

WHY (CONSUMER) BANKRUPTCY?

*Richard M. Hynes**

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I. INTRODUCTION

Numerous scholars have offered justifications for bankruptcy's discharge, or "fresh start."¹ Their theories may explain why society would offer debt relief to the insolvent, but they do not explain why this relief should be offered in the form of a bankruptcy discharge. While many think of bankruptcy and insolvency as the same,² they are not. Insolvency means the "inability to pay debts,"³ and the available evidence suggests that most insolvent consumers default without filing for bankruptcy.⁴ Non-bankruptcy law simply does not provide creditors with sufficient remedies to force these consumers to repay in full. Creditors are not merely faced with the difficulty of squeezing blood from a turnip; both federal and state laws consciously limit the ability of creditors to enforce their claims. Any normative theory of consumer bankruptcy must explain how bankruptcy interacts with non-bankruptcy law within a larger system of debt relief.

Generations of scholars have argued over bankruptcy's role within a larger system of debtor-creditor law,⁵ but this literature focuses almost ex-

1. See, e.g., Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretative Theory*, 21 U. RICH. L. REV. 49 (1986) (reviewing the literature); Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047 (1987); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1402 (1985); Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 89-103 (1990) (reviewing the literature). The phrase "fresh start" derives from an early twentieth century Supreme Court decision. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). Bankruptcy gives "the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Id.* (emphasis added).

2. See, e.g., WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 172 (3d ed. 1961) (defining a bankrupt as "a person who becomes insolvent").

3. *Id.* at 1170.

4. See, e.g., AM. BANKER'S ASS'N, 1997 INSTALLMENT CREDIT SURVEY REPORT 109 (9th ed. 1997) (reporting that approximately seventy percent of all bank consumer credit losses occur outside of bankruptcy); VISA U.S.A., INC., 1999 ANNUAL BANKRUPTCY SURVEY (2000) (reporting that two-thirds of credit card loans charged off as uncollectible are not attributable to bankruptcy). Note, however, that some of these loans may be discharged in a bankruptcy proceeding after they are charged off as uncollectible. Also note that these percentages are based on outstanding loans and not individuals. However, it is likely that the percentage of debtors who use bankruptcy is even lower because those who are most likely to be judgment proof outside of bankruptcy—those with low incomes—are less likely to have large loans.

5. See, e.g., CHARLES JORDAN TABB, *BANKRUPTCY ANTHOLOGY* 51-133 (2002) (providing excerpts of articles on the role of bankruptcy); Garrand Glenn, *Essentials of Bankruptcy: Prevention of Fraud, and Control of Debtor*, 23 VA. L. REV. 373 (1937); James Monroe Olmstead, *Bankruptcy a Commercial Regulation*, 15 HARV. L. REV. 829 (1902); Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1 (1940).

clusively on bankrupt businesses rather than bankrupt consumers.⁶ Unfortunately, the purposes assigned to bankruptcy in the debate over business bankruptcy do not readily apply to our current system of consumer bankruptcy. These theories of business bankruptcy focus on bankruptcy's ability to better distribute scarce assets among creditors who will not be paid in full.⁷ However, Chapter 7, the most common form of consumer bankruptcy,⁸ generally does not distribute *any* assets to general creditors. Over ninety-five percent of Chapter 7 bankruptcies yield no repayment for general creditors,⁹ and many of the Chapter 7 filings that do result in distributions are business bankruptcies.¹⁰

Bankruptcy may offer important procedural advantages for insolvent consumers and their creditors, but this does not justify our current structure of debtor-creditor law. Society could adopt a largely procedural bankruptcy system that provides the posited advantages of an organized distribution of proceeds to creditors and still offers consumers the same debt relief that they would receive under non-bankruptcy law.¹¹ However, our current system of consumer bankruptcy departs sharply from this procedural model. Although the existing Bankruptcy Code largely looks to non-bankruptcy law to determine how much (if any) of a consumer's assets creditors can seize,¹² it ignores non-bankruptcy law when determining how much income

6. For example, in a famous debate over the role of bankruptcy within a larger system of debtor-creditor law, Professors Douglas Baird and Elizabeth Warren explicitly limit their debate to business bankruptcy. See Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 776-77 (1987) ("In order to join issue more clearly and to narrow the focus of the debate somewhat, Professor Baird and I have agreed to debate the basis of bankruptcy policy in the context of business bankruptcies.").

7. See, e.g., Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982) (arguing that bankruptcy can help solve a race to the assets by providing for pro rata distributions to general creditors and thus maximizing collections for creditors); Warren, *supra* note 6, at 785 ("Bankruptcy law aims first to conserve and divide an estate that cannot meet all its obligations . . .").

8. In the second quarter of 2004, approximately seventy-three percent of all non-business bankrupt debtors chose Chapter 7. ABI World, *Non-Business Bankruptcy Filings by Chapter, 1990-2004, per Quarter*, available at http://www.abiworld.org/Template.cfm?Section=Non_business_Bankruptcy_Filings&CONTENTID=10996&TEMPLATE=/ContentManagement/ContentDisplay.cfm (last visited Sept. 26, 2004).

9. See, e.g., EXECUTIVE OFFICE FOR U.S. TRUSTEES, UNITED STATES TRUSTEE PROGRAM: PRELIMINARY REPORT ON CHAPTER 7 ASSET CASES 1994 TO 2000, 7 (2001) (explaining that "[h]istorically, the vast majority (about 95 to 97 percent) of Chapter 7 cases yield no assets."), available at <http://www.usdoj.gov/ust/library/chapter07/assetcases/Publicat.pdf>.

10. U.S. GEN. ACCOUNTING OFFICE, BANKRUPTCY ADMINISTRATION: CASE RECEIPTS PAID TO CREDITORS AND PROFESSIONALS, GAO/GGD-94-173 (July 28, 1994) (noting that business cases represented about a third of all asset Chapter 7 cases and generated about eighty percent of all revenue), available at <http://archive.gao.gov/t2pbat2/152238.pdf>.

11. See *infra* Part II.C.3.

12. The Bankruptcy Code gives the debtor the choice of the exemptions available under non-bankruptcy law or certain bankruptcy-only exemptions. 11 U.S.C. § 522(d) (2000). However, the Code also gives each state the right to "opt-out" of these bankruptcy-only exemptions and force their residents to choose the non-bankruptcy exemptions, and about two-thirds of the states have done so. See Richard M. Hynes et al., *The Political Economy of State Property Exemptions*, 47 J.L. & ECON. 19, 26-27 (2004) [hereinafter *Political Economy*].

the consumer must repay and for how long the consumer must keep repaying.¹³

Other scholars have recognized that our system of consumer bankruptcy could take a very different form. For example, Professor Jackson notes that the discharge could be granted in a proceeding that lacks a mechanism for collecting assets from the debtor or distributing proceeds to creditors.¹⁴ Yet the system of public notice that he suggests as an alternative for providing a discharge could still be described as a form of bankruptcy because it would serve as a proceeding that compels all creditors of a single debtor to accept "some arrangement or some disposition of their claims against the bankrupt's property, whether they all agreed to it or not."¹⁵

This Article makes a stronger claim: by amending non-bankruptcy collections laws, society could largely replicate the fresh start offered by the bankruptcy discharge without any formal proceeding at all.¹⁶ Non-bankruptcy exemptions can protect a consumer's wages from garnishment and her assets from attachment, and other laws can protect the consumer from harassment. Of course, the consumer's debts will remain outstanding, and she must labor under the threat that her creditors will one day be able to enforce their claims or judgments. However, society can adopt short statutes of limitations so that the consumer need not fear these claims and judgments after a reasonable amount of time has passed.¹⁷

The central question addressed by this Article is why we offer substantially more, or at least different, debt relief in our bankruptcy system than we offer under non-bankruptcy law.¹⁸ This Article argues that the most plausible explanation is that bankruptcy facilitates means-testing, broadly defined as a determination that the consumer lacks the means to repay her debts. Therefore, there should be no debate over whether consumer bankruptcy should be means-tested;¹⁹ the *raison d'être* of consumer bankruptcy is means-testing.

One may argue, however, over the form that this means-test should take. A formal proceeding (binding on all creditors) may facilitate an

13. See *infra* Part II.C.

14. See Jackson, *supra* note 1, at 1396 n.8 ("For example, the law might grant discharge through a system of public notice whereby certain assets (such as future wages) would be freed from the claims of existing creditors. The mechanism of public notice would inform creditors of the debtor's election.").

15. See Radin, *supra* note 5, at 4.

16. See *infra* Part II.

17. See *infra* Part II.B.3.

18. The previous literature does offer three possible explanations for the puzzle, but none of these explanations withstand scrutiny. See *infra* Part III.A. The relationship between the bankruptcy discharge and the statute of limitations is largely unexplored in the literature. *But see, e.g.*, Discussion, 41 LAW & CONTEMP. PROBS. 123, 125 (1977) (noting that a discharge and a statute of limitations raise similar issues and calling for further study).

19. See, e.g., Judge Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177 (1999); Gary Klein, *Means-Tested Bankruptcy: What Would it Mean?*, 28 U. MEM. L. REV. 711 (1998); *Resolved: The Time has Come for Means-Tested Consumer Bankruptcy*, 17 AM. BANKR. L.J. 6 (1998) (excerpting a debate); Jack F. Williams, *Distrust: The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REV. 105 (1999).

evaluation of the consumer's financial condition because it would be too expensive to relitigate this issue with each creditor. However, American bankruptcy law has never contained an explicit requirement that consumers repay their debts if they have sufficient income,²⁰ and bankruptcy law professors have traditionally opposed costly investigations of consumers' ability to repay.²¹ The law need not conduct any investigation to "means-test" bankruptcy; the law could rely on punishment to verify that consumers need relief.²² Perhaps bankruptcy facilitates this punishment.

If one does conclude that the bankruptcy proceeding helps verify that a consumer needs debt relief, one must explain why society offers any debt relief to debtors who do not file for bankruptcy. That is, society could adopt draconian non-bankruptcy collections measures on the theory that if the consumer were truly unable to pay her debts she would prove this fact in a bankruptcy proceeding. Yet the law does not do this. Instead, it creates partially overlapping systems of debt relief and allows the consumer to choose between them.

Perhaps this overlapping system is designed to accommodate the diverse group of debtors who become insolvent. If society requires a more complicated system to determine when wealthier, or higher income, consumers should repay some of their debts, it may adopt this complicated system along with a parallel system designed for consumers with fewer assets or lower income. Society must structure these systems so that each consumer selects the system appropriate for her circumstances.

The proper role of bankruptcy in the larger system of debt relief has important implications for the current debate over bankruptcy reform. For example, the consumer credit industry is currently pushing for an explicit means-test in bankruptcy against near-uniform opposition from bankruptcy law professors.²³ One of the primary arguments scholars make against the proposed reforms is that they will raise the cost of filing for bankruptcy to a price beyond the reach of consumers who truly need bankruptcy relief.²⁴

20. Today a debtor may be denied access to Chapter 7 of the Bankruptcy Code if the court deems her filing to be a "substantial abuse" of the Code. 11 U.S.C. § 707(b) (2000). While most, if not all, courts would consider the debtor's "ability to pay" in the substantial abuse analysis, there is broad disagreement as to the meaning of the phrase "substantial abuse" and how vigorously courts should enforce this provision. *See infra* notes 48-50 and accompanying text.

21. For example, more than eighty bankruptcy law professors have written an open letter to Congress claiming that the means-testing provisions of the pending bankruptcy legislation would impose unacceptably high costs on the bankruptcy system. *See* Letter from various law professors to Congress (Sept. 7, 1999) [hereinafter Letter of Sept. 7, 1999] (on file with author) ("Dozens of provisions in S. 625 . . . increase the cost and complexity of the system.").

22. *See infra* Part III.B.2. For an interesting theoretical inquiry into the use of punishment and information to verify a debtor's inability to repay, see Kelly Welch, *From Debtor's Prison to Bankruptcy: The Enforcement of Optimal Debt Contracts* (Working Paper 2001) (on file with author).

23. *See, e.g.*, Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 48 (2001) (emphasizing that "[t]he vast majority of America's bankruptcy law professors have repeatedly expressed their vehement opposition to the bankruptcy reform bills. About 100 professors have written Congress on four separate occasions imploring Congress not to pass such a bill. Exactly two law professors have urged passage.").

24. *See, e.g.*, Letter of Sept. 7, 1999, *supra* note 21 ("The trick is identifying the real abusers at an

This last criticism loses much of its sting if consumers who cannot afford to file for bankruptcy receive adequate debt relief from non-bankruptcy laws that limit collection. While the literature recognizes the existence of these non-bankruptcy laws,²⁵ it largely treats such limitations as exogenous to the normative discussion of bankruptcy law.²⁶ In fact, the literature seems more willing to discuss potential reforms to our nation's social insurance²⁷ or even public education²⁸ systems than changes in non-bankruptcy collections.²⁹ This Article argues that the distinction between bankruptcy and non-bankruptcy law is largely artificial. Since both are part of a larger system of debt relief, they must be considered together.

Part II argues that the law can roughly duplicate the relief offered by consumer bankruptcy without the need of a formal proceeding that we would call bankruptcy. Society may find that a bankruptcy proceeding offers some advantages unavailable under non-bankruptcy law. However, these advantages may be achieved in a procedural bankruptcy system that looks to non-bankruptcy law to determine the total amount that a consumer must pay.

Part III suggests that society may wish to depart from a purely procedural model of bankruptcy if the bankruptcy process helps determine a consumer's need for relief. Part IV explores the justification for non-bankruptcy

acceptable cost, without unfairly burdening those 'honest but unfortunate' debtors who legitimately need Chapter 7 bankruptcy relief."); Jean Braucher & Charles W. Mooney, Jr., *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 (Feb. 2003) ("Because preparing a means-testing calculation would make filing in bankruptcy more complex and thus time-consuming, the predictable effect would be to drive up fees of lawyers and document-preparers. Some of the worst-off debtors would be unable to afford a bankruptcy discharge.").

25. See, e.g., ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO INCOME TRAP* 154 (2003) ("Although one wouldn't guess it from all the fiery rhetoric, bankruptcy filings account for just a fraction of lending industry losses; in the large majority of cases, the bank simply gets tired of trying to collect."); Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means-Testing as a Distraction and the National Bankruptcy Review Commission Proposals as a Starting Point*, 6 AM. BANKR. INST. L. REV. 1, 9 (1998) ("Of course, debtors excluded from bankruptcy do not necessarily repay their debts, so reductions in bankruptcy losses are not equivalent to reductions in default losses.").

26. These scholars sometimes criticize the consumer credit industry for exaggerating the cost of bankruptcy, noting that much of the debt discharged in bankruptcy would not have been collected even if the debtor did not file. See, e.g., Elizabeth Warren, *The Phantom \$400*, 13 J. BANKR. L. & PRAC. 77, 82 (2004). Similarly, we should not overestimate the benefit of bankruptcy; many consumers in financial distress would be able to avoid repaying their debts even if they had no access to bankruptcy.

27. See, e.g., TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 257-61 (2000) (discussing bankruptcy's role within a larger social safety net).

28. See WARREN & TYAGI, *supra* note 25, at 32-46.

29. In fact, these scholars sometimes ignore the existence of these laws entirely when discussing the adverse effects of depriving consumers of access to the bankruptcy discharge. See, e.g., WARREN & TYAGI, *supra* note 25, at 154-55 ("Families [barred from receiving a bankruptcy discharge] would no longer be able to free themselves from certain unsecured debts, so they would be required to make payments (plus penalties, late fees, and interest) on some of those bills for the rest of their natural lives—even if those payments took up 100 percent of their paychecks."). This quotation ignores federal law that prohibits general creditors from seizing more than twenty-five percent of a debtor's take-home pay. See 15 U.S.C. § 1673 (2002). Of course, tax and certain family law creditors can seize up to sixty percent of some consumers' paychecks, *id.*, but these claims would not be discharged in bankruptcy anyway. 11 U.S.C. §§ 523(a)(1), (5) (2000).

relief assuming that bankruptcy provides a superior means of verifying a consumer's need for relief. Part IV suggests that a primary justification for this non-bankruptcy relief is that it provides a more cost-effective method for determining that lower-income debtors are unable to repay their debts. This conclusion has important implications for the debate over bankruptcy reform as it suggests that a great many bankrupt consumers do not belong in bankruptcy.

II. PROVIDING BANKRUPTCY'S "FRESH START" WITH NON-BANKRUPTCY LAW

The best evidence that the law may provide effective debt relief without a bankruptcy discharge is that most insolvent consumers do not file for bankruptcy.³⁰ Of course, in some cases the creditor may abandon collection efforts because he believes that the consumer will file for bankruptcy if pressed,³¹ and many insolvent consumers actually do choose bankruptcy. Therefore, it is useful to describe the debt relief that bankruptcy offers and demonstrate how non-bankruptcy law could (and to some extent does) provide similar relief.

A. *The Protections Afforded by Bankruptcy*

The overwhelming majority of American consumers who receive a bankruptcy discharge do so in Chapter 7.³² Society could adopt a very different system of consumer bankruptcy. Generations of scholars have argued that a system of debt adjustment such as that used in our current Chapter 13 should be much more common,³³ and scholars periodically advocate a system that, like the bankruptcy system used in some other common-law coun-

30. See *supra* note 4 and accompanying text.

31. See, e.g., Michele White, *Why Don't More Households File for Bankruptcy?*, 14 J.L. ECON. & ORG. 205 (1998) (arguing that many consumers do not file for bankruptcy because they can avoid repayment by credibly threatening to do so).

