CONSUMER CREDIT AND BANKRUPTCY: ASSESSING A NEW PARADIGM

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Congress's enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005[1] has wrought the most significant revision of the bankruptcy relief available to individual debtors in over 100 years. The Bankruptcy Act of 1898[2] established for the first time a permanent federal bankruptcy system in which individual debtors could freely and voluntarily avail themselves of a liberal bankruptcy discharge of indebtedness, through a surrender of nonexempt assets, without any creditor consent requisite to the discharge.[3] That basic structure remained a seemingly indelible fixture of federal bankruptcy law until the advent of BAPCPA, which restricts *both* individual debtors' access to such a "liquidation" discharge (though chapter 7) *and* the scope of the relief afforded by such a chapter 7 discharge.

On April 7, 2006—approximately one year after President George W. Bush signed BAPCPA into law on April 17, 2005—the University of Illinois College of Law brought together in Chicago over a dozen of North America's leading bankruptcy scholars to critically assess this momentous, controversial legislation. We are pleased and proud to publish the excellent papers presented at that conference in this symposium issue of the *University of Illinois Law Review*.

My Illinois colleague, coauthor, former bankruptcy teacher, and principal organizer of this conference, Professor Charles Jordan Tabb, opens the symposium with his paper, *The Top Twenty Issues in the History of Consumer Bankruptcy*. Tabb's insightful retrospective situates BAPCPA within the context of our longstanding Anglo-American tradition of bankruptcy relief. By carefully charting bankruptcy's ever-changing accommodation of debtor and creditor interests, Tabb usefully

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1. Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.).
2. Pub. L. No. 55-171, 30 Stat. 544 (amended variously and repealed 1978).
3. *See generally* Charles Jordan Tabb, *A Century of Regress or Progress? A Political History of Bankruptcy Legislation in 1898 and 1998*, 15 EMORY BANKR. DEV. J. 343 (1999).

reminds us that if bankruptcy history teaches anything, it is that creditors' "draconian" triumph through BAPCPA's enactment is unlikely to be a permanent victory.

Judge Eugene R. Wedoff has tirelessly and astutely tracked, analyzed, and educated bench, bar, and academy with respect to the entire array of legislative changes contained in the dozens of bankruptcy bills produced through the extended legislative process—spanning five Congresses—that ultimately led to the enactment of BAPCPA. In our second symposium article, *Major Consumer Bankruptcy Effects of BAPCPA*, Judge Wedoff provides an incredibly lucid, concise, and useful summary of the most significant alterations of the Bankruptcy Code effected by BAPCPA.

Professor/Judge[4] Bruce Markell's contribution to this symposium, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA*, examines BAPCPA's revisions of the chapter 11 reorganization process for individual debtors. Markell provides a case study in the dreadfully inept legislative drafting on display in BAPCPA. The provisions of interest for Markell's paper conform, in several respects, the treatment of individual debtors in chapter 11 to that which prevails in chapter 13 under a wage-earner repayment plan. As Markell points out, however, substantial differences between the two remain. In creating a unique chapter 11 process for individual debtors, BAPCPA not only introduced several complex interpretive ambiguities, but also failed to resolve some of the thorniest theoretical conundrums presented by the individual chapter 11 debtor, such as the applicability (or not) of the absolute priority rule. Markell suggests that use of a common and eminently sensible drafting convention to create a new individual-debtor subchapter within chapter 11 could have successfully clarified Congress's intent with respect to these issues.

