what consumer creditors hoped to sponsor with BAPCPA, but the resurgence of thrift would be a fitting irony.

## VI. CONCLUSION

So if you are a consumer creditor have you got what you paid for? Surely you have removed a dozen or more substantive warts. Certainly you have raised the price of bankruptcy enough to deter some from filing.

Whether you have raised the price sufficiently to deter large numbers remains to be seen. That will depend not on the substantive rules but on the new process and procedure rules, or, more accurately, on how sternly those rules are enforced. If the US Trustees fully exercise their powers to make the Chapter 7 trustees toe the line and if the Chapter 7 trustees are equally unforgiving of the peccadilloes of the debtors' lawyers, I predict a large reduction in filings. If the US Trustees, the Chapter 7 trustees and the other members of the bankruptcy organism regress to an affable, bureaucratic relation, I predict little change.

Time will tell whether BAPCPA is only an additional, small step in the continued retreat from the heady day of the debtor in 1978 or whether it is a large step that will not only reduce the number of filing, but, perhaps, even mark the dawn of 21<sup>st</sup> century debtor thrift.

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62. My respondents attribute some of the current decline in filings to stories, now circulating among laymen, that bankruptcy was repealed on October 17. This shows that there is an informal exchange of information among consumers about their perceptions of the availability and efficacy of bankruptcy.