32. Chapter 7 accounts for approximately seventy percent of all non-business bankruptcy filings with almost all of the remaining non-business bankruptcies filed in Chapter 13. See ABI World, *supra* note 8. This statistic understates the role of Chapter 7 because only about one-third of Chapter 13 filings result in a discharge. See, e.g., TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS 215-17 (1989) (finding a two-thirds failure rate for Chapter 13 cases); Jean Braucher, *An Empirical Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown*, 9 AM. BANKR. INST. L. REV. 557, 557 (2001) (finding that a majority of plans were not completed); Marjorie L. Girth, *The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals*, 65 IND. L.J. 17, 40-42 (1989) (finding a sixty-three percent completion rate in Buffalo, N.Y.); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 440 (1999) (finding a one-third completion rate in one district in Mississippi); William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 68 AM. BANKR. L.J. 397, 411 tbl.2 (1994) (finding that only thirty-one percent of Chapter 13 cases closed as completed).

33. In fact, the desire to increase the use of these individual repayment plans was an important argument supporting the Bankruptcy Reform Act of 1978. H.R. Rep. No. 95-595, ch. 3, at 122 (1977).

tries,³⁴ effectively taxes the consumer's post-bankruptcy income for the benefit of her creditors.³⁵

Though consumer bankruptcy can take many forms, it commonly offers four types of protection. First, bankruptcy provides consumers with temporary protection against creditor harassment and continued calls for repayment. Second, bankruptcy provides consumers with at least some protection of their assets and income while they are in bankruptcy. Third, the bankruptcy discharge effectively frees all of the consumer's future income and assets from the claims of pre-petition creditors and makes the protection from harassment by these pre-petition creditors permanent. Fourth, bankruptcy sometimes, but not always, provides the consumer with relief from the threat of foreclosure by secured creditors.

1. Chapter 7

When a consumer files for bankruptcy the court imposes an automatic stay³⁶ that immediately, though perhaps temporarily, stops collections efforts such as telephone calls and letters demanding repayment. Consumers who file under Chapter 7 and meet certain requirements receive an immediate discharge of their debts³⁷ which enjoins future collections efforts and makes protection from harassment permanent.³⁸ This discharge effectively shields any post-petition income that the consumer earns and any new assets that the consumer acquires from attachment by the consumer's pre-petition creditors. Thus, Chapter 7 protects the consumer's income earned during the bankruptcy process or thereafter.

Chapter 7 also provides consumers with substantial protection of their assets while in bankruptcy. In exchange for the discharge, the consumer must forfeit any assets that she has at the time of her petition if these assets are not protected by a bankruptcy exemption.³⁹ These assets are then liquidated with the proceeds distributed to certain priority creditors⁴⁰ and then to general creditors on a pro rata basis.⁴¹ However, the bankruptcy exemptions are typically generous relative to the actual assets of most Americans,⁴² to

34. See, e.g., Rafael Erfat, *The Fresh Start Policy in Israel*, 7 AM. BANKR. INST. L. REV. 555 (1999) (providing a brief description of the bankruptcy systems in various common-law countries); Paul B. Lewis, *Can't Pay Your Debts, Mate? A Comparison of the Australian and American Personal Bankruptcy Systems*, 18 BANKR. DEV. J. 297 (2002) (describing the Australian bankruptcy system).

35. See Braucher & Mooney, *supra* note 24 (proposing a system that assesses an effective tax on the consumer's income in bankruptcy); Hung-Jen Wang & Michelle J. White, *An Optimal Personal Bankruptcy Procedure and Proposed Reforms*, 29 J. LEGAL STUD. 255 (2000) (proposing a system that assesses an effective tax on the consumer's income in bankruptcy).

36. 11 U.S.C. § 362 (2000).

37. Chapter 7 will not discharge some debts, such as child support, taxes, or fraudulently obtained debts. *Id.* § 727.

38. *Id.* § 524.

39. *Id.* § 522.

40. *Id.* § 507.

41. *Id.* § 726.

42. For example, in 1995 the median homeowner had roughly fifty thousand dollars of home equity. See, U.S. DEP'T OF COMMERCE CURRENT POPULATION REPORTS: THE SURVEY OF INCOME AND

say nothing of most Americans in financial distress.⁴³ Moreover, bankruptcy courts allow consumers to sell many of their non-exempt assets and purchase exempt assets prior to filing.⁴⁴ As a result, only a very small minority of consumers in Chapter 7 have non-exempt assets when they file. Distributions to general creditors are largely a matter of theory in non-business Chapter 7 cases.⁴⁵

As mentioned above, bankrupt consumers must meet specific requirements to obtain a discharge in Chapter 7. For example, the consumer cannot hide assets from creditors or lie to the court,⁴⁶ and the consumer cannot have obtained another bankruptcy discharge within the last six years.⁴⁷ Moreover, since 1984, either the bankruptcy judge or the U.S. Trustee (but not the consumer's creditors or the bankruptcy trustee) can move to dismiss the consumer's bankruptcy petition if he believes the petition to be a "substantial abuse" of the Code.⁴⁸ The meaning of this term is unclear, but many courts assume that it has something to do with the debtor's ability to pay debts as they come due.⁴⁹ The pending bankruptcy reforms would apply a more explicit test of a consumer's ability to repay out of future income.⁵⁰

Chapter 7 offers the consumer only limited protection of assets that the consumer has pledged as collateral. In theory, the consumer can redeem collateral by paying the secured creditor the lesser of the total amount owed or the market value of the collateral.⁵¹ In practice, however, this right is rather limited because redemption requires cash, and few bankrupt consum-

PROGRAM PARTICIPATION v-vii (Michael E. Davern & Patricia J. Fisher) (2001). Twenty-two states have exemptions that would allow them to exempt at least this amount. *See, e.g.*, Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 U. Ill. L. Rev. 301, 309-12 [hereinafter *Non-Procrustean Bankruptcy*].

43. One study of bankrupt debtors in 1991 revealed that the median homeowner in bankruptcy had just \$5,500 in home equity. SULLIVAN, WARREN & WESTBROOK, *supra* note 27, at 221.

44. For a discussion of the limits of pre-bankruptcy planning, see Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235 (1995).

45. *See supra* notes 9-10 and accompanying text.

46. 11 U.S.C. § 727 (2000).

47. *Id.* The debtor may be able to receive a Chapter 7 discharge if her prior discharge was given in Chapter 12 or 13, she paid at least seventy percent of her unsecured creditors' claims, and she made her "best effort." *See id.* The pending bankruptcy reform legislation would make the consumer wait eight years. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. REP. NO. 108-975, § 312 (2003).

48. 11 U.S.C. § 707(b) (2000).

49. Some courts hold that an ability to pay one's debts alone supports a finding of substantial abuse. *E.g., In re Kelly*, 841 F.2d 908, 914-15 (9th Cir. 1988); *accord* *United States v. Harris*, 960 F.2d 74, 76 (8th Cir. 1992). However, other courts find that an ability to pay one's debts is not sufficient by itself to find substantial abuse. *See, e.g., In re Green*, 934 F.2d 568, 572 (4th Cir. 1991). Still, most courts seem to regard the ability to pay as the primary consideration in the substantial abuse analysis. *See, e.g., In re Lamanna*, 153 F.3d 1, 5 (1st Cir. 1998); *In re Stewart*, 175 F.3d 796, 808-09 (10th Cir. 1999). As discussed below, some academics claim that these standards are not vigorously enforced. *See infra* note 350 and accompanying text.

50. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, *supra* note 47, § 102.

51. Section 506 divides the secured creditor's claim into a secured claim equal to the market value of the collateral and an unsecured claim equal to the remaining balance of the loan. The debtor is able to redeem the collateral in bankruptcy by repaying the secured claim. 11 U.S.C. § 722 (2000). However, if the debtor does not redeem the collateral in bankruptcy, the creditor will retain a lien with a value equal to the entire face value of her original claim. *Dewsnup v. Timm*, 502 U.S. 410, 418-19 (1992).

ers have this in an abundant supply.⁵² As a result, the secured creditor can credibly threaten to repossess collateral at the conclusion of the bankruptcy proceeding⁵³ if it is not paid in full.⁵⁴ Because of this threat, consumers will often reaffirm debts secured by collateral that they wish to retain.⁵⁵

In short, consumers who choose Chapter 7 emerge free from debt except for those obligations they reaffirm and those obligations that are exempted from the discharge. Their discharge puts an end to the calls seeking repayment and frees their future income from attachment. While in theory consumers must sacrifice their non-exempt assets to gain this discharge, in practice the number of bankrupt consumers who have any non-exempt assets is negligible. Still, Chapter 7 provides at most temporary relief from secured debts, and consumers are likely to reaffirm these debts if they wish to keep the assets that they have pledged as collateral.

2. Chapter 13 and Other Systems of Debt Adjustment

In contrast to the relatively expeditious Chapter 7, Chapter 13 bankruptcies can last up to five years, as consumers must propose and complete a repayment plan if they are to receive a discharge.⁵⁶ During this time the automatic stay will protect consumers from harassment in much the same way that it protects the consumer in Chapter 7.⁵⁷ If a consumer successfully completes a repayment plan, the court will grant a discharge that, like the discharge of Chapter 7, will make the protection from harassment permanent and shield the consumer's post-bankruptcy income and assets from most pre-petition creditors.⁵⁸

One of the major differences between Chapters 7 and 13 is the treatment of the consumer's income and assets in bankruptcy. A commonly cited benefit of Chapter 13 is its ability to help the consumer retain assets that are

52. See, e.g., ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 293 (2001) ("For most debtors, section 722 might as well be redemption on the debtor running a three minute mile.").

53. A secured creditor could foreclose sooner if given relief from the automatic stay. 11 U.S.C. § 362 (2000).

54. A few courts allow debtors to simply retain their collateral by continuing to make their pre-bankruptcy payments, but this reasoning has little support in the Code. See, e.g., WARREN & WESTBROOK, *supra* note 52, at 293-94 (describing the courts' discovery of an "unstated alternative" in the Code).

55. For a discussion of the role of reaffirmations in bankruptcy, see Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 713 (1999) (finding that twenty-five percent of cases sampled had a reaffirmation agreement in the file). Some of the debts that consumers reaffirm are unsecured. The consumer may wish to retain good relations with a creditor so that he can obtain credit after bankruptcy. The consumer may also fear that a creditor will claim that the debt was obtained by fraud or is otherwise not dischargeable in bankruptcy. See 11 U.S.C. § 523 (2000).

56. 11 U.S.C. § 1322(d) (2000) (providing a default rule of three-year repayment plans but allowing a court to order a five-year plan for cause).

57. *Id.* § 362.

58. The discharge offered in Chapter 13 is substantially broader than the discharge offered in Chapter 7. For example, the consumer in Chapter 13 may obtain a discharge of debts for willful and malicious injuries—intentional torts—by the consumer. *Id.* § 1328.

either unprotected by exemptions or pledged as collateral.⁵⁹ Instead of liquidating the consumer's non-exempt assets, Chapter 13 requires that the consumer propose to pay an amount equal to the value of the assets over the course of the plan.⁶⁰ Perhaps more importantly, Chapter 13 may allow consumers to retain assets pledged as collateral without reaffirming their loans because they need not produce enough cash to redeem the collateral immediately. That is, Chapter 13 allows consumers to retain assets pledged as collateral as long as they *propose* to repay an amount equal to the claims secured by the collateral.⁶¹ Significantly, bankruptcy will generally reduce this secured claim, thus reducing the amount that the consumer must propose to repay to the value of the collateral, but only if this is less than the total amount that the consumer owes to the secured creditor.⁶²

In exchange for this asset protection, Chapter 13 claims some of the income that the consumer earns while in bankruptcy.⁶³ Specifically, if a creditor objects to the consumer's repayment plan, the consumer must promise to repay an amount equal to the excess of her projected income over her reasonably necessary expenses during a three-year period.⁶⁴ If Chapter 13 operated in accordance with its plain meaning, it would simply replace the consumer's pre-petition obligations with a new set of obligations determined in accordance with her ability to pay. Chapter 13 would operate as an "Adjustment of Debts of an Individual with Regular Income."⁶⁵

59. See, e.g., Barry Adler et al., *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 587-88 (2000) ("As this sketch suggests, a debtor will file under Chapter 13 when he values his nonexempt assets more than the fraction of his future earnings that the court-approved plan will require him to give up.").

60. The plan must pay unsecured creditors an amount equal to what they would have received in a Chapter 7 filing, or an amount equal to the debtor's non-exempt assets. 11 U.S.C. § 1325(a)(4) (2000).

61. *Id.* § 1325(a)(5).

62. *Id.* § 506. The remainder of the loan becomes an unsecured obligation. Note, however, that bankruptcy courts will not reduce the value of the home mortgage in this manner, *id.* § 1322(b)(2), and the pending bankruptcy legislation would exempt other secured loans if the loans were recently used to purchase the collateral in question. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, *supra* note 47, §§ 306(b), 309(a)(1)(c).

63. From its inception in 1978 until 1984, Chapter 13's only explicit repayment requirement obligated the consumer to repay as much as she would in Chapter 7. Robert B. Chapman, *The Bankruptcy of Haig-Simons? The Inequity of Equity and the Definition of Income in Consumer Bankruptcy Cases*, 10 AM. BANKR. INST. L. REV. 765, 783 (2002). Consumers without non-exempt assets began proposing plans that promised little or no repayment for unsecured creditors. Chapter 13's predecessor, Chapter XIII, required creditor consent to confirm a plan, 11 U.S.C. §§ 1051, 1052 (repealed 1978), and as a result, almost all plans promised full repayment for all creditors. DAVID T. STANLEY & MARJORIE GIRTH, *BANKRUPTCY: PROBLEM, PROCESS REFORM* 94 (1971) (finding that approximately ninety-nine percent of Chapter XIII plans proposed to pay all debts in full); *accord* BENJAMIN WEINTRAUB & ALAN N. RESNICK, *BANKRUPTCY LAW MANUAL* ¶ 9.01, at 9-3 (2d ed. 1986). Some judges reacted to the appearance of low or no repayment plans by ruling that the plans violated the good faith requirements of Chapter 13. See, e.g., *In re Burrell*, 2 B.R. 650, 653 (Bankr. N.D. Cal. 1980) ("Although debtor's plan meets the best effort test, it falls considerably short of meeting the substantial payment requirement."); *In re Raburn*, 4 B.R. 624, 625 (Bankr. M.D. Ga. 1980) (refusing to confirm a plan unless it paid seventy percent of allowed unsecured claims). For a general review of these cases, see Brandon L. Johnson, *Good Faith and Disposable Income: Should the Good Faith Inquiry Evaluate the Proposed Amount of Repayment?*, 36 GONZ. L. REV. 375 (2000-01).

64. 11 U.S.C. § 1325(b) (2000).

65. This is in fact the title of Chapter 13. *Id.* §§ 1301-1330.

Note that this system of debt adjustment is not unique to Chapter 13. For example, the bankruptcy chapter for family farmers, Chapter 12, contains a provision almost identical to that of Chapter 13.⁶⁶ Bankruptcy courts in England have long conditioned discharge on the future payment of an amount fixed by the court with reference to the consumer's ability to pay.⁶⁷ Of course this adjustment of debts is not absolute. Chapter 12,⁶⁸ Chapter 13,⁶⁹ and the English system⁷⁰ would allow for an additional adjustment of these obligations if the consumer's financial condition materially changed.

In practice, Chapter 13 may not operate as its language would suggest. Some scholars argue that in many jurisdictions the consumer must propose a minimum percentage repayment for unsecured creditors or else face costly litigation that she simply cannot afford.⁷¹ Others argue that this projected disposable income clause provides little leverage for creditors because most consumers remain free to file under Chapter 7 and thus are able to propose plans with very little repayment.⁷² Finally, some courts order the consumer to include in her plan a promise to increase her payments if her actual income exceeds her projected income.⁷³ Such a clause effectively imposes an income tax on the consumer.

In short, like Chapter 7, Chapter 13 protects consumers from harassment. Chapter 13 does not offer consumers an immediate discharge; they are asked to make payments from their income over a period of three to five years. In exchange the consumers are given a greater ability to retain assets.

66. *Id.* § 1225(b).

67. *See, e.g.*, JACOB S. ZIEGEL, COMPARATIVE CONSUMER INSOLVENCY REGIMES: A CANADIAN PERSPECTIVE 115-19 (2003) (discussing "income payment orders" that are determined by a court's evaluation of the debtor's ability to pay); Douglass G. Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 69, 81-82 (1982) (describing a system in which debtors make "voluntary" pledges of repayment out of their future income in exchange for a discharge).

68. 11 U.S.C. § 1229 (2000).

69. *Id.* § 1329.

70. *See, e.g.*, Boshkoff, *supra* note 67, at 75-103 (describing the English system); The Insolvency Service, Dep't of Trade & Industry of England and Wales, *Guide to Bankruptcy* (2004), available at <http://www.insolvency.gov.uk/pdfs/gtbweb.pdf> (last visited Sept. 26, 2004).

71. *See, e.g.*, Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 532 (1993) ("The reality is that Chapter 13 trustees and judges in the four cities [studied] effectively deter 0% plans and keep most plans above a floor percent that is known to local practitioners."). This impression is shared by those who advise consumers on how to file for bankruptcy. *See, e.g.*, ROBIN LEONARD, CHAPTER 13 BANKRUPTCY: REPAY YOUR DEBTS 7/1 (5th ed. 2001) ("In some courts, the judge will not approve your plan unless you propose paying your unsecured creditors a significant portion of what you owe them, usually at least 70%. The lawyers then respond by rarely or never submitting plans with less than the specified percentage.").