Professor Jean Braucher always has her finger on the pulse when it comes to knowing how the consumer bankruptcy system is functioning. In her symposium piece, *The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need Not Be Futile*, Braucher (like Markell) addresses the horrendous drafting of BAPCPA, but from a different angle. Given (1) the disingenuousness of BAPCPA's consumer credit proponents in their arguments for adoption of BAPCPA, (2) the lack of any congressional endorsement of the credit industry's true objectives in BAPCPA's legislative history, and (3) the multitude of interpretive quandaries BAPCPA will present to the judiciary in the coming years, Braucher keenly notes that this combination provides judges an opportunity to legitimately "resist" the credit industry's unstated purposes in implementing the provisions of BAPCPA. Braucher identifies four levels of possible resistance that have already appeared in

4. (Or "P/J" for short.) He may don the black robe from time to time these days, but (for better or worse) his soul remains that of an academic.

the early opinions interpreting BAPCPA. Braucher sees little to be gained from three of these—the kicking-and-screaming implementation of BAPCPA she calls "venting (but vanquished)," insincere strict textualism that she dubs "nihilistic nitpicking," and a no-holds-barred outright refusal to apply the terms of BAPCPA by "torturing the text." Braucher believes the most productive judicial reaction to BAPCPA is a form of "subtle subversion" that takes Congress at its word and interprets BAPCPA's ambiguities in a manner designed to further the laudatory stated goals of that legislation, even when the result flies in the face of the credit industry's apparent motives in their design of BAPCPA. Braucher also has encouragement and advice for the consumer debtor bar in resisting BAPCPA's evident assault upon them.

Professor William Whitford's contribution to this symposium, *A History of the Automobile Lender Provisions of BAPCPA*, provides a fascinating political history of BAPCPA's impact on the auto finance industry. Whitford concludes that auto lenders' relative position in borrowers' bankruptcy cases is greatly improved after BAPCPA, and in fact, that auto lenders are the commercial creditor group whose position is most improved by BAPCPA, largely because of the new limitations on strip-down of automobile liens in chapter 13. How this came to be, Whitford reveals, was somewhat fortuitous, as the auto lenders' "wish list" for bankruptcy reform initially did not even question the basic principle of bifurcation of undersecured claims. In the thick of the subsequent legislative process, however, Senator Abraham of Michigan—for the benefit of the auto finance industry—introduced a surprise amendment at a markup session of the Senate Judiciary Committee that would have entirely eliminated lien strip-down in chapter 13. Despite the prejudice this would cause to the interests of unsecured creditors, the broad consumer creditor coalition that was so important to BAPCPA's ultimate enactment did not publicly protest the Abraham amendment. The subsequent legislative process scaled back the Abraham amendment, most significantly after Senator Abraham lost his bid for reelection, but BAPCPA as enacted contained a strip-down limitation much more generous to auto lenders than that envisioned by the creditor coalition when it commenced its extended legislative press for bankruptcy reform. Professor Whitford would take heart from this illustration of the limits on wealthy and powerful interest groups' control over the legislative process, were it not for the fact that the checks on the will of the creditor coalition revealed by this account were rather adventitious and were not motivated by any principled consideration of sound bankruptcy policy.

Professor Jacob Ziegel's symposium paper, *What Can the United States Learn from the Canadian Means Testing System?*, is an incisive look at BAPCPA from a Canadian comparative perspective. The heart of the "AP" in BAPCPA (its purported "Abuse Prevention") is the so-called means test, which mandates dismissal from chapter 7 of those

debtors with sufficient means (as measured by BAPCPA's labyrinthine formulae) to repay some portion of their debts from future income through a chapter 13 repayment plan. Canada has substantial experience in quantifying debtors' "means" for debt repayment, but as Ziegel demonstrates, this experience does not easily translate into our American bankruptcy system. Canada has rough equivalents of both our chapter 7 liquidation and our chapter 13 repayment schemes. But Canada's equivalent of means testing exists in an intermediate otherworld unknown to our system: as a condition to obtaining the Canadian equivalent of a chapter 7 discharge, Canadian debtors must surrender nine months' (postfiling, predischarge) surplus income to creditors. Ziegel nonetheless sees the Canadian approach as a productive middle ground between an American-style straight liquidation and a long-term (and, consequently, often infeasible) repayment regime. Under the Canadian system, debtors are quite successful in "earning" their discharges through a relatively brief period of what can be significant "belt tightening" (given relatively spartan expense allowances). Ziegel believes that this approach brings discharged debtors the psychological gratification that comes from accomplishment through effort. Moreover, Canadian creditors seem content with this system, in spite of meager marginal returns, if only because this approach conveys a symbolic message that debtors cannot simply walk away from their debts by filing bankruptcy.

Professor Iain Ramsay's paper, *Comparative Consumer Bankruptcy*, provides an outstanding prospectus for the entire enterprise of comparative consumer bankruptcy scholarship, which will undoubtedly blossom as consumer credit capitalism continues to spread and becomes a truly global phenomenon. Ramsay exhorts comparativists to search for explanations of differing consumer bankruptcy systems in a rich array of institutional, economic, social, historical, and political data, and provides wonderful illustrations of the matrix of interdependent influences that sophisticated and nuanced comparisons must consider. And while debt and bankruptcy are undoubtedly cultural phenomena, Ramsay cautions against a too-ready resort to culture to explain differences in consumer credit and bankruptcy systems, at least as between developed countries. Ramsay notes that culture is a complex creature that is, in many ways, "contingent" or shaped by historical and institutional forces that are not immutable. The structural changes that are fueling the rise of consumer credit capitalism worldwide, therefore, may also see corresponding cultural shifts. Consequently, Ramsay believes that the proper role of culture in comparative consumer bankruptcy scholarship is as a residual explanation, *after* institutional and structural explanations have been exhausted.

In her paper, *Abuse or Protection? Economics of Bankruptcy Reform Under BAPCPA*, Professor Michelle White provides an astute analysis of the economic efficiency of consumer bankruptcy law before

and after BAPCPA. White identifies the principal economic objectives of consumer bankruptcy as providing consumption insurance to risk-averse debtors, maintaining debtors' incentives to work to their full potential, facilitating the operation of credit markets by requiring payment from available assets or income, and discouraging opportunistic filings by debtors who have not experienced declines in income or wealth available to pay debts. Using these criteria, White concludes that consumer bankruptcy law pre-BAPCPA provided a high level of consumption insurance and maintained debtors' work incentives through its full exemption of postbankruptcy personal service income, but that debtors' ability to freely choose between a chapter 7 or chapter 13 filing provided ample opportunity for opportunistic behavior. Debtors' ability to choose bankruptcy repayment from either wealth or postbankruptcy earnings meant that debtors could choose to repay from whichever repayment source they lacked. BAPCPA does not eliminate debtors' incentives to behave opportunistically in their filing decisions, but it does considerably complicate opportunists' profitable strategies, which now require more sophisticated manipulation of income, expenditures, debt, and assets. Whether BAPCPA improves overall economic efficiency, though, is questionable, as debtors have strong incentives under BAPCPA to work less and reduce their incomes during the six months before filing bankruptcy. Moreover, the many new "hurtles" to filing bankruptcy increase the overall cost of bankruptcy for both opportunists and nonopportunists, severely undermining bankruptcy's consumption insurance function.

Professor Douglas Baird is a true giant among bankruptcy law scholars, but in his symposium article, *Technology, Information, and Bankruptcy*, rather than examining changing consumer bankruptcy laws, Baird focuses on the vast long-term increase in consumer borrowing—which is not attributable to changing bankruptcy laws and from which rising bankruptcy filings are simply an inevitable consequence. Baird ascribes the rise in consumer borrowing to financial innovations, greatly facilitated by revolutionary advances in information technology. Securitization has expanded the pool of funds available for consumer lending, and advances in data processing capabilities and credit scoring models (by increasing consumer lenders' ability to assess and accurately price consumer credit risk) have expanded the pool of eligible consumer borrowers and the means by and purposes for which they can borrow. This story of higher volume, diversification, and price discrimination, of course, is also a story of increasing risk tolerance by consumer lenders, and simultaneously, a story of ever-increasing asset liquidity for consumer debtors, who can now borrow against and highly leverage nearly any asset, including human capital. In this new consumer credit environment, it is easy for debtors to fall prey to widespread cognitive biases—systematically erring on the side of overconsumption and overborrowing—and indeed, consumer lenders' business models seem to exploit these predispositions. As an economist, Baird bristles at the suggestion