72. *See, e.g.*, DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 55-61 (Revised ed. 1993).

73. *See* Rowley v. Yarnall, 22 F.3d 190, 193 (8th Cir. 1994); *In re Smith*, 222 B.R. 846, 858 (Bankr. N.D. Ind. 1998); *In re Krull*, 54 B.R. 375, 378 (Bankr. D. Col. 1985) (requiring that the debtor repay with all of her "projected disposable income" plus fifty percent of the amount by which her actual income exceeded her disposable income). This approach was later followed in *In re Riggleman*, 76 B.R. 111, 114 (Bankr. S.D. Ohio 1987). However, the Southern District of Ohio has since adopted the approach of *In re Anderson*, 21 F.3d 355 (9th Cir. 1994). *See In re Bass*, 267 B.R. 812, 819 (Bankr. S.D. Ohio 2001). For a more detailed description of these cases, see Richard M. Hynes, *Optimal Bankruptcy in a Non-Optimal World*, 44 B.C. L. REV. 1, 57-68 (2002) [hereinafter *Optimal Bankruptcy*].

3. Taxation-Based Bankruptcy

If interpreted in accordance with its plain meaning, the projected disposable income test would create a lump-sum tax equal to the consumer's projected ability to pay, and thus would not distort (but would still affect) the consumer's incentive to work during bankruptcy.⁷⁴ However, if interpreted to require consumers to repay with all of their actual income in excess of their reasonably necessary expenses, Chapter 13 could impose a one-hundred percent marginal tax rate that would deprive consumers of the incentive to earn any more than their allotted expenses.⁷⁵ Because of this concern about the consumer's work incentives, the National Bankruptcy Review Commission⁷⁶ suggested reforms that would have replaced the projected disposable income test with a progressive tax on the consumer's actual income during the life of her Chapter 13 plan.⁷⁷ Some scholars suggest that a taxation-based bankruptcy system should be the standard form of bankruptcy in the United States,⁷⁸ as it is in other countries such as Australia.⁷⁹

Beyond requiring that consumers repay with some portion of their income over a fixed number of years, the details of these proposals vary. Some proposals would not change other important aspects of bankruptcy law, such as the treatment of secured claims and after-acquired property,⁸⁰ while other proposals are silent on these issues.⁸¹ By contrast, the taxation-based bankruptcy systems currently used in other countries differ markedly from United States law on these matters. For example, in Australia, any assets that consumers acquire while they are still in bankruptcy are subject to attachment if they cannot claim an appropriate exemption,⁸² and secured

74. See *Optimal Bankruptcy*, *supra* note 73, at 57-62. Simply put, a lump-sum tax does not "distort" an individual's incentive to work because she is allowed to keep the entirety of the last dollar earned; thus, there is no "substitution effect." However, there is a "wealth effect." The tax leaves her less wealthy, giving her an incentive to work harder. For a fuller description of these two effects in the context of consumer bankruptcy, see *id.*

75. See, e.g., NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, FINAL REP. 269 (1997) [hereinafter, NBRC REPORT], available at <http://govinfo.library.unt.edu/nbrc/report/01title.html>; Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 AM. BANKR. L.J. 461, 471 (1997); Wang & White, *supra* note 35, at 256. As a matter of theory, however, one cannot conclude that a bankruptcy tax rate of one-hundred percent discourages the aggregate work incentive any more than a lower marginal rate. The higher tax rate will certainly discourage those in bankruptcy from working. However, it will also provide those teetering on the edge of bankruptcy with a greater incentive to work hard and avoid default. One cannot determine which tax rate provides better work incentives on average without comparing the size of these two groups. See *Optimal Bankruptcy*, *supra* note 73, at 74.

76. In 1994, Congress established the National Bankruptcy Review Commission to study bankruptcy. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 602-03, 108 Stat. 4106, 4147 (1994).

77. See NBRC REPORT, *supra* note 75, at 269.

78. See, e.g., Braucher & Mooney, *supra* note 24; Wang & White, *supra* note 35.

79. See *supra* note 34 and accompanying text.

80. See, e.g., Braucher & Mooney, *supra* note 24.

81. See, e.g., Wang & White, *supra* note 35 (failing to mention the treatment of secured credit or after-acquired property in their proposal).

82. See Lewis, *supra* note 34, at 323-24.

creditors largely remain free to foreclose on their collateral if they are not paid.⁸³

*B. Recreating Bankruptcy's Debt Relief without
the Bankruptcy Proceeding*

Sadly, financial distress is not a recent phenomenon.⁸⁴ Despite the record number of recent bankruptcy filings, some statistics suggest that financial distress may have been as common in previous generations. According to Professor Charles Warren, approximately seventy-five thousand Americans were sent to debtor's prison each year in the years surrounding 1833.⁸⁵ If true, the ratio of the number of individuals sent to debtor's prison to the total population of the United States in 1833 is roughly equal to the ratio of the total number of bankruptcy filings in 2002 to the total population of the United States in that year.⁸⁶

While financial distress is not new, consumer bankruptcy is dramatically more common than in the past. The United States lacked a lasting bankruptcy system until the very end of the nineteenth century,⁸⁷ and bankruptcy remained relatively rare for generations thereafter. Annual non-business bankruptcy filings did not reach one hundred thousand until 1961,⁸⁸ by contrast, in 2003 there were over one-and-a-half million non-business bankruptcy filings.⁸⁹ These statistics understate the increase in bankruptcies because spouses could not file a joint petition until after 1978.⁹⁰

83. *Id.* at 326-28.

84. For an excellent history of consumer credit in American history, see LENDOL CALDER, *FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT* (1999).

85. CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 52 n.8 (1935).

86. The United States population in 1833 was approximately fourteen million. U.S. DEPARTMENT OF COMMERCE, *HISTORICAL STATISTICS OF THE UNITED STATES COLONIAL TIMES TO 1970*, A6-8 (1975) (reporting a population of approximately 14,162,000). Therefore, approximately one out of every two hundred Americans went to debtor's prison each year. See Press Release, Administrative Office of the U.S. Courts, http://www.uscourts.gov/Press_Releases/cy02.pdf (indicating that in fiscal year 2002, there were over one and a half million bankruptcy filings out of a total population of about two hundred eighty million); U.S. CENSUS BUREAU, *AMERICAN COMMUNITY SURVEY PROFILE 2002*, available at <http://www.census.gov/acs/www/Products/Profiles/Single/2002/ACS/Tabular/010/01000US1.htm> (estimating the 2002 population of the United States at 280,540,330). Therefore, there was approximately one bankruptcy filing for every two hundred individuals in 2002.

87. The Constitution grants Congress the power to enact uniform bankruptcy laws. U.S. CONST. art. I, § 8, cl. 4. However, prior to 1898, Congress enacted three bankruptcy acts that together lasted less than twenty years. Congress repealed the Bankruptcy Act of 1800 in 1803, 2 Stat. 248 (1803), the Bankruptcy Act of 1841 in 1843, Act of March 3, 1843, 5 Stat. 614 (1843), and the Bankruptcy Act of 1867 in 1878, Act of June 7, 1878, 20 Stat. 99 (1878). For a history of bankruptcy in the United States, see DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* (2001); Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995).

88. DIR. OF ADMIN. OFFICE OF THE U.S. CTS., 1961 ANN. REP., REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE U.S. 211 (1962).

89. There were 1,625,208 non-business bankruptcy filings in twelve months ending December 31, 2003. See THE FEDERAL JUDICIARY, TABLE F-2 U.S. BANKRUPTCY COURTS, at http://www.uscourts.gov/Press_Releases/1203f2.xls (last visited Sept. 26, 2004).

90. For a study addressing the empirical complications created by these changes, see Ian Domowitz & Thomas Eovaldi, *The Impact of the Bankruptcy Reform Act of 1978 on Consumer Bankruptcy*, 36 J.L.

The central positive claim of this Article is that even if the United States did not have a consumer bankruptcy system, the law could still grant a consumer effective relief from her debts. Consider again the common elements of relief that consumer bankruptcy offers: (1) protection from creditor harassment, (2) protection from foreclosure by secured creditors, (3) protection of assets and income while the consumer is in bankruptcy, and (4) a discharge that permanently shields the consumer's assets and income from pre-petition creditors. Non-bankruptcy debt relief laws either provide or can be modified to provide close substitutes for each of these protections.

1. *Protection from Harassment*

Creditors have long relied on shaming, intimidation, or other forms of aggressive collection techniques to induce a defaulting debtor to repay. In ancient Indian and Irish society, an unpaid creditor would sit or even fast at the debtor's doorstep, relying on social pressure to force the debtor to repay.⁹¹ Similarly, early English creditors would employ women to publicly chastise defaulting debtors at the debtors' place of employment,⁹² and today at least one collector in Latin America employs costumed devils and scantily clad women to publicly humiliate defaulting debtors.⁹³ Even in this country, some collectors use their status as "bikers" to scare debtors into repaying.⁹⁴ Lastly, some commentators characterize the letters and phone calls that creditors use to ask for repayment as a form of harassment designed to force repayment.⁹⁵

& ECON. 803, 821 (1993) (estimating that the Bankruptcy Reform Act of 1978 increased the number of bankruptcy filings by twenty-two percent but noting that this estimated effect is not statistically significant because of the very large standard error).

91. Louis Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 229 (1917-1918). Of course the techniques of "sitting dharna" and hunger strikes were used more recently in these societies, though usually as a form of protest or civil disobedience. Irish Northern Aid, Inc., *Irish Hunger Strikes Chapter 10* (2001), at <http://www.inac.org/irishhistory/hungerstrikes/chapters/10> (last visited Sept. 26, 2004) (describing Celtic hunger strikes and the "sitting dharna" used in other cultures).

92. See, e.g., Samuel A. Rea, *Arm Breaking, Consumer Credit and Personal Bankruptcy*, 22 ECON. INQUIRY 188, 195 (1984) (claiming that creditors employed women as "bawlrouts" to publicly shame a defaulting debtor).

93. See Marc Lifsher, *In Venezuela, If You Don't Pay Your Bills, A Devil Might Pay You a Visit*, WALL ST. J., June 25, 2001, at A1 (describing the antics of a debt collector who calls himself "Dr. Diablo").

94. See, e.g., WARREN & WESTBROOK, *supra* note 52, at 26-28 (describing a collection agency that relies on a tough biker image to convince debtors to repay).

95. See, e.g., Daniel Keating, *Offensive Uses of the Bankruptcy Stay*, 45 VAND. L. REV. 71, 75 (1992) ("Therefore, under the current automatic stay, even informal collection activities such as making harassing telephone calls or posting deadbeat signs on the debtor's premises are violations of the stay."); Michelle J. White, *Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal For Change*, 65 U. CHI. L. REV. 685, 690 (1998) (framing a hypothetical, "Neither debtor owns a house. Creditors are regularly harassing both debtors with threatening telephone calls and have begun garnishing their wages."); BANKING DEPT., STATE OF NEW YORK, FREQUENTLY ASKED QUESTIONS, at <http://www.banking.state.ny.us/faq.htm#faqqrdr> (last visited Sept. 26, 2004) (indicating that asking how to stop such calls is a "frequently asked question").

Historically, non-bankruptcy law contained few limits on these collection techniques.⁹⁶ However, the twentieth century saw an expansion of tort law and the rise of doctrines applicable to many forms of harassment such as invasion of privacy, misuse of the legal process, the intentional infliction of emotional distress, and interference with contractual relations.⁹⁷ All fifty states have passed general consumer protection acts, and most of these laws are flexible enough to apply to many forms of collection abuse.⁹⁸ In the 1970s, a few states added comprehensive debt collection laws that explicitly prohibit harassing or deceptive collection practices and provide a private right of action for the debtor.⁹⁹ In 1977, Congress enacted a federal version of a comprehensive debt collection statute, the Fair Debt Collection Practices Act,¹⁰⁰ and the Federal Trade Commission has enacted various regulations to supplement this protection.¹⁰¹ One reason that modern American debt collectors do not employ costumed devils or scantily clad women to publicly humiliate debtors is that such practices are not permitted under the law.¹⁰²

This Article claims that non-bankruptcy law can provide relief equivalent to that provided by a bankruptcy discharge, not that non-bankruptcy law currently does so. Many feel that existing non-bankruptcy limitations on collections activity are insufficient. For example, the Fair Debt Collections Practices Act does not apply to the original creditor,¹⁰³ and few consumers know that they can stop a collections agency from sending dunning letters by sending a written request.¹⁰⁴ However, scholars have suggested reforms that would remedy these perceived deficiencies,¹⁰⁵ and there is no reason that Congress could not enact these reforms if it so desired.¹⁰⁶

96. 2 HOWARD J. ALPERIN & ROLAND F. CHASE, CONSUMER LAW 438-40 (1986).

97. See, e.g., ALPERIN & CHASE, *supra* note 96, at §§ 676-681; Robert M. Berger, *The Bill Collector and the Law—A Special Tort, At Least for a While*, 17 DEPAUL L. REV. 327 (1968); Charles E. Hurt, *Debt Collection Torts*, 67 W. VA. L. REV. 201 (1965); William Richard Carroll, Comment, *Debt Collection Practices: The Need for Comprehensive Legislation*, 15 DUQ. L. REV. 97 (1976).

98. ALPERIN & CHASE, *supra* note 96, at 356.

99. See, e.g., CAL. CIV. CODE § 1788 (West 1998); ALPERIN & CHASE, *supra* note 96, at § 632 (collecting statutes).

100. 15 U.S.C.A. § 1692 (1997).

101. ALPERIN & CHASE, *supra* note 96, at 349.

102. See Fair Debt Collection Practices Act, *supra* note 100; *Graziano v. Harrison*, 763 F. Supp. 1269, 1275 (D.N.J. 1991) (“The purpose of the Fair Debt Collection Practices Act was to protect consumers from unfair, deceptive and harassing collection practices while leaving collectors free to employ efficient, reasonable and ethical practices in pursuit of their profession.”); 15A AM. JUR. 2D *Collection and Credit Agencies* § 15 (2003) (explaining that a debt collector can be liable for “extreme and outrageous conduct in attempting to collect a debt”).

103. See 15 U.S.C. § 1692(a) (2000) (excluding original creditors from the definition of debt collector).

104. See, e.g., Elwin Griffith, *The Search for More Fairness in the Fair Debt Collection Practices Act*, 37 U. RICH. L. REV. 511, 555-57 (2003) (arguing that collectors should have to inform the consumer that they can stop the dunning letters, thus implying that consumers generally do not know about this right).

105. *Id.* at 555-63.

106. This Article does not claim that Congress should enact further limitations on creditor collections, only that it is possible.

2. *Forestalling Foreclosure*

The most frequently used form of American consumer bankruptcy, Chapter 7, provides consumers with little protection against secured creditors. Generally, consumers lack the cash necessary to redeem collateral,¹⁰⁷ and the automatic stay typically adds only a minor delay to the foreclosure process.¹⁰⁸ The consumer bankruptcy systems found in other common-law countries offer similarly limited protection against the secured creditor; bankruptcy does not typically inhibit foreclosure in Australia,¹⁰⁹ Canada,¹¹⁰ or England.¹¹¹

By contrast, Chapter 13 of the American Bankruptcy Code offers substantial protection against the secured creditor. First, a Chapter 13 bankruptcy filing offers the consumer time. Consumers are able to delay foreclosure through an automatic stay that could last up to five years.¹¹² While some argue that consumers abuse this power by repeatedly filing for relief in Chapter 13 in order to delay foreclosure indefinitely,¹¹³ even the pending bankruptcy reforms would not deny the automatic stay when the consumer files for protection the first time.¹¹⁴ Second, the consumer may be able to reduce the secured creditor's lien to the value of the collateral if this is less than the total amount that she owes.¹¹⁵

Significantly, society does not need a bankruptcy system that binds all of the consumer's creditors to provide either form of protection offered by Chapter 13. For example, nearly half of all states require that a mortgage holder bring an action in court in order to foreclose,¹¹⁶ and the notice and

107. See *supra* note 52 and accompanying text.

108. See, e.g., STEPHEN ELIAS ET AL., HOW TO FILE FOR CHAPTER 7 BANKRUPTCY 1/15 (11th ed. 2004) ("If your home mortgage is in foreclosure, the automatic stay temporarily stops the proceedings. However, the creditor will often be able to proceed with the foreclosure sooner or later.").

109. See, e.g., Lewis, *supra* note 34, at 326.

110. See, e.g., Ziegel, *supra* note 67, at 25-27 ("Canadian consumer bankruptcy law is much more favourable to secured creditors than is US law. There is no automatic stay in a straight bankruptcy"); BankruptcyCanada.com, *Frequently Asked Questions*, at <http://www.bankruptcycanada.com/questions1.htm> (last visited Sept. 14, 2004) ("By law, all actions against a bankrupt must cease once the documents are filed. This does not apply to secured creditors such as banks holding, for example, a lien on a car.").

111. See, e.g., GUIDE TO BANKRUPTCY, *supra* note 70, at 12-13 (explaining that under the British system, secured creditors can sell your home if mortgage payments are discontinued); Boshkoff, *supra* note 67, at 78 n.44 (noting that the English "receiving order" does not prevent secured creditors from seizing their collateral).