that expanding the borrowing options available to consumers can be a bad thing, even if it does necessarily bring an increase in bankruptcy filings. For Baird, the biggest challenge of responsible legal reform in this environment is not fine-tuning the consumer bankruptcy system, but rather is countering consumers' cognitive biases without unduly restricting consumer choice.

Professor Melissa Jacoby, in *Bankruptcy Reform and Homeownership Risk*, explores the underappreciated, undertheorized, and understudied mortgagor protection function of chapter 13, which provides defaulting homeowners a unique means of curing, "de-accelerating," and reinstating a defaulted home mortgage debt. Jacoby perceptively posits that this federal antiforeclosure regime may well be functioning primarily to prolong unsustainable homeownership among borrowers with little or no equity in their homes, at considerable cost to mortgagors and mortgagees alike, and with likely ripple effects on access to, and the costs of, mortgage credit. In theory, sustainable homeownership can be maintained, notwithstanding default, through private workouts or refinancing, and chapter 13 therefore would be the refuge of *only* those defaulters unable to feasibly sustain their homeownership. Jacoby, however, identifies several obstacles to private workouts for even sustainable homeowners, obstacles which may well justify chapter 13's antiforeclosure protections, but only if chapter 13 can effectively sort and screen out cases of unsustainable homeownership. Although chapter 13's feasibility requisite to plan confirmation is a mandate to perform just such a case-by-case sorting and screening review, there is little indication that plan feasibility is a meaningful barrier to prolonging unsustainable homeownership through (even multiple) chapter 13 filings. Jacoby, however, identifies select provisions of BAPCPA—particularly those provisions dealing with repeat filers—that have the potential to permit judges to screen out cases of unsustainable homeownership.

Our next symposium article, *The Paradox of Consumer Credit*, comes from my newest Illinois colleague (and former law school classmate and *Law Review* coeditor), Professor Bob Lawless. Lawless is a first-rate, ever-inquisitive empiricist, and for this symposium, he set about to determine whether changes in bankruptcy laws have statistically significant effects on the number of bankruptcy filings—a particularly relevant inquiry given that BAPCPA was pitched as reform necessary to halt skyrocketing filing rates. Given the wealth of data indicating that bankruptcy filing rates closely track consumer debt levels, though, it is legitimate to question whether the particulars of federal bankruptcy law significantly impact filing rates, independent of long-term macroeconomic trends. Lawless's regressions reveal that substantial changes in consumer bankruptcy laws in 1938 and 1978 had no statistically significant relationship to bankruptcy filing rates. Counterintuitively, though, the more stringent 1984 amendments actually coincided with a statisti-

cally significant *increase* in bankruptcy filing rates—perhaps attributable to an uptick in consumer lending spurred by the more stringent bankruptcy laws. In the course of conducting this analysis, however, Lawless discovered an even more counterintuitive result—a statistically significant *negative* relationship between nonmortgage debt (what the Federal Reserve calls "consumer credit") and bankruptcy filing rates—consumer credit goes up and bankruptcy filing rates fall. The opposite, however, is true with respect to mortgage debt and overall consumer debt. Lawless, therefore, has discovered an intriguing dynamic between consumer credit and bankruptcy filings: over the short term, increases in consumer credit are actually used to stave off bankruptcy filings, yet over the long haul, those debt increases lead to a predictable increase in bankruptcy filings.