112. See *supra* note 56 and accompanying text.

113. See, e.g., Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 502-03 (1997) ("The [National Bankruptcy Review] Commission received a great deal of testimony from debtors' attorneys asserting that many people do not file for Chapter 13 in order to receive a discharge; they file only for the automatic stay."). *But see* Susan L. DeJarnatt, *Once is Not Enough: Preserving Consumers' Rights to Bankruptcy Protection*, 74 IND. L.J. 455, 474-80 (1999) (arguing that Chapter 13 trustees do not perceive serial filings designed to delay foreclosure to be a significant source of bankruptcy abuse).

114. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, 108th Cong. §§ 302-303 (2003).

115. See *supra* note 62 and accompanying text.

116. See, e.g., Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L.

procedural requirements may substantially delay foreclosure.¹¹⁷ Moreover, many states grant the defaulting mortgagor the right to “redeem” the collateral up to two years after the foreclosure sale at the price obtained in the foreclosure sale.¹¹⁸ Most states that grant this right of redemption allow the mortgagor to remain in possession during this period.¹¹⁹ These non-bankruptcy “mortgagor protection laws” provide the consumer with time to recover financially and are often justified on the same insurance and market failure grounds that are used to justify the bankruptcy discharge.¹²⁰ Even if a state does not extend similar protections against foreclosure by other secured creditors, there is no obvious reason that it could not do so.

Society could amend non-bankruptcy law to provide something similar to the ability of bankrupt consumers to reduce the value of the liens against their property. In order to accomplish this, non-bankruptcy law would need to invoke a procedure in which a judge estimates the value of the collateral and adjusts the lien accordingly. However, this process involves only the claim of one creditor, and thus there is no reason that this procedure must bind all of a consumer’s creditors. There is also no reason that this adjustment must take place in a system that we would call bankruptcy.¹²¹ Of course the creditor would be entitled to seek the full amount owed pursuant to a deficiency judgment unless prohibited by the state,¹²² but this would be an unsecured obligation that would be enforced against the consumer’s other assets and income.

3. *Protection of Assets and Income While the Consumer Is in Bankruptcy*

Even before granting a discharge, bankruptcy law allows the consumer to retain some of her assets and income while her creditors remain unpaid. Non-bankruptcy law provides temporary protection as well. Defaulting consumers may have their wages garnished if they do not file for bankruptcy. However, federal non-bankruptcy law exempts the greater of thirty times the federal minimum wage or seventy-five percent of the consumer’s take-home pay from garnishment and allows states to exempt even more.¹²³ Some states provide further limits,¹²⁴ and a few prohibit wage garnishment

REV. 489, 492-93 (1991).

117. *Id.* at 493 (“Mortgagees generally favor power of sale foreclosures because they are quicker and less costly than judicial foreclosure.”).

118. *Id.* at 495.

119. *Id.*

120. *Id.*

121. *See* Radin, *supra* note 5 (describing bankruptcy as a process that binds all of a debtor’s creditors).

122. *See* Schill, *supra* note 116, at 494-95 (describing limits on deficiency judgments).

123. *See, e.g.*, 15 U.S.C. § 1673 (2002) (exempting the greater of thirty times the federal minimum wage or seventy-five percent of the debtor’s take-home pay).

124. *See, e.g.*, DEL. CODE ANN. tit. 10, § 4913 (2003) (exempting eighty-five percent of earned but unpaid wages); 740 ILL. COMP. STAT. 170/4 (2004) (exempting the greater of eighty-five percent of earned but unpaid weekly wages or forty-five times the Federal minimum hourly wage).

entirely.¹²⁵ Thus, consumers are able to shield most, and in some cases all, of their income from their creditors, and society can increase the amount of income protected by simply amending these statutes.

For the most part, the consumer may use the same asset exemptions outside of bankruptcy that she may use inside of bankruptcy. The Bankruptcy Code gives the consumer the choice between certain bankruptcy-specific exemptions found in § 522(d) of the Code and the exemptions available to her under state law and non-bankruptcy federal law.¹²⁶ However, the Code also gives each state the right to deny their residents this choice and insist that their residents use the state and non-bankruptcy federal exemptions.¹²⁷ The vast majority of states chose to “opt-out” of the § 522(d) exemptions within the first few years of the enactment of this choice,¹²⁸ and many of the states that did not choose to opt-out of this system have non-bankruptcy exemptions that are so generous that the availability of the federal exemptions in § 522(d) has little practical significance.¹²⁹

Even if a state has opted out of the § 522(d) exemptions, there may be some difference in the ability of its residents to exempt assets inside and outside of bankruptcy. Some states that chose to opt-out of the federal exemptions enacted state exemptions that can only be used in bankruptcy,¹³⁰ but these states are few in number. A more significant difference is that the bankrupt consumer need only store her wealth in exempt form at the time of filing. In other words, the consumer who does not file for bankruptcy faces a continuous threat of attachment if she ever holds a non-exempt asset, such as cash in her savings account.¹³¹ Of course, this distinction would matter little if the exemptions were sufficiently generous so that few consumers would face a realistic chance of attachment. Moreover, there is no reason that bankruptcy must treat exemptions in this manner. Other nations have bankruptcy proceedings that span a number of years, and creditors remain free to attach any non-exempt asset that a consumer acquires during this time.¹³² In addition, courts could invoke strict limits on pre-bankruptcy planning,¹³³ and thereby limit the ability of the debtor to take advantage of

125. See, e.g., 42 PA. CONS. STAT. § 8217 (2002) (prohibiting wage garnishment in favor of general creditors); TEX. PROP. CODE ANN. § 42.001(b)(1) (2000) (prohibiting wage garnishment in favor of general creditors).

126. 11 U.S.C. § 522(b) (2000).

127. *Id.*

128. See *Political Economy*, *supra* note 12, at 26-27.

129. *Id.*

130. See, e.g., OHIO REV. CODE ANN. §§ 2329.66(A)(4)(a), (A)(17) (West 2003); CAL. CIVIL PROCEDURE CODE § 703.140 (2004).

131. Some states do provide specific exemptions for bank deposits. See, e.g., N.Y. DEBT. & CRED. LAW § 283(2) (2001) (exempting up to \$2,500 in bank deposits). Other states provide exemptions that can be used to protect a limited amount of any property. See, e.g., ALA. CODE § 6-10-6 (1975) (exempting \$3,000 of personal property).

132. See, e.g., Boshkoff, *supra* note 67, at 82 (noting that an English bankruptcy court can reach the debtor's post-petition earnings); Lewis, *supra* note 34, at 323-24 (noting that the Australian bankruptcy court can reach property the debtor receives after filing but prior to discharge).

133. This Article does not necessarily advocate strong limits on pre-bankruptcy planning. For articles addressing this issue, see Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their*

the fact that American bankruptcy only measures the debtor's non-exempt assets at one instant.

This Article does not argue that current non-bankruptcy law protects a sufficient amount of the consumer's assets or income; the point is simply that both federal and state governments can protect the consumer's assets and income and thereby make bankruptcy less necessary. In fact, one of the primary arguments made in support of the federal limitations on garnishment was that these limitations would remove many poor debtors from bankruptcy.¹³⁴

4. *Providing a Fresh Start*

Perhaps the most critical difference between a consumer who receives a bankruptcy discharge and a consumer with no assets or income that her creditors can attach is that in the latter case the consumer's obligations remain outstanding. Even if a consumer's current income and assets are exempt, the consumer may have little incentive to save and acquire new assets or to work hard and increase her earnings if these assets and earnings will not also be protected. That is, non-bankruptcy law may provide only temporary protection, and the consumer may continue to live under a "debt-overhang" that robs her of her will to work hard and to save.¹³⁵ A discharge can remove this debt-overhang and give the consumer a fresh start that will return her to productive society.¹³⁶

Even if debts remained outstanding forever, they would not create a significant debt-overhang if there is little chance that the consumer will ever earn or save enough to have non-exempt assets or income. Therefore, non-bankruptcy law could overcome the overhang problem simply by enacting larger exemptions or otherwise making the enforcement of debts more difficult. Earlier generations of consumer finance scholars, writing when consumer bankruptcy was far less common, advocated severe limitations on non-bankruptcy debt collections as a way of providing debt relief. In fact, some scholars argued that the law should refuse to enforce debts, or at least

Assets on the Eve of Bankruptcy: Villains or Victims of Fresh Start?, 70 N.Y.U. L. REV. 235 (1995). But see Juliet M. Moringiello, *Distinguishing Hogs from Pigs: A Proposal for a Preference Approach to Pre-Bankruptcy Planning*, 6 AM. BANKR. INST. L. REV. 103, 140 (1998) (arguing that "[a] preference approach to pre-bankruptcy planning would further the desirable goal of uniformity in the bankruptcy laws and would provide some certainty to courts and to debtors' attorneys").

134. See, e.g., *Consumer Credit Protection Act: Hearings on H.R. 11601 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking & Currency*, 90th Cong., 1st Sess. 721 (1967) (Vern Countryman arguing for limitations on garnishment to "relieve the Federal bankruptcy system of the burden of cases . . . filed only to avoid garnishment").

135. Note, however, that some economists now suggest that consumers would, on average, work more if no discharge existed because they would have an incentive to work hard and repay their debts. See, e.g., IGOR LIVSHITS ET AL., *CONSUMER BANKRUPTCY: A FRESH START* (Federal Reserve Bank of Minneapolis, Research Department, Working Paper No. 617, 2002) (suggesting that the bankruptcy discharge may reduce the consumer's incentive to work).

136. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

unsecured debts.¹³⁷ Though this sounds extreme, one must be careful when describing how this proposal differs from a freely available discharge. This is addressed in Part III.

Non-bankruptcy law has a less extreme measure for addressing the overhang problem: the statute of limitations.¹³⁸ At one time, a claim discharged in bankruptcy had roughly the same legal status as a claim on which the statute of limitations had run. Both could be reaffirmed without further consideration,¹³⁹ and the consumer had to plead each as an affirmative defense in a suit brought by a creditor to enforce the debt.¹⁴⁰ Today, the consumer who wishes to reaffirm a debt in bankruptcy must comply with certain procedural requirements,¹⁴¹ and the discharge serves as an injunction against further collections so the consumer will not have to plead it as an affirmative defense.¹⁴² These changes to bankruptcy law are quite significant. However, it would be a mistake to claim that the changes are critical for bankruptcy relief; our system of bankruptcy operated without them for over seventy years, about two-thirds of its existence.¹⁴³ Moreover, society could alter the effect of the statute of limitations to more closely track that of the discharge. For example, the Fair Debts Collection Practices Act now prohibits bill collectors from invoking judicial remedies on a debt on which the statute of limitations has run,¹⁴⁴ and society could expand the scope of this prohibition so that it mimics the injunction that accompanies a bankruptcy discharge. Similarly, society could change non-bankruptcy law so that reaffirmations of debts barred by the statute of limitations would be unenforceable unless consumers complied with whatever procedures were deemed necessary to protect them.

Statutes of limitations vary with the type of the claim; for written contracts they can be as long as fifteen years.¹⁴⁵ However, a few states have limitation periods that are within the three to five years¹⁴⁶ that it may take an

137. See, e.g., DAVID CAPLOVITZ, CONSUMERS IN TROUBLE: A STUDY OF DEBTORS IN DEFAULT 301-04 (1974) (effectively calling for the abolishment of formal remedies for unsecured credit); ARCHIBALD ROSSER, CREDIT PERNICIOUS 31-43 (1823) (arguing that courts should not enforce consumer debts as defined by the amount borrowed).

138. The relationship between the bankruptcy discharge and the statute of limitations is largely unexplored in the literature. For an article raising the issue, see, for example, Discussion, 41 LAW & CONTEMP. PROB. 123, 125 (1977) (noting that a discharge and a statute of limitations raise similar issues and calling for further study).

139. See, e.g., *Mills v. Wyman*, 20 Mass. 207, 227 (1825).

140. See, e.g., *Tabb*, *supra* note 87, at 35.

141. 11 U.S.C. § 524(c) (2000).

142. *Id.* § 524(a)(2).

143. The effect of a bankruptcy discharge was changed in 1970. Dischargeability Act, Pub. L. No. 467, 84 Stat. 990 (1970).

144. See 15 U.S.C.A. § 1692(f) (West 2003); *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (1987) ("The court agrees with Kimber that a debt collector's filing of a lawsuit on a debt that appears to be time-barred . . . is an unfair and unconscionable means of collecting the debt.").

145. See, e.g., KY. REV. STAT. ANN. § 413.090 (Michie 2002). For a collection of state statutes of limitation, see CardReport.com, *Statute Of Limitations For Debt*, at <http://www.cardreport.com/laws/state-of-limitations.html> (last visited Sept. 26, 2004).

146. See, e.g., IDAHO CODE § 5-216 (Michie 2003); KAN. STAT. ANN. § 60-511 (Supp. 2002); VA. CODE ANN. § 8.01-246 (Michie 2003).

American consumer to complete a Chapter 13 repayment plan or an Australian¹⁴⁷ or British¹⁴⁸ consumer to obtain a bankruptcy discharge. If the consumer has no assets or income that a creditor can attach, a creditor may simply give up, and his claim will eventually be barred by this limitation.

Some creditors will sue and obtain a judgment, and at common law a judgment could survive indefinitely, though it might become dormant if the creditor did not take sufficient action to enforce it within a year and a half of its signing.¹⁴⁹ Today, however, every state but Delaware has a statute that causes a judgment to expire after a term of years.¹⁵⁰ Some might worry that Delaware provides an exception that swallows the rule since so many credit card issuers are based there.¹⁵¹ However, even if the creditor could sue the consumer in Delaware, the creditor would still need to domesticate its judgment in the consumer's home state because that is where the consumer's assets are found.¹⁵² Therefore, the statute of limitations imposed by the consumer's home state would govern.

Note that the statute of limitations for judgments does not merely catch the idle creditor. Unlike a statute of limitations on a claim, a statute of limitations can run on a judgment even if the creditor is actively trying to enforce it. In fact, many states insist that all acts required to enforce the judgment be completed before the statute of limitations expires, and some creditors have seen their judgment expire even though a foreclosure sale had taken place and the only remaining required act was a judicial confirmation of sale.¹⁵³

This Article does not claim that non-bankruptcy law currently uses statutes of limitations to replicate the effect of a bankruptcy discharge, only that it can. The statute of limitations for judgments can be quite long; many states provide that a judgment will survive for up to twenty years.¹⁵⁴ Moreover, the vast majority of states allow a creditor to renew or revive a judgment an unlimited number of times so that a judgment could, in theory, remain outstanding forever.¹⁵⁵ Yet if a true debt-overhang exists (that is, if the

147. See, e.g., Lewis, *supra* note 34, at 318 ("Finally, like chapter 13, the typical period until discharge in Australia is three years.").

148. See, e.g., Boshkoff, *supra* note 67, at 87 (noting that many more debtors receive a discharge five years after filing for bankruptcy than receive a discharge immediately after filing). Note, however, that England recently passed legislation that would provide most bankrupt debtors with a discharge after only one year. See Enterprise Act, 2002, c. 40 (Eng.). The portion of this legislation governing consumer insolvency became effective in April, 2004. See *id.*

149. See THOMAS D. CRANDALL ET AL., THE LAW OF DEBTORS AND CREDITORS § 6.79, 6-227 (2002); Stefan A. Riesenfeld, *Collection of Money Judgments in American Law—A Historical Inventory and Prospectus*, 42 IOWA L. REV. 155, 172 (1957).

150. See 47 Am. Jur. 2d *Judgments* § 969 (2003) (explaining that judgments expire after a certain time period).

151. See Comment, Smiley v. Citibank (*South Dakota*), N.A.: *Charging Toward Deregulation in the Credit Card Industry*, 22 DEL. J. CORP. L. 601, 628 n.221 (1997) (noting that "[f]ive of the ten largest credit card issuers in the nation are located in Delaware . . .").

152. See CRANDALL, *supra* note 149, at 6-227.

153. See, e.g., Hazel v. Van Beek, 954 P.2d 1301, 1307 (Wa. 1998).

154. See, e.g., ALA. CODE § 6-2-32 (2003); FLA. STAT. ch. 55.081 (2003).

155. See CRANDALL, *supra* note 149, at 6-226 to -234. Whether the debtor renews or revives his

consumer is unlikely to ever repay all her debts in full), it is unlikely that the more junior claimants will take the trouble to revive their judgments.

Note that the possibility of using short, and non-renewable, statutes of limitations to replicate the effect of a bankruptcy discharge is not entirely hypothetical. A few states currently provide fairly short, and in some cases non-renewable, time limits on judgments. Some states provide periods for enforcing judgments that are as low as four¹⁵⁶ or five¹⁵⁷ years. More significantly, a few states allow a creditor to renew a judgment only once so that there is an absolute time limit on a judgment.¹⁵⁸ Admittedly, each of these states allows the original judgment to last ten years¹⁵⁹ so that a diligent creditor can retain his judgment for up to twenty years. However, at least one of these states once had a five-year limitation,¹⁶⁰ or about the length that the pending bankruptcy legislation would force high-income consumers to stay in Chapter 13 before receiving a discharge.¹⁶¹ Again, this Article does not claim that current non-bankruptcy law relief is equivalent to that offered by the Bankruptcy Code. This article claims only that non-bankruptcy law *could* be reformed to provide such relief.

Finally, the statute of limitations on judgments does not act as a blunderbuss that strikes all judgments regardless of their nature. Like the bankruptcy discharge, the statute of limitations may exempt some judgments based on the underlying claim for relief. For example, some states have statutes of limitations that provide special treatment for debts arising from family law,¹⁶² or from willful damage to property,¹⁶³ and there seems little reason that these statutes could not be modified to more closely match the exceptions to the bankruptcy discharge.

The functional equivalence between a very short statute of limitations on judgments with no possibility of renewal and a bankruptcy discharge may raise constitutional issues if a state enacts such a statute of limitations.¹⁶⁴ However, there is no reason why the federal government could not

judgment may have an impact on his priority against other creditors, but this detail is not necessary for this Article.

156. 42 PA. CONS. STAT. § 5525 (2002).

157. KAN. STAT. ANN. § 60-2403 (Supp. 2002); WYO. STAT. ANN. § 1-17-307 (Michie 2003).

158. N.D. CENT. CODE § 28-20-35 (2003) (requiring the cancellation of all judgments or renewals after twenty years); OR. REV. STAT. § 18.360(1) (2003) (limiting a judgment lien to ten years with one renewal permitted); WASH. REV. CODE ANN. §§ 4.56.210(1), (3), 6.17.020(3) (West 1989) (limiting a judgment lien to ten years with one renewal permitted).

159. N.D. CENT. CODE § 28-20-35 (2003); OR. REV. STAT. § 18.360 (2003); WASH. REV. CODE ANN. § 6.17.020(1) (West 1989).

160. KY. REV. STAT. ANN. § 427.030 (Michie 2002); VT. STAT. ANN. tit. 12, § 1270(2) (2003); WYO. STAT. ANN. § 1-20-106b (Michie 2003).

161. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, *supra* note 47, § 318.

162. *See, e.g.*, WASH. REV. CODE § 4.56.210(2) (West 1989) (providing that a judgment lien for child support survives until ten years after the eighteenth birthday of the youngest child for whom support is ordered).

163. N.D. CENT. CODE § 32-03-09 (2003) (providing that judgments for willful damage to property are not cancelled by the general statute of limitations on judgments).

164. U.S. CONST. art. I, § 8, cl. 4. A state-created discharge that applies to debts incurred prior to the enactment of the discharge has been held to violate the Contracts Clause. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819). Even a discharge that applies only prospectively may run afoul of the Full

enact such a limit. If the federal government can limit the percentage of income that a state court can garnish and the types of property that the state court can attach, the federal government could limit the number of years that this income can be garnished. Of course, the federal limitations on garnishment were enacted in part with reference to the federal government's bankruptcy powers,¹⁶⁵ and such a statute of limitations may be enacted pursuant to this power as well. However, we do not consider garnishment proceedings as "bankruptcy" merely because the percentage of income that a creditor may claim is regulated pursuant to Congress's bankruptcy power, and we would not consider these proceedings as "bankruptcy" merely because their duration was regulated pursuant to this same power.

C. *Procedural Bankruptcy*

Perhaps there are two critical aspects of consumer bankruptcy that non-bankruptcy law cannot effectively replicate. First, bankruptcy may be better able to distribute scarce proceeds when no creditor will be repaid in full. Second, bankruptcy, or at least voluntary bankruptcy, places considerable power in the hands of the consumer by allowing her to decide when to admit failure. Yet even if one decides that these distinctions are significant, they do not justify our current system because society can accommodate these goals within a bankruptcy system that provides the consumer with roughly the same relief that she would have received under non-bankruptcy law.

1. *Distribution of Proceeds*

Much of the bankruptcy literature is comprised of an on-going debate between the "Traditionalists" and the "Proceduralists" over the extent to which bankruptcy law should respect non-bankruptcy entitlements.¹⁶⁶ The Traditionalists argue that non-bankruptcy collections law is designed to resolve the conflict between a single creditor and a debtor who refuses to repay and that bankruptcy plays a unique role in determining how an insolvent debtor's assets will be distributed when there are insufficient assets to pay all creditors in full.¹⁶⁷ Because Traditionalists believe that bankruptcy

Faith and Credit Clause if it applies to the debt of foreign citizens. *Ogden v. Saunders*, 25 U.S. (12 Wheat) 213, 368-69 (1827). Moreover, such a discharge could well be preempted by the existing Bankruptcy Code. *See, e.g., International Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929).

165. Consumer Credit Protection Act § 301, 15 U.S.C. § 1671(b) (2003) ("Congress determines that the provisions of this subchapter are necessary and proper for the purpose of carrying into execution the powers of the Congress to regulate commerce and to establish uniform bankruptcy laws.").

166. Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573 (1998-99); Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. (forthcoming 2004).

167. *See, e.g., Warren, supra note 6*, at 782 ("State collection law swings into action on the complaint of a single creditor, and it provides that creditor an avenue to pursue payment of the obligation owed to it. In enforcing the rights of one creditor, state collection law does not address the possible consequence that the collection will render the debtor unable to pay its remaining creditors.").

plays a unique role in addressing financial collapse, they argue that bankruptcy need not follow non-bankruptcy priorities.

The Proceduralists counter that non-bankruptcy law is in fact designed to determine how an insolvent debtor's assets should be distributed when there are insufficient assets to repay all creditors in full; non-bankruptcy law does this through its various priority rules.¹⁶⁸ As a result, the Proceduralists argue that one must find a further purpose to explain the existence of bankruptcy law, and that bankruptcy law should deviate from the priorities established under non-bankruptcy law only to the extent necessary to achieve this purpose. They generally argue that this purpose is to resolve a collective action problem among general creditors that could reduce the aggregate amount collected from the insolvent debtor. According to these scholars, non-bankruptcy law's reliance on a first-come, first-served priority system for general creditors creates a potential "race to the assets" that may result in the premature and piecemeal liquidation of a corporation that fails to maximize the repayment of all creditors.¹⁶⁹ Bankruptcy helps solve this collective action problem by distributing any available proceeds pro rata among the general creditors, thus lessening the incentive to liquidate early.¹⁷⁰

The debate between the Proceduralists and the Traditionalists focuses on business bankruptcies,¹⁷¹ and some scholars have doubted the applicability of this race to the assets theory in the consumer setting.¹⁷² Unlike a firm, a consumer is not liquidated, and these scholars argue that the consumer will "go on as before" even if one creditor rushes in and seizes most of the consumer's assets.¹⁷³ As a matter of theory, however, this skepticism may be unwarranted. The premature seizure of some assets, such as tools of the trade, may imperil the consumer's ability to work and earn income that could be used to repay creditors as a group. For example, if the consumer loses her automobile, she may be unable to drive to work. Moreover, commentators have long argued that if one or more creditors brings a garnishment order against the consumer's employer, her employer may dismiss the

168. See, e.g., Baird, *supra* note 6, at 822 ("Many laws, from UCC Article 9 to ERISA, concern themselves with distributing such losses. Nonbankruptcy priority rules distribute losses and will continue to do so regardless of whether a special set of bankruptcy priority rules exists.").

169. See Jackson, *supra* note 7, at 861-68.

170. *Id.* This is, of course, a drastically simplified version of the debate.

171. See, e.g., Warren, *supra* note 6, at 776-77 ("In order to join issue more clearly and to narrow the focus of the debate somewhat, Professor Baird and I have agreed to debate the basis of bankruptcy policy in the context of business bankruptcies.").

172. On the other hand, scholars have pointed out that non-bankruptcy law can preempt much of the race to the assets problem in the business context by assigning rights to the debtor's assets in advance through security interests. See Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645 (1992).

173. See Adler et al., *supra* note 59, at 586 ("[I]f there is a collective action problem, it must take a different form than it takes for business bankruptcy. To see why, suppose there were no bankruptcy procedure and one creditor rushed to judgment, seizing most of the insolvent consumer's assets. This would injure the other creditors, but the injury is only a wealth transfer. As just said, the consumer will go on as before, whether one creditor takes the lion's share or the creditors share ratably.").

consumer to avoid the necessary paperwork or because the employer will view the employee as untrustworthy.¹⁷⁴ Obviously, the loss of employment imperils any repayment. Non-bankruptcy law partially addresses these difficulties. Many states exempt tools of the trade from attachment,¹⁷⁵ and federal and state laws prohibit the termination of an employee on the grounds that a garnishment order has been entered against her.¹⁷⁶ Unfortunately, the effectiveness of these laws is untested; even the assertion that garnishment leads to job loss rests solely on anecdotal evidence. It is at least possible, however, that a race to judgment could lessen aggregate collections.

Rather than revisit the debate over the conceptual validity of the race to the assets theory, this Article notes that neither the Proceduralist nor the Traditionalist explanations can have much importance in the overwhelming majority of Chapter 7 non-business bankruptcies because there are *no* proceeds to distribute to general creditors.¹⁷⁷ The consumer will, on occasion, reaffirm a loan from a secured creditor and may even reaffirm a loan from an unsecured creditor,¹⁷⁸ but these reaffirmations are typically based on a desire to keep a particular asset, avoid litigation, or keep a credit line open after bankruptcy and thus have nothing to do with the race to the assets problem. In short, the need to better distribute proceeds to creditors cannot explain why the vast majority of bankrupt consumers are in bankruptcy since there are no proceeds to distribute.

2. *Letting the Consumer Declare Default*

The first bankruptcy system enacted in the United States did not allow the debtor to voluntarily file a petition for relief,¹⁷⁹ but many debtors were able to convince a friendly creditor to file a petition for them.¹⁸⁰ Today, the voluntary petition seems to be a staple of bankruptcy. The consumer's ability to voluntarily file for relief may confer important benefits that would be difficult to replicate using non-bankruptcy law. Under non-bankruptcy law there are separate statutes of limitations for claims and for judgments, and by waiting until just before the statute of limitations runs before suing, a creditor could maximize the period in which the consumer's income and assets are subject to the threat of attachment and delay the fresh start. Of

174. For example, prior to enacting federal limitations on wage garnishment, Congress asserted that hundreds of workers lose their jobs as a result of garnishment proceedings because their wages are garnished by "unscrupulous merchants" and lenders whose practices "trap the unwitting workers." H.R. REP. NO. 90-1040 (1967), reprinted in 1968 U.S.C.A.N. 1962, 1966 (quoting the President's recommendations on urban and rural poverty, H.R. DOC. NO. 90-88, 10 (1967)).

175. See, e.g., VA. CODE ANN. § 34-26 (Supp. 2003) (exempting tools, books, and instruments of trade up to \$10,000 if needed in occupation or education).

176. See, e.g., 15 U.S.C. § 1673(a) (2000).

177. See *supra* notes 9-10.

178. See *supra* note 55 and accompanying text.

179. Tabb, *supra* note 87, at 14 ("Only creditors, upon proof of the debtor's commission of an act of bankruptcy, could initiate a bankruptcy.").

180. *Id.* ("Debtors, however, apparently were often able to persuade a friendly creditor to bring a case.").

course, if society deems this period to be too long, it can shorten these limits, though the statute of limitations on claims may need to be kept fairly long so that plaintiffs may discover their loss and develop their case. Moreover, the consumer may receive some emotional benefits from the finality that filing for bankruptcy and declaring default brings.

Non-bankruptcy law could address these perceived problems by allowing the consumer to file for a declaratory judgment of default that would start the statute of limitations on collections running.¹⁸¹ Such an approach may prove quite cumbersome, however, as the consumer may need to make multiple filings to address her multiple creditors. A single bankruptcy filing is generally a more administratively efficient means of declaring general default.

One should not overestimate a formal bankruptcy system's procedural advantages. For example, the consumer who wishes to achieve financial closure by declaring default may be able to do so without filing for bankruptcy or invoking any court proceeding. In fact, if the consumer writes a letter demanding that the creditor stop further collections efforts, the Fair Debt Collection Practices Act requires that bill collectors honor this request except as necessary to pursue judicial action.¹⁸²

3. *Creating a Purely Procedural Bankruptcy System*

Even if the procedural advantages offered by bankruptcy are important, these advantages do not justify the imbalance between the relief offered inside and outside of bankruptcy. Society *could* instead adopt a largely procedural bankruptcy system that achieves these advantages and still provides consumers with the same level of debt relief they would have received had they not filed.¹⁸³ Whether society should do this, however, is discussed below in Part III.

Imagine a bankruptcy system identical to the existing Chapter 7 of the Bankruptcy Code in terms of: (1) most procedural matters, including voluntary filings; (2) the treatment of secured creditors; (3) the priority of any distributions; and (4) the use of non-bankruptcy law to determine which of the consumer's assets the bankruptcy estate will claim.¹⁸⁴ Imagine, however,

181. This is related to a suggestion by Professor Jackson that society could adopt a procedure whereby the debtor would make a public filing that would free certain assets, such as the debtor's future earnings, from the claims of creditors but would not serve a collecting function. See Jackson, *supra* note 1, at 1396 n.8.

182. Federal Trade Commission Facts for Consumers, *Fair Debt Collection* (1999), at <http://www.ftc.gov/bcp/online/pubs/credit/fdc.htm> (last visited Sept. 26, 2004) ("You can stop a debt collector from contacting you by writing a letter to the collector telling them to stop. Once the collector receives your letter, they may not contact you again except to say there will be no further contact or to notify you that the debt collector or the creditor intends to take some specific action.")

183. The consumer bankruptcy system outlined in this section would be more procedural than the system proposed by Professor Mooney, because Professor Mooney's system would invoke different tax rates inside and outside of bankruptcy. See Mooney, *supra* note 166.

184. As discussed above, this is not an entirely accurate description of the current Bankruptcy Code. See *supra* notes 126-32 and accompanying text.

that this procedural bankruptcy system looks to non-bankruptcy law for other substantive law as well. Specifically, assume that this procedural bankruptcy system looks to non-bankruptcy garnishment law to determine how much of the consumer's future income must be devoted to repaying pre-petition creditors and looks to the non-bankruptcy statute of limitations on judgments to determine how many years the consumer must make these payments before obtaining a discharge.

If non-bankruptcy law set a firm statute of limitations for judgments of, say, three years and adopted fairly liberal exemptions from garnishment, this procedural bankruptcy system would be virtually indistinguishable from the taxation-based bankruptcy systems advocated by some scholars¹⁸⁵ and employed in some countries.¹⁸⁶ If non-bankruptcy law exempted the consumer's income entirely and set the statute of limitations so that judgments had a negligible duration, this procedural bankruptcy system would resemble Chapter 7 of the Bankruptcy Code.

III. SHOULD CONSUMER BANKRUPTCY BE PURELY PROCEDURAL?

Part II demonstrates that society could adopt a purely procedural bankruptcy system that still offers consumers a fresh start and insures consumers against hardship if it is willing to offer this same relief under non-bankruptcy law. In practice many consumers find that the existing Bankruptcy Code offers substantially more generous relief than is available under current non-bankruptcy law; there were more than one and a half million non-business bankruptcy filings in 2003.¹⁸⁷

Society may have valid reasons for offering consumers greater relief in bankruptcy than they would receive if they did not file, yet the existing literature fails to provide a plausible reason for this divergence. This Article argues that the divergence may be explained by expanding on the analogy between debt relief and insurance.¹⁸⁸ Bankruptcy may offer more generous debt relief because the bankruptcy procedure ensures that the consumer has suffered some misfortune and is entitled to more relief; bankruptcy confers greater relief because the bankruptcy process serves as a means-test.

A. *The Insufficiency of Existing Explanations*

The existing literature offers three possible justifications for why the law offers more debt relief in bankruptcy: (1) the debtor cooperation theory; (2) federalism; and (3) forgiveness. As we shall see, none of these explanations are plausible.

185. See *supra* notes 75-83 and accompanying text.

186. *Id.*

187. See *supra* note 89.

188. See *infra* notes 228-231 and accompanying text.

1. Debtor Cooperation Theory

The bankruptcy discharge was first justified as a means of maximizing the creditor's return by rewarding the debtor for cooperating with the superior collections process found in bankruptcy.¹⁸⁹ Yet this justification was primarily used when bankruptcy was much more favorable to creditors.¹⁹⁰ For example, some of the early bankruptcy laws enacted in the United States did not allow debtors to voluntarily file for relief,¹⁹¹ and only granted a discharge if the debtor either paid some minimum percentage of her debts, obtained creditor consent, or both.¹⁹² Moreover, the earliest bankruptcy laws in common-law jurisdictions were open only to merchants or traders.¹⁹³ Perhaps debtor cooperation with the collection process was necessary because merchants could easily hide significant assets from their creditors.

Even if we accept the debtor cooperation theory as a justification for the early discharge, this theory has little relevance for modern consumer bankruptcy, and today scholars justify the bankruptcy discharge with other theories.¹⁹⁴ Simply put, the most common form of bankruptcy, Chapter 7, yields nothing for general creditors in the overwhelming majority of bankruptcies,¹⁹⁵ and thus one cannot credibly argue that bankruptcy maximizes creditor collections.

2. Federalism

The mixture of state and federal regulation of credit markets presents fertile ground for scholars of federalism.¹⁹⁶ Scholars typically simplify the analysis by characterizing bankruptcy as federal law and non-bankruptcy debtor-creditor law as state law.¹⁹⁷ Often scholars argue for a more prominent role for bankruptcy (as federal law) because the states have done a poor job enacting non-bankruptcy debt relief laws. For example, a very large number of scholars have argued that the federal bankruptcy law should not incorporate state property exemptions because state exemption laws are either archaic¹⁹⁸ or so disparate in value as to be "fundamentally unfair."¹⁹⁹

189. See, e.g., Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991).

190. *Id.*

191. *Id.* at 346.

192. *Id.* at 346-47.

193. *Id.* at 334-35.