There is no academic with a better understanding of credit card lending than Professor Ronald Mann.[5] In *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, Mann goes behind the credit card industry's public rhetoric promoting enactment of BAPCPA to ascertain what the credit card industry really hoped to gain by enactment of BAPCPA (and for which they would spend approximately $100 million on lobbying and campaign contributions). Mann concludes that BAPCPA is unlikely to have any substantial effect on consumers' borrowing behavior and, consistent with Professor Lawless's findings, that credit card issuers certainly could not count on BAPCPA to reduce bankruptcy filing rates. On its face, BAPCPA's means test seems designed to shift high-income filers from chapter 7 (where credit card companies typically receive no return) into chapter 13 (where credit card issuers may receive plan payments). BAPCPA's amendments of chapter 13, however, raise the distinct possibility that *both* credit card issuers' average payouts in chapter 13 *and* the proportion of chapter 13 filings relative to chapter 7 filings will *decline* post-BAPCPA. Moreover, the very small percentage of pre-BAPCPA chapter 7 filers who would have failed BAPCPA's means test confirms credit card insiders' frank admissions that they do not expect the means test to produce significant revenues. Even assuming the worst (from the credit card lenders' perspective) with respect to all of the foregoing, Mann's explanation of credit card lenders' business model provides a fascinating account of how they can expect BAPCPA to produce a very profitable return on their substantial investment therein. While conventional lenders profit from borrowers' full and timely repayment according to the terms of the loan, credit card lenders' only revenues from those customers who pay their balance in full each month are through interchange fees on the customers' transactions, which is a relatively low-margin proposition. The highest profits for credit card lenders come from customers who carry a balance on their cards, through the interest that consequently accrues (at rates vastly in

5. *See, e.g.*, RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS (2006).

excess of their cost of funds), as well as from lucrative over-limit and late-payment fees. Indeed, Mann demonstrates that these revenue sources are so profitable that they can relatively quickly and easily return the lenders' actual monetary investment in a customer's account despite the fact that the nominal account balance is never—and can never hope to be—fully repaid. Once the lender has recouped its actual monetary investment in a customer's account, all further payments on the account are pure profit to the lender, and the lender has an incentive to keep the customer paying something (anything) on the account for as long as possible. BAPCPA's real value to credit card lenders, then, is in its collective provisions that increase the cost and decrease the benefits of filing bankruptcy, thus predictably delaying even inevitable bankruptcy filings and extending the time debtors spend in the credit card lenders' ultra-profitable "sweat box."

Our final symposium article, *Private Liability for Reckless Consumer Lending*, is Professor John Pottow's provocative response to credit card lenders' "sweat box" business model, which seems nearly indifferent to borrower delinquencies, defaults, and bankruptcy filing rates. Taking Congress at its word (in its justifications for BAPCPA), that the current bankruptcy filing rate is troublingly high, Pottow agrees that both the consequences for individual debtors and the externalities of bankruptcy filings provide reason to suspect that there are more bankruptcy filings than are socially desirable. Given the established link between aggregate credit card debt and the bankruptcy filing rate, the various cognitive biases that fuel consumers' increasing debt burdens, and credit card lenders' "sweat box" lending model (which actually exploits consumers' systematic decision-making errors), Pottow concludes that the rational response to too many bankruptcy filings is to reign in credit card lenders' indifference to borrower default. In that regard, Pottow suggests that serious consideration should be given to an idea proposed by the late, great Professor Vern Countryman over thirty years ago: a tort cause of action for "reckless credit," which would impose a duty not to extend credit when the lender knows, or with reasonable inquiry should know, that the debtor will be unable to service the debt according to its terms in the ordinary course of her affairs. As between debtor and creditor in such a scenario, Pottow regards the creditor as the superior loss avoider (if forced to internalize the costs of the inevitable default). Pottow acknowledges and explores serious difficulties his proposal would engender regarding causation, assumption of risk, damages, increased price or rationing of credit, moral hazard, relative culpability, and paternalism. He ultimately concludes that none of these concerns should rule out his proposal, but that some may counsel a more restrained version that limits a debtor's relief to an affirmative defense on the reckless loan rather than also permitting a monetary damage recovery from the reckless lender.