194. See *id.* at 355, 363-64.

195. See *supra* note 9 and accompanying text.

196. See, e.g., Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 TEX. L. REV. 1381, 1402-07 (2003); Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063 (2002).

197. See, e.g., Jackson, *supra* note 1, at 1431.

198. Lee Robert Bogdanoff, *Exemptions Under the Bankruptcy Code: Using California's New Homestead Law as a Medium for Analysis*, 72 CAL. L. REV. 922, 932 n.70 (1984); Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 403 n.164 (1994); Richard M. Lombino, *Uniformity of Exemptions: Assessing the Commission's Proposals*, 6 AM. BANKR. INST. L. REV. 177, 184 (1998); Jean

In his seminal work on the bankruptcy discharge, Professor Jackson offers a slightly different explanation for bankruptcy's more generous treatment of the consumer's future income.²⁰⁰ According to Professor Jackson, the bankruptcy discharge (as federal law) may protect the consumer's human capital because the market failures that justify mandatory debt relief create a particular problem for human capital and these market failures are somehow amenable to a nationwide rule.²⁰¹

Though the extent to which the federal government should control debtor-creditor law remains an open question,²⁰² this debate is largely orthogonal to the question of why bankruptcy should offer greater debt relief than that available under non-bankruptcy law. First, the federal government can, and does, regulate non-bankruptcy collections.²⁰³ Recall that the federal government limits garnishment to no more than twenty-five percent of an individual's take-home pay,²⁰⁴ and certainly has the power to exempt other assets as well.²⁰⁵ Federal non-bankruptcy law also provides limited protection against harassment by debt collectors²⁰⁶ and the reporting of defaults not associated with bankruptcy.²⁰⁷ Even if the existing federal non-bankruptcy protections are inadequate, it is unclear why the solution to that problem is to offer a bankruptcy discharge rather than to strengthen these non-bankruptcy limitations on collections.

A second reason why the federalism debate is orthogonal to the analysis of this Article is that society could adopt a bankruptcy system with more generous relief than available under non-bankruptcy law, and could allow

McGreevy, *Proposed Reforms in Iowa Bankruptcy Exemption Laws: A Solution to the Fraudulent Conveyance Dilemma*, 74 IOWA L. REV. 1219, 1234 (1989); William J. Woodward, Jr., *Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO ST. L.J. 335, 342 (1982). See, e.g., Vern Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 681-84 (1960).

199. See, e.g., NBRC REPORT, *supra* note 75, at 121-25; Letter from various law professors to Senator Patrick Leahy and Congressman F. James Sensenbrenner (May 22, 2002), at <http://nacba.com/homestead.html> (last visited Sept. 26, 2004) ("The central purpose of the Senate's uniform federal cap on the homestead exemption was to ameliorate the fundamental unfairness created when residents of one state can protect in a 'uniform' federal bankruptcy system an asset worth millions while residents of other states face sharp limitations on the amount of property they can protect.").

200. See Jackson, *supra* note 1, at 1431-33.

201. *Id.*

202. See, e.g., G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 227 (2000) (arguing for continued state control over exemption policies).

203. A sharp increase in the federal control of non-bankruptcy debtor-creditor law could meet with significant resistance given the important role that states have historically played in this area. However, the federal government's power to do so would seem clear under the Commerce Clause of the Constitution. Even if the federal government felt compelled to invoke its bankruptcy powers, as it did when it enacted federal limitations on wage garnishment, we would not think of these new laws as bankruptcy laws unless they applied to consumers who filed a bankruptcy petition. See *supra* notes 164-65 and accompanying text.

204. See 15 U.S.C. § 1673 (2002) (exempting the greater of thirty times the federal minimum wage or seventy-five percent of the debtor's take-home pay).

205. Today, however, many federal exemptions are limited to assets held by narrowly defined groups such as federal judges. See, e.g., 28 U.S.C. § 376(n) (2000) (exempting annuities paid to survivors of judges, including bankruptcy judges).

206. Fair Debt Collections Practices Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1692-1692o (2000)).

207. Fair Credit Reporting Act, 15 U.S.C. §§ 1681-81u (2000).

the states to supply the substantive law used both inside and outside of bankruptcy. Since the establishment of a lasting bankruptcy system in 1898, consumers have been able to use their state's property exemptions in bankruptcy.²⁰⁸ The application of state property exemptions in a system of "uniform [l]aws on the subject of [b]ankruptcies throughout the United States"²⁰⁹ was quickly challenged in *Hanover National Bank v. Moyses*.²¹⁰ However, the Supreme Court upheld their application under the theory that bankruptcy was "geographically" uniform because creditors in each state were entitled to reach the same assets in bankruptcy that they could reach under that state's collections law.²¹¹

After the passage of the Bankruptcy Reform Act of 1978, some states took state control of exemptions a step further by enacting exemptions that would apply only in bankruptcy.²¹² These exemptions have also been challenged, and to date the decisions are mixed. Some courts have ruled that these exemptions are unconstitutional because the geographic uniformity argument of *Hanover* applies only to exemptions that are available outside of bankruptcy as well.²¹³ Others have argued that these exemptions violate the Supremacy Clause,²¹⁴ because while Congress authorized States to opt-out of the Section 522(d) exemptions,²¹⁵ it did not specifically authorize them to create exemptions that would apply only in bankruptcy.²¹⁶ Still other courts have questioned whether these bankruptcy-only exemptions

208. See, e.g., Tabb, *supra* note 87, at 24.

209. U.S. CONST. art. I, § 8, cl. 4.

210. 186 U.S. 181, 188-89 (1902).

211. *Hanover*, 186 U.S. at 190 ("We concur in this view, and hold that the [bankruptcy] system is, in the constitutional sense, uniform throughout the United States, when the trustee takes in each State whatever would have been available to the creditors if the bankrupt law had not been passed. The general operation of the law is uniform although it may result in certain particulars differently in different States.").

212. See, e.g., CAL. CIV. PROC. CODE § 703.140 (2004).

213. See *In re Mata*, 115 B.R. 288, 291 (Bankr. D. Colo. 1990); *In re Lennen*, 71 B.R. 80, 83 (Bankr. N.D. Cal. 1987); *In re Reynolds*, 24 B.R. 344, 347 (Bankr. S.D. Ohio 1982). *Contra In re Kulp*, 949 F.2d 1106, 1109 n.3 (10th Cir. 1991); *In re Cross*, 255 B.R. 25, 30-31 (Bankr. N.D. Ind. 2000); *In re Vasko*, 6 B.R. 317, 319-20 (Bankr. N.D. Ohio 1980); *In re Shumaker*, 124 B.R. 820, 825 (Bankr. D. Mont. 1991).

214. U.S. CONST. art. VI, cl. 2.

215. 11 U.S.C. § 522(b) (2000).

216. *Mata*, 115 B.R. at 291 ("There is nothing in the Code or in the legislative history underlying its adoption indicating that Congress intended to delegate such authority to the various states."); *Lennen*, 71 B.R. at 83 ("[T]he statutory wording of section 522(b)(2)(A) that the debtor may claim property as exempt under 'State or local law that is applicable' should not, in view of constitutional considerations, be interpreted so liberally as to authorize a state exemption scheme which is applicable only in federal bankruptcy court."); *Cross*, 255 B.R. at 34 ("[T]he power to forbid . . . is not the same thing as having been given the power to create. Thus, in giving the states the ability to opt out of the federal bankruptcy exemptions Congress did not give them the authority to create bankruptcy exemptions."). *Contra Vasko*, 6 B.R. at 320-22 (holding that the state exemptions applicable only in bankruptcy do not violate the Supremacy Clause); *Shumaker*, 124 B.R. at 826 ("Congress' enactment of § 522(b)(1) . . . was a clear 'signal' to each state, in accordance with the geographic uniformity doctrine, that each state could validly adopt its own bankruptcy exemption scheme."). Moreover, some courts have questioned whether Congress could delegate the right to set bankruptcy-only exemptions even if it wanted to. See, e.g., *Reynolds*, 24 B.R. at 346 ("To hold otherwise would permit an evasion or annulment of the federal bankruptcy laws indirectly that would not be countenanced directly since the Congress did not delegate its bankruptcy powers, assuming such could be done.").

violate the Equal Protection Clause because the exemptions are unavailable to consumers who do not file for bankruptcy.²¹⁷ Regardless, a great many courts have upheld these statutes,²¹⁸ including the only appellate court to have addressed this issue.²¹⁹

If Congress may delegate to the states the power to set property exemptions that apply only in bankruptcy, there seems little reason why it could not adopt a bankruptcy system that applied some sort of tax on the consumer's future earnings and then delegate to the states the right to set the rate of this tax as well as its duration. That is, there seems little reason why the states could not supply all (or virtually all) of the needed substantive law in bankruptcy. Again, this Article does not argue that Congress should do this, only that it could.

3. *Forgiveness*

A few scholars eschew the sterile language of insurance when discussing the bankruptcy discharge in favor of the more emotive language of morality and forgiveness.²²⁰ According to this literature, forgiveness requires certain preconditions: "there must be a wrong committed, the wrong must harm another, the wronged party resents what occurred, and the wrongdoer acknowledges the wrong done and takes steps to rectify it."²²¹ This theory could explain why the consumer is given greater debt relief in bankruptcy than she may receive under non-bankruptcy law if the bankruptcy filing serves as the consumer's acknowledgement of her wrongdoing.²²²

Even if forgiveness theory justifies debt relief²²³ and forgiveness is only appropriate after consumers acknowledge their wrong,²²⁴ forgiveness theory

217. See, e.g., *Reynolds*, 24 B.R. at 347 ("[T]he Ohio statute either enacts special bankruptcy legislation or enacts legislation violative of Article IV, Section 2 (Privileges and Immunities Clause) and the Equal Protection Clause, Amendment XIV of the United States Constitution."). *Contra Bloom*, 5 B.R. at 453; *Shumaker*, 124 B.R. at 826; *Vasko*, 6 B.R. at 323 (citing *Bloom*, 5 B.R. at 453).

218. See *supra* notes 213-17.

219. *In re Kulp*, 949 F.2d 1106, 1106 (10th Cir. 1991).

220. See, e.g., KAREN GROSS, *FAILURE AND FORGIVENESS* (1997); Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515 (1991); Jason J. Kilborn, *Mercy, Rehabilitation, and Quid Pro Quo: A Radical Reassessment of Individual Bankruptcy*, 64 OHIO ST. L.J. 855 (2003); Terrence L. Michael & Michael R. Pacewicz, *Settling Objections to Discharge in Bankruptcy Cases: An Unsettling Look at Very Unsettled Law*, 37 TULSA L. REV. 637 (2002); Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3 (1986).

221. See GROSS, *supra* note 220, at 93 (citing JORAM GRAF HABER, *FORGIVENESS* 32 (1991)).

222. *Id.* at 94 ("Finally, debtors admit to failure and take steps to redress their wrong by accessing the legal system. The system makes that wrong a matter of public record and requires the debtors to submit to judicial scrutiny.").

223. Some scholars question the link between the moral and legal obligations to repay debts. See, e.g., Todd J. Zywicki, *With Apologies to Screwtape*, 9 J. BANKR. L. & PRAC. 513 (2000) (noting that many religions and cultures have a legal forgiveness of debts but that this forgiveness does not discharge the moral obligation to repay if the debtor's circumstances subsequently improve).

224. For example, some religions view repentance as a prerequisite for forgiveness while others do not. See MICHAEL E. MCCULLOUGH, KENNETH I. PARGAMENT & CARL E. THORESEN, *FORGIVENESS* 32-35 (2000).

cannot explain why society offers greater relief in bankruptcy than under non-bankruptcy law. Bankruptcy serves neither as an acknowledgement of the consumer's debt nor as an acknowledgement that the consumer committed a wrong by not repaying the debt. Even if a consumer vigorously denies her liability to a given creditor, this creditor will still have a claim in the consumer's bankruptcy, albeit a disputed and unliquidated claim.²²⁵ The bankruptcy discharge will bar any further efforts by the creditor to establish the consumer's personal liability for this claim,²²⁶ and the consumer need not ever acknowledge the claim's validity. In fact, some scholars argue that consumers can, and should, use bankruptcy as the ultimate weapon in their effort to settle disputed claims.²²⁷ In short, one simply cannot say that bankruptcy serves as an acknowledgment of the consumer's obligation. Because bankruptcy provides no acknowledgement of the consumer's obligation, this theory of forgiveness does not explain why society offers greater relief in bankruptcy.

B. Does Bankruptcy Serve as a "Means-Test"?

Perhaps the justification for giving the consumer greater debt relief in bankruptcy can be found by returning to the justifications for giving the consumer any debt relief at all. Although there are competing theories,²²⁸ the most plausible justification for the bankruptcy discharge is that it provides the consumer with a form of insurance²²⁹ that the consumer failed to purchase due to some form of market failure.²³⁰ Like insurance, bankruptcy provides a benefit (debt relief) when the consumer has suffered some hard-

225. 11 U.S.C. § 101(5) (2000). See Baird, *supra* note 72, at 79-87, for an especially understandable treatment of this issue.

226. 11 U.S.C. § 524 (2000).

227. See, e.g., William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 69 AM. BANKR. L.J. 397, 401-04 (1994) (arguing that bankruptcy may be a useful tool for settling disputed claims).

228. See, e.g., Hallinan, *supra* note 1, at 50-52 (reviewing the literature); Tabb, *supra* note 1, at 56-57 (reviewing the literature).

229. See, e.g., Adler et al., *supra* note 59, at 587 ("As it happens, consumer bankruptcy is best justified as partial wage insurance . . ."); Hallinan, *supra* note 1, *passim*; Sullivan, Warren & Westbrook, *supra* note 32, at 252-61 (discussing the relationship between bankruptcy and other forms of social insurance); Wang & White, *supra* note 35, at 255 ("An important function of personal bankruptcy is to provide partial wealth insurance for risk-averse debtors by discharging some debt when debtors' ability to repay turns out to be low."). Note, however, that a growing number of economists question whether the insurance that bankruptcy provides improves consumer welfare. See, e.g., Kartik B. Athreya, *Welfare Implications of the Bankruptcy Reform Act of 1999*, 49 J. MONETARY ECON. 1567 (2002) (finding a large increase in welfare from the complete elimination of bankruptcy); Kartik B. Athreya & Nicole B. Simpson, *Personal Bankruptcy or Public Insurance?* (Fed. Reserve Bank of Richmond, Working Paper No. 03-14, 2003) (suggesting that consumer welfare would be improved if bankruptcy laws were made significantly less generous); Satyajit Chatterjee et al., *A Quantitative Theory of Unsecured Consumer Credit With Risk of Default* (Fed. Reserve Bank of Phila., Working Paper No. 02-6, 2002) (finding a large increase in welfare from a ban on Chapter 7 filings by debtors with above median income). *But see* LIVSHITS ET AL., *supra* note 135 (finding that the bankruptcy discharge may increase or decrease consumer welfare depending on the assumptions made).

230. See Richard M. Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 68 (2002), for a discussion of the failures that can afflict credit markets.

ship, and the consumer pays premiums for this insurance in the form of higher interest rates.²³¹

Part II of this Article demonstrates that the insurance justification for the bankruptcy discharge remains incomplete because other limitations on collections may provide debt relief and thus may provide the insurance that the consumer fails to purchase in the market. However, by focusing our attention on the moral hazards that insurance creates, the analogy to insurance may help us understand bankruptcy's proper role within a larger system of debt relief.

When discussing moral hazard, consumer finance literature tends to focus on the fact that insurance will lessen the individual's incentive to avoid the harm that is insured against.²³² In doing so, the literature often speaks in more colorful terms: just as the grasshopper fails to plan for the coming winter, the insured may fail to guard against misfortune if her insurance will lessen the pain of her loss—the “grasshopper problem.”²³³ In the debt relief context the grasshopper spends more money than she can repay, fails to purchase sufficient health insurance, or behaves in a manner that results in unemployment.

Unfortunately, the grasshopper problem is unlikely to help us understand bankruptcy's role in a larger system of debt relief. In theory, a bankruptcy proceeding could solve the grasshopper problem directly by denying relief to all consumers who did not take sufficient care to avoid financial distress.²³⁴ Faced with the loss of insurance, a rational individual would take the right amount of care to avoid the loss and there would be no grasshopper problem. In fact, the bankruptcy laws of England have long given a bankruptcy judge the discretion to deny a discharge if the consumer “has brought on, or contributed to, his bankruptcy by rash and hazardous speculations, or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs.”²³⁵

Of course, the ability of a bankruptcy court to solve the grasshopper problem by denying relief when the consumer does not take sufficient care to avoid financial distress is just another manifestation of the standard result

231. See, e.g., Hallinan, *supra* note 1, at 103-05.

232. See, e.g., Adler et al., *supra* note 59 (discussing the effect that various aspects of bankruptcy law have on a debtor's incentive to avoid financial distress).

233. Several prominent bankruptcy scholars have used the story of the ant and the grasshopper to explain the moral hazard created by bankruptcy. See, e.g., Jones & Zywicki, *supra* note 19, at 219-20; LoPucki, *supra* note 75, at 464; Elizabeth Warren, *The Bankruptcy Crisis*, 73 *IND. L.J.* 1079, 1084 (1998). In Aesop's fable of the ant and the grasshopper, the grasshopper plays the summer away while the ant toils to save for winter. There are numerous versions of this fable and they differ largely on how the grasshopper is treated in the winter. See, e.g., JACOB LAWRENCE, *AESOP'S FABLES* (1998).

234. While scholars have not advocated this approach generally, some have suggested that consumers who seek relief in Chapter 13 should be barred from modifying their plan of repayment after further hardship if they could have prevented this hardship. See, e.g., Karen Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 *U. PA. L. REV.* 59, 148 (1986).

235. Bankruptcy Act, 1914, 4 & 5 *Geo. 5*, c. 59, § 26(3) (Eng.). For a description of bankruptcy in England, see Boshkoff, *supra* note 67.

that a well-constructed negligence standard will induce consumers to take the proper level of care. If an individual could insure against the consequences of her negligence, her incentive to take this care would be reduced or eliminated.²³⁶ Yet a system that denies consumers the ability to insure against their own negligence would leave them with an unacceptably high level of risk. Courts may incorrectly label reasonable behavior as negligent, and consumers are sometimes unable to hold themselves to the reasonable level of care mandated by the courts.²³⁷ Therefore, since at least the beginning of the twentieth century American law has allowed²³⁸—and in the case of automobile liability insurance, generally *required*²³⁹—consumers to insure against negligent behavior. Similarly, public insurance programs (such as unemployment insurance) typically provide relief for the consequences of negligent misbehavior²⁴⁰ and, unsurprisingly, American debt relief laws give relief to the consumer whose negligent financial management has caused her insolvency.²⁴¹

The insured who suffers too many losses will be unable to get further coverage at an affordable cost. Likewise, the consumer who defaults too frequently will be unable to borrow—at least at an affordable interest rate. Insurers can further address the grasshopper problem by limiting the relief provided. For example, insurance policies frequently require a co-payment so that the grasshopper experiences at least some of the consequences of her negligence. Similarly, society can control the grasshopper problem by making the consequences of default more painful. However, society can use both bankruptcy and non-bankruptcy law to make default painful, and thus this form of moral hazard provides little guidance for our inquiry.

This Article focuses on a second form of moral hazard. Just as the opossum plays dead to ward off predators, the insured may exaggerate her misfortune in order to maximize her relief—the “opossum problem.” In private insurance markets, the opossum files false claims. In the public assistance context, the opossum refuses to work a reasonable amount to support herself, and instead lives off of the public. Similarly, in the debt relief context, the opossum feigns financial death even though she has the means to repay some or all of her debts without undue hardship.

This Article argues that if there is a reason to offer the consumer greater relief in bankruptcy than under non-bankruptcy law, it is that the bankruptcy

236. See, e.g., Steven Shavell, *Economic Analysis of Accident Law* 211 (1987).

237. *Id.* at 212 (suggesting this difficulty partially explains our ability to insure against our own negligence).

238. See, e.g., *Breeden v. Frankford Marine, Accident & Plate Glass Ins. Co.*, 119 S.W. 576 (Mo. 1909).

239. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 221 (4th ed. 1998) (“Automobile liability insurance is now almost universal, although this is partly because states required drivers to buy insurance or present equivalent evidence of financial responsibility for accidents.”).

240. See, e.g., MARK A. ROTHSTEIN ET AL., *EMPLOYMENT LAW* 771 (2d ed. 1999) (noting that workers will generally receive unemployment insurance unless their dismissal was caused by willful misbehavior).

241. See, e.g., *Optimal Bankruptcy*, *supra* note 73, at 27-33.

proceeding operates as a means-test that mitigates the opossum problem. This does not mean that a bankruptcy proceeding must adopt an explicit means-test of the type advocated by the credit industry. There are two approaches to solving the opossum problem: (1) investigating each consumer's ability to pay, and (2) punishing defaulting consumers and thus removing the incentive to play 'possum. The central question of this section is how a bankruptcy *proceeding* may facilitate such an investigation or such punishment. Subpart 1 will explore how bankruptcy facilitates the collection and use of information to measure a consumer's ability to pay. Subpart 2 will examine how punishment can be used to determine whether the consumer has the ability to pay and how bankruptcy facilitates or controls the application of this punishment.

1. *Bankruptcy and Information*

Recall that this section asks whether a formal bankruptcy procedure helps verify a consumer's need for relief. If a system of debt relief utilizes extensive information about the consumer's financial condition to determine if the consumer should repay her debts, there is a strong argument for gathering this information only once in a proceeding that binds all creditors, thereby avoiding duplicative litigation.²⁴² The strength of this justification for offering greater relief in bankruptcy depends on the costs of gathering the information used in bankruptcy which in turn depends on the type of information used. The justification is quite compelling if society will undertake the difficult and expensive task of forecasting the consumer's future earnings and expenses. The justification is less compelling if society adopts a system that, like Chapter 7 or taxation-based bankruptcy, considers only the consumer's actual income or assets. After all, non-bankruptcy law considers these very same facts when setting a consumer's repayment obligation, though the bankruptcy procedure may facilitate a broader inquiry into the consumer's income or assets. The justification is even less compelling in a system that sets exemptions of income and assets so large that the vast majority of consumers repay nothing.²⁴³ If the exemptions are substantially in excess of a consumer's income at the time of borrowing, creditors are unlikely to seek a judicial procedure to verify that the consumer's income and assets remain exempt at the time of default.

Note too that, as a positive matter, information has not played an important role in determining the consumer's "ability to pay" in American bankruptcy law. Although leading opinions suggest that the consumer's ability to pay plays a role in the "substantial abuse" analysis,²⁴⁴ some scholars com-

242. See, e.g., John C. Weistart, *The Costs of Bankruptcy*, 41(4) L. & CONTEMP. PROBS. 107 (1977); Jackson, *supra* note 1, at 1395-96.

243. This is clearly the case for the existing Chapter 7. See *supra* note 9.

244. See *supra* note 20 and accompanying text.

plain that this provision is effectively “dead-letter,”²⁴⁵ and, in any case, this potential means-test is a rather recent innovation. The “substantial abuse” provision was added in 1984,²⁴⁶ whereas the fundamental structure of Chapter 7 dates back to the enactment of its predecessor, Chapter VII, in 1898.²⁴⁷ Like Chapter 7, Chapter VII required that the debtor repay with all of her non-exempt assets. But also like Chapter 7, Chapter VII rarely resulted in any repayment for general creditors,²⁴⁸ in part because property exemptions have historically been fairly generous relative to the assets of ordinary Americans.²⁴⁹

Other forms of consumer bankruptcy employed in the United States may not have used a significantly greater amount of information to determine a debtor’s ability to pay. Many forms of early bankruptcy, including Chapter 13’s predecessor, Chapter XIII, required creditor consent before granting a discharge.²⁵⁰ It is possible that creditors used this consent requirement to insist that the consumer prove that she was repaying an amount commensurate with her ability to pay. Unfortunately, this claim is not plausible as scholars report that virtually all Chapter XIII plans promised the identical repayment: the full repayment of all creditors.²⁵¹ Similarly, numerous scholars question whether the disposable income test of Chapter 13 truly adjusts the consumers’ debts based on their ability to pay, arguing either that consumers are forced to simply promise the standard repayment rate of their jurisdiction²⁵² or that consumers are able to evade this provision by simply threatening to convert their case to Chapter 7.²⁵³

2. *Bankruptcy and Punishment*

If the information needed to determine a consumer’s ability to repay is sufficiently expensive, society may rationally refuse to collect any information at all. In more colorful terms, “the game [isn’t] worth the candle.”²⁵⁴ This does not mean that the system will ignore the opossum problem, only

245. *Id.*

246. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984).

247. *See Optimal Bankruptcy*, *supra* note 73, at 49.

248. *See, e.g.*, STANLEY & GIRTH, *supra* note 63, at 87 n.27 (reporting that eighty-nine percent of straight, or Chapter VII, bankruptcies in 1964 yielded nothing for creditors).

249. Adjusted for inflation, the exemptions available to the consumer on the eve of the Bankruptcy Reform Act of 1978 generally exceed those available today. *See, e.g.*, *Political Economy*, *supra* note 12.

250. *See, e.g.*, Tabb, *supra* note 87, at 11.

251. *See* STANLEY & GIRTH, *supra* note 63, at 94.

252. *See* Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 532 (1993) (“The reality is that chapter 13 trustees and judges in the four cities [studied] effectively deter 0% plans and keep most plans above a floor percent that is known to local practitioners.”). This impression is shared by those who advise consumers on how to file for bankruptcy. *See* ROBIN LEONARD, CHAPTER 13 BANKRUPTCY: REPAY YOUR DEBTS 7/1 (5th ed. 2001) (“In some courts, the judge will not approve your plan unless you propose paying your unsecured creditors a significant portion of what you owe them, usually at least 70%.”) The lawyers then respond by rarely or never submitting plans with less than the specified percentage. *Id.*

253. *See* BAIRD, *supra* note 72, at 55.

254. *See* Tabb, *supra* note 23, at 15-16.

that the system must find an alternative method of means-testing. When insurance programs cannot use information to restrict benefits to those who have suffered some misfortune, they generally employ punishment to separate the opossums from the needy. Subpart a will provide a brief overview of how punishment can help solve the opossum problem. Subpart b will explore bankruptcy's role in administering this punishment.

a. *How Punishment Mitigates the Opossum Problem*

An insurer can mitigate the opossum problem by offering benefits unattractive to those who do not need relief; insurers can adopt various forms of opossum repellent. Society can structure assistance so that it is more valuable to those intended to receive it. For example, subsidized health care is more valuable to the sick.²⁵⁵ Other forms of opossum repellent are less benign. For example, the government may choose to provide extremely undesirable public housing so that only those who truly need assistance would agree to live there. Some economists allege that a social assistance program that includes a work requirement (workfare) could be efficient even if this work yields no valuable output or training.²⁵⁶ The work requirement effectively transforms the assistance program into a very low paying job for the recipient, and those who can earn more and support themselves would do so, leaving only the truly needy to apply for support.

Punishment can solve the opossum problem if it is more costly for those who overstate their need for relief than for those who have truly suffered. Yet it is extremely difficult, if not impossible, to structure relief that repels the opossums without harming those who need relief. Those who choose inferior public housing because they are truly poor are forced into substandard lodging, and recipients of workfare are forced to labor (and thus sacrifice leisure) even though their output produces little or no social value.

Debt relief contains several forms of punishment or opossum repellent. The loan sharks or bookies in the movies²⁵⁷ never conduct extensive inquiries as to their debtors' well-being. If they are not paid, they punish the debtor, perhaps by breaking her arm. This credible threat of punishment serves to distinguish those debtors who should repay their loans from those who should not. Those who have considerable disposable income will reduce their spending so they may repay the loan and avoid a broken arm, while those who cannot cut their spending will endure the punishment.

255. See, e.g., Gary Burtless, *The Economist's Lament: Public Assistance in America*, 4 J. ECON. PERSP. 57, 67 (1990).

256. See, e.g., Timothy Besley & Stephen Coate, *The Design of Income Maintenance Programmes*, 62 REV. ECON. STUD. 187, 201 (1995).

257. See, e.g., ROCKY (Mgm/Ua Studios 1976) (prior to his shot at the title, Rocky Balboa was an enforcer for Philadelphia mobsters); *The Sopranos: Happy Wanderer* (HBO television broadcast, Feb. 20, 2000); *The Sopranos: Bust Out* (HBO television broadcast, March 19, 2000); *The Sopranos: Fun-house* (HBO television broadcast, Apr. 9, 2000) (demonstrating a situation where, in similar disregard for the debtor's well-being, a "friend's" gambling debt led Tony Soprano to commandeer his "friend's" sporting goods store and use it for a money laundering operation).

The punishment of debtor-creditor law need not take on such a grisly form. As long as it is non-pecuniary in nature, punishment has the potential of distinguishing those who can repay their debts from those who cannot. Punishment helps verify that a consumer cannot repay her debts because a truly destitute consumer will value each dollar that she has much more than she would if she were flush with cash. Parting with \$1,000 is fairly easy if one has plenty of cash, but a consumer will endure great hardship to avoid repayment if the money is needed to feed her children. By contrast, a pecuniary penalty does not serve this role because both the well-off and the insolvent consumer would be willing to tolerate any pecuniary penalty up to \$1,000 to avoid a \$1,000 payment.

Perhaps the main reason that consumers repay their obligations is that they fear the guilty conscience, the social stigma or the damage to their credit reputation that results from failing to repay their debts.²⁵⁸ The consumer's guilt or shame can be thought of as a form of punishment because it harms the consumer but does not benefit the creditor or anyone else unless it induces the consumer to repay. Likewise, a creditor who reports a default to a credit bureau imposes a punishment on the consumer by making it harder for the consumer to borrow in the future. While this report may benefit future lenders by helping them avoid making bad loans, it offers no direct benefit to the existing creditors.

Previous scholars have suggested that punishment can be used to control other problems that plague credit markets. If creditors cannot distinguish high-risk debtors from low-risk debtors but the debtors know their own risk of default, this asymmetric information may cause creditors to ration credit for fear that only the high-risk debtors will apply for a loan.²⁵⁹ Low-risk debtors can avoid this credit rationing if they can credibly distinguish themselves from their high-risk neighbors. The low-risk debtors can signal their quality by agreeing to collection terms that will make their life unpleasant after default.²⁶⁰ These terms signal that the debtor is a good risk because low-risk debtors default less often and thus find the harsh terms less costly than their high-risk neighbors. Harsh collection terms can also mitigate the grasshopper problem, or the various forms of debtor misbehavior that make financial distress more likely.²⁶¹ Stated simply, if financial distress will be more unpleasant, a debtor will take more care to avoid it.

The arguments for using punishment to control the credit rationing and grasshopper problems are incomplete because one can also mitigate these

258. See Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. L. & POL. 393, 420-21 (2001).

259. See Joseph E. Stiglitz & Lawrence Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393, 401 (1981).

260. See Rea, *supra* note 92, at 196-99.

261. For example, Professor Robert Scott suggests that punishment may be used to control various forms of debtor misbehavior such as shirking, overborrowing, and engaging in risky projects. See, e.g., Robert E. Scott, *Rethinking the Regulation of Coercive Creditor Remedies*, 89 COLUM. L. REV. 730, 744-46 (1989). Each of these forms of misbehavior can be thought of as manifestations of the grasshopper problem because they make financial distress more likely.

problems by simply increasing the amount that a defaulting consumer must repay. To mitigate the credit rationing and grasshopper problems, one need only make default more painful. Rather than employ punishment, society can make default more painful and undesirable by requiring the consumer to make a larger repayment after default and thus endure a meager standard of living.²⁶² More significantly, as long as other forms of market failure do not afflict credit markets, requiring a larger repayment will likely be preferable to punishment because the increased repayment yields a benefit to the creditor (he is repaid at least in part) while punishment does not.²⁶³

For example, Professor Robert Scott has argued in favor of laws that allow a creditor to seize the defaulting consumer's household goods, even though these goods have little or no value to the creditor, on the grounds that this punishment will cause the consumer to take more care to avoid financial distress.²⁶⁴ Assume that instead of seizing household goods the creditor seizes an item of equal importance to the consumer but with a greater resale value. Because each asset has the same importance to the consumer, the threat of the loss of each asset will have the same impact on the consumer's incentive to take care. However, the proceeds from the asset with a significant resale value can be used to increase the lender's profits or to reduce the interest rate initially charged. Of course, the law may prevent the creditor from seizing more of the consumer's valuable assets or income,²⁶⁵ but this does not necessarily serve as a justification for punishment.²⁶⁶ Rather, one must explain why the law would force the consumer to rely on punishment rather than to pledge a greater repayment.

Professor Scott suggests one reason why punishment may be more efficient than measures that result in a direct benefit to the creditor. Professor Scott analogizes the taking of a security interest to the seizure of a hostage and claims that when a creditor holds a hostage with a high market value, the creditor has a significant incentive to misbehave by fabricating a default so that he may retain the hostage.²⁶⁷ For example, the creditor may exaggerate the importance of a default and then, despite the procedural protections of Article 9 of the Uniform Commercial Code,²⁶⁸ the creditor may sell the asset below the market price to a friend and proceed against the con-

262. Professors Aghion & Hermalin present an argument similar to that of Professor Rea that is based on the amount repaid rather than on punishment. See Phillippe Aghion & Benjamin Hermalin, *Legal Restrictions on Private Contract Can Enhance Efficiency*, 6 J.L. ECON. & ORG. 381, 401 (1990).

263. This argument has been made in the context of public assistance. See Beseley & Coate, *supra* note 256, at 206 (arguing that if the government provides social assistance in order to provide a minimum level of utility or happiness, it is always more efficient to screen those who can support themselves by offering smaller benefits than by imposing a punishment such as a work requirement, because the government may reduce expenditures by reducing benefits).

264. See Scott, *supra* note 261, at 746-48.

265. For example, the consumer may not waive her right to a bankruptcy discharge. 11 U.S.C. § 524(a)(2) (2000).

266. See Scott, *supra* note 261, at 747.

267. See *id.* at 748.

268. See U.C.C. §§ 9-601 to -624 (2000).

sumer for the balance in a deficiency judgment.²⁶⁹ If the collateral has little or no resale value, however, the creditor will have no reason to misbehave in this manner.²⁷⁰

While Professor Scott provides a possible argument for preferring punitive measures, this argument is implausible and inconsistent with observed market behavior. If it were more efficient to pledge low-value collateral than high-value collateral, then wealthy consumers would pledge household goods before pledging their car or their home. However, even when the law permitted the taking of security interests in household goods, consumers who owned a home were much more likely to obtain a loan from a bank than from the finance companies that specialized in taking security interests in household goods.²⁷¹

The consumer and creditor may choose to use punishment to solve the credit-rationing and grasshopper problems if the contractual relationship is also plagued by the opossum problem. Moreover, there is one other possible justification for the use of punishment that can be adapted from the social assistance literature, but this argument has limited applicability beyond the very poor. Some justify work requirements in social assistance programs as a form of punishment designed to control the opossum and grasshopper problems discussed above.²⁷² For example, a workfare requirement can make social assistance less attractive, providing citizens with an incentive to develop the skills necessary to support themselves, thus solving the grasshopper problem. A workfare requirement may also deter citizens from using social assistance when they have the skills to support themselves, thus solving the opossum problem.²⁷³ If society adopts these programs to ensure that its citizens have some minimal level of welfare or happiness, however, it would never use workfare to provide the poor with an incentive to develop the skills necessary to support themselves because it could always provide citizens with the same incentive by just reducing social assistance benefits.²⁷⁴

Assume, however, that society wishes to guarantee its poorest citizens some minimal level of consumption but does not really care about the happiness of these citizens. By assumption, society cannot reduce social assistance benefits below the level of consumption it wishes to guarantee. By threatening to punish consumers who receive social assistance, however,

269. See Alan Schwartz, *The Enforceability of Security Interests in Consumer Goods*, 26 J.L. & ECON. 117, 119-20 (1983), for an article questioning a secured creditor's incentive to sell an asset below its fair value.

270. See Scott, *supra* note 261, at 749.

271. See Gregory E. Boczar, *Competition Between Banks and Finance Companies: A Cross Section Study of Personal Loan Debtors*, 33 J. FIN. 245, 250 (1978).

272. Besley & Coate, *supra* note 256 and accompanying text.

273. Timothy Besley & Stephen Coate, *Workfare versus Welfare: Incentive Arguments for Work Requirements in Poverty-Alleviation Programs*, 82 AM. ECON. REV. 249 (1992) (discussing the "screening" (opossum problem) and "deterrent" (grasshopper problem) functions of punishment in the social assistance context).

274. *Id.* at 253-56.

society will give the poor an incentive to develop the skills necessary to support themselves. Of course, not everyone will be able to do so, and some will suffer this punishment. By assumption, however, society is untroubled by the unhappiness caused by this punishment.²⁷⁵

Similarly, if debt relief laws are designed to ensure that the consumer has some minimal level of consumption so that her fellow citizens will not be forced to witness her poverty, one could argue for the use of punishment to solve the grasshopper problem because society does not care about the harm that this punishment inflicts. However, debtor-creditor law is not designed to ensure that all consumers enjoy at least some minimum standard of living. Debtor-creditor law helps consumers retain the standard of living that they currently enjoy; as a consequence, some defaulting consumers are able to live quite comfortably while others remain impoverished.²⁷⁶

b. How Does a Bankruptcy Procedure Help Punish the Consumer?

It is well understood that punishment can discourage a consumer from defaulting when she should repay.²⁷⁷ However, how a procedure like bankruptcy can and should facilitate this punishment is less explored. Because non-bankruptcy law may also inflict punishment on the consumer, we must answer the latter question if we are to understand bankruptcy's role in a larger system of debt relief.

Consider the argument that only consumers who truly need relief will choose bankruptcy because a bankruptcy filing damages the consumer's ability to borrow again. A bankruptcy filing creates a long-term blemish on the consumer's credit reputation;²⁷⁸ federal law allows credit reporting agencies to report the filing for ten years.²⁷⁹ A bankruptcy filing damages a consumer's credit reputation because it indicates that the consumer who filed may be more likely to default again than the consumer with a clean credit history. But do credit markets need a bankruptcy system to record the consumer's failure to pay?

Historically, the public nature of a bankruptcy filing may have significantly enhanced the ability of creditors to learn of a consumer's default and thus adjust their assessment of the risk of lending to that consumer. Contracts are generally private, and unless a creditor pursued some remedy in the courts, other creditors may have had little opportunity to learn of a consumer's default. Today, however, many creditors subscribe to credit reporting services. These services provide the creditor with a great deal of infor-

275. *Id.* at 256-58.

276. *See Non-Procrustean Bankruptcy*, *supra* note 42.

277. Rea, *supra* note 92 and accompanying text.

278. David Musto, *What Happens When Information Leaves a Market? Evidence from Post-Bankruptcy Consumers*, 77 J. BUS. (forthcoming), at <http://finance.wharton.upenn.edu/~musto/papers/c7.pdf> (last visited Sept. 27, 2004).

279. 15 U.S.C. § 1681c (2000).

mation about the consumer's financial affairs including the consumer's history of payments to each of the subscribing creditors. Therefore, the primary consumer lenders will know of each time that the consumer was delinquent on her prior debts. If the passage of time makes it clear that the consumer will not repay her obligation, the creditor will charge off the loan as uncollectible, and the credit report will record this fact as well. These charge-offs, like any other non-bankruptcy information, will be wiped clean in seven years time,²⁸⁰ but the law could allow a non-bankruptcy default to be reported for just as long as a bankruptcy filing. In short, it is not clear that credit markets need a system like bankruptcy to identify those consumers who fail to repay their debts.

Next, consider the social stigma attached to bankruptcy. At one time, bankruptcy was clearly designed to shame the defaulting debtor. For example, in the Middle Ages, bankrupt merchants were made to perform "repulsive ceremonies" that "savoured of nursery wit."²⁸¹ Today, American bankruptcy law no longer goes to such great lengths to publicly humiliate the debtor. In fact, the Bankruptcy Act of 1978 made several changes to lessen the shame experienced by the consumer, including the replacement of the label "bankrupt" with the less offensive "debtor."²⁸² Some have lamented this loss of shaming,²⁸³ even attributing the rise in bankruptcy filings to the loss of stigma.²⁸⁴

Of more relevance to this Article is whether creditors need a system like bankruptcy to shame the consumer when the historical record clearly demonstrates that they do not. As discussed above, creditors have gone to great lengths to shame defaulting debtors who did not make use of the bankruptcy process by sitting or fasting on the debtor's doorsteps or employing scantily clad women and costumed characters to humiliate the debtor.²⁸⁵ In fact, creditors will have an incentive to impose too much punishment on a defaulting consumer because the consumer will almost always have the capacity to pay one dollar more and she can be forced to do so if threatened with a sufficiently severe penalty. We generally think that it is bankruptcy's role to reduce this harassment or punishment, though, as demonstrated by Part II, non-bankruptcy law may regulate this harassment as well.²⁸⁶

280. *Id.* Note that unsatisfied civil judgments may be reported for longer than seven years if the statute of limitations is longer than seven years. *Id.*

281. Garrard Glenn, *Essentials of Bankruptcy: Prevention of Fraud, and Control of Debtor*, 23 VA. L. REV. 373, 387 (1937).

282. Gross, *supra* note 234, at 110 (arguing that this change was made in an effort to reduce the stigma of bankruptcy).

283. G. Marcus Cole, *A Modest Proposal for Bankruptcy Reform*, in 5 GREEN BAG 269 (2d ed. 2002) (arguing for a mild form of debtor's prison as a form of shaming to discourage debtors from overspending).

284. David B. Gross & Nicholas S. Souleles, *An Empirical Analysis of Personal Bankruptcy and Delinquency*, 15 REV. FIN. 319 (2002) (arguing that much of the rise in bankruptcy filings must have been caused by a decline in the stigma of filing because it cannot be explained by economic factors).

285. *See supra* notes 91-95 and accompanying text.

286. *See supra* notes 91-106 and accompanying text.

There are two forms of punishment in bankruptcy that non-bankruptcy law cannot easily replicate: (1) forcing the consumer to default on all of her loans, including those owed to a creditor whom she would prefer to repay; and (2) limiting the frequency with which the consumer may claim debt relief. In practice, the first punishment plays a small role in our bankruptcy law. However, the second punishment has been a fixture of American bankruptcy law almost since its inception.

A bankrupt debtor may default on most of her loans²⁸⁷ but remain obligated to preferred creditors if she can reaffirm these favored loans. Most of the debate over the role of reaffirmation agreements in bankruptcy centers on whether these agreements are in the consumer's best interest at the time of filing. Some argue that parties only enter into agreements if they are mutually beneficial; therefore, reaffirmation agreements must improve the lot of consumers at the time of bankruptcy.²⁸⁸ Critics of reaffirmation agreements argue for greater judicial supervision of these agreements on the grounds that consumers (even those represented by attorneys) frequently make poor decisions regarding reaffirmations.²⁸⁹

More interesting are the claims that reaffirmation agreements should be banned even if they improve the lot of the consumer at the time of filing. Adler and his co-authors provide one such argument, but their argument is incomplete. Stated simply, they claim that reaffirmation agreements may lessen the pain of default for the consumer and thus may lead her to take less care to avoid financial distress.²⁹⁰ A ban on reaffirmation agreements would reduce consumer welfare after default but would produce no direct benefit to any other party, effectively serving as a punishment. As explained above, arguments for the use of punishment to cause consumers to take more care to avoid financial distress are incomplete. Society can more efficiently induce consumers to take care by forcing the consumer to repay more after default.²⁹¹

One can make a more powerful argument against reaffirmation agreements by focusing on the opossum problem. Elizabeth Warren has argued that wealthy consumers use reaffirmation agreements to "work the system" and provides as an example a wealthy bankrupt who reaffirms a lease on her Mercedes.²⁹² If we believe that bankrupt consumers should be allowed to shield all of their future income from the claims of their pre-petition creditors, it should not bother us that a consumer chooses to spend some of this income on the luxury car that she currently drives. If we assume instead that

287. Bankruptcy exempts some loans from the discharge for public policy reasons. 11 U.S.C. § 523 (2000) (providing that Chapter 7 of the Bankruptcy Code does not discharge, among other things, debts arising from willful and malicious injury).

288. See, e.g., Adler et al., *supra* note 59, at 601-02.

289. Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 764-65 (1999).

290. Adler et al., *supra* note 259, at 601-03.

291. See *supra* notes 259-275 and accompanying text.

292. Warren, *supra* note 113, at 500.

the law does a poor job of limiting the relief to that which the consumer deserves, then a ban on reaffirmations may help screen those consumers who should pay more by serving as a form of punishment. That is, a consumer may be loathe to default if doing so means that she must default on all of her loans simultaneously.

Despite some early discussion by the National Bankruptcy Review Commission,²⁹³ there seems little chance that reaffirmation agreements will be banned. A far more important form of punishment used by bankruptcy is the limitation of the consumer's further access to debt relief. The Bankruptcy Reform Act of 1898 marked the first time that a consumer could receive a discharge without obtaining the consent of her creditors, and Congress quickly followed this innovation with another reform that forced the consumer to wait a period of years before obtaining a second discharge.²⁹⁴ Today, a consumer cannot receive a discharge in Chapter 7 if she has received another Chapter 7 discharge within the last six years or another discharge pursuant to a repayment plan in which she repaid less than seventy percent of her debts.²⁹⁵ The pending bankruptcy legislation would extend this waiting period to eight years and remove the exception for filings in which the consumer repaid at least seventy percent of her debts.²⁹⁶ Today the consumer who has received a discharge remains free to receive another in Chapter 13, but the pending legislation would make her wait at least four years after filing in Chapter 7 and up to two years after receiving a discharge in another Chapter 13.²⁹⁷ Though some have questioned the wisdom of extending the limitation on serial discharges to Chapter 13,²⁹⁸ the literature is virtually silent on the limitation imposed in Chapter 7.

There are two conflicting ways in which the ban on repeat filings may affect the consumer's incentive to initially file for bankruptcy. First, the ban on repeat filings may deter a consumer from filing for bankruptcy if she fears that by doing so she will lose her right to file for Chapter 7 again and thus jeopardize her ability to withstand future misfortune. This effect operates in a manner similar to that of punishment because the consumer loses something, the right to further relief in Chapter 7, and her current creditors receive no corresponding direct benefit. If this ban on subsequent discharges is intended as a form of punishment, however, one may well question its advisability. Ideally, society would create punishments that harm the consumer who has truly suffered misfortune much less than the consumer who retains the ability to repay her debts, as this would minimize the social costs of the punishment. However, the consumer who has truly suffered misfortune, say a hospitalization or an extended period of unemployment, may be

293. See *id.* at 498-502.

294. Tabb, *supra* note 189, at 365-67.

295. 11 U.S.C. § 727 (2000).

296. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, 108th Cong. § 312(1) (2003).

297. See *id.* at § 312(2)(f)(1)-(2).

298. See, e.g., DeJarnatt, *supra* note 113.

even more likely than their more fortunate peers to suffer further misfortune and thus need further debt relief.

Note, however, that the ban on subsequent discharges may actually work to encourage the consumer to file for bankruptcy. To understand this argument, assume that there is no limit on the number of times that a consumer can file under Chapter 7, that few consumers have any assets that could be seized in bankruptcy,²⁹⁹ and that courts do not use the substantial abuse provision of the Bankruptcy Code to deny the discharge to those consumers with an ability to repay their debts out of their future income.³⁰⁰ If this were true, the only check on the consumer's decision to file would be her credit reputation. In this world, a bankruptcy filing could have devastating effects on a consumer's ability to obtain credit in the future because creditors would be worried that the consumer would file again. Some consumers might suffer extreme hardship to avoid suffering this fate. If the consumer's ability to obtain future debt relief were limited, however, the consequences of default may be less severe. That is, creditors may be more willing to extend credit to those who have previously defaulted on their loans because they know that these consumers will find it more painful to default again in the future. By limiting the ability of the honest, but unfortunate, consumer to obtain further debt relief, the law may help such a consumer obtain the credit needed to start her life again and thus may facilitate the fresh start.

Of course the consumer will remain subject to future risks and thus may need further debt relief, even if this relief is somehow less generous. Society could, for example, offer two forms of bankruptcy relief and make the more generous form available only once. Alternatively, society could make bankruptcy available only once and force those who experience further misfortune to find refuge under non-bankruptcy law. This topic is discussed in the next section.

IV. WHY HAVE PARALLEL SYSTEMS OF DEBT RELIEF?

Part III argues that society may decide to adopt a bankruptcy system that offers more generous relief than available under non-bankruptcy law if it believes that a bankruptcy procedure helps verify that the defaulting consumer lacks the ability to repay her debts. If true, why does society provide debt relief to consumers who do not file for bankruptcy? Specifically, society could adopt non-bankruptcy debtor-creditor laws that (1) presume that those consumers who do not file for bankruptcy should repay their debts in full, and (2) employ severe collections measures designed to force debtors to repay in full, if at all possible. However, modern non-bankruptcy law clearly does not do this. The days of debtor's prison and capital punishment

299. As discussed above, there is ample support for this assumption. *See supra* notes 9-10 and accompanying text.

300. *See supra* note 20 and accompanying text.

for the non-payment of debts³⁰¹ have long since passed. Today, non-bankruptcy law limits the amount of income and assets that a creditor can attach³⁰² and the manner in which a creditor can contact a defaulting consumer or report the default to third parties.³⁰³ These laws make some consumers “judgment proof” by making it either impossible, or just too costly, to enforce a judgment against them.³⁰⁴

Given that society also offers a bankruptcy discharge, why does it significantly limit non-bankruptcy collections? Two explanations immediately present themselves, yet neither is complete. First, non-bankruptcy law may be designed to delay, rather than deny collections.³⁰⁵ This explanation is consistent with much of the structure of non-bankruptcy law, but is markedly inconsistent with the fact that most of the loans that banks charge off as non-collectible are not owed by bankrupt debtors.³⁰⁶ Second, non-bankruptcy law may offer the consumer some relief to mitigate the effect of the limitation on the number of times that a consumer can receive a discharge in Chapter 7.³⁰⁷ This argument is incomplete because consumers denied access to Chapter 7 can still receive relief in Chapter 13.³⁰⁸

Perhaps a stronger justification for the debt relief offered in non-bankruptcy law is that the non-bankruptcy collections process may serve as a cheaper, albeit less perfect, method of verifying a consumer’s inability to pay and thus should grant the consumer less generous debt relief.³⁰⁹ This explanation for the role of non-bankruptcy law has important implications for the current debate over bankruptcy reform. For decades, the consumer credit industry has lobbied for some form of information-based means-test that would prevent consumers from receiving the immediate discharge of Chapter 7 if their income is sufficiently greater than their living expenses.³¹⁰ Our nation’s bankruptcy law professors have generally opposed this explicit means-testing,³¹¹ and today this opposition is overwhelming within the academy.³¹²

Many of the arguments raised by the opponents of explicit means-testing address the specific details of the tests proposed, and this Article will

301. Ancient Athens considered defaulting on a debt to be a capital crime. *See, e.g.*, Lawrence H. White, *Bankruptcy as an Economic Intervention*, 1 J. LIBERTARIAN STUD. 281, 281 (1977). In ancient Rome the creditors of a defaulting debtor could enslave the debtor or “divide the debtor’s body into proportionate shares.” *Id.*

302. *See supra* Part II.B.3.

303. *See supra* Part II.B.1.

304. *See* Susan D. Kovac, *Judgment-Proof Debtors in Bankruptcy*, 65 AM. BANKR. L.J. 675 (1991) (discussing judgment-proof debtors).

305. *See infra* Part IV.A.

306. *See supra* note 4.

307. *See supra* notes 298-300 and accompanying text.

308. 11 U.S.C. § 1328 (2000).

309. *See infra* Part IV.C.

310. *See* Vern Countryman, *Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 820-27 (1983).

311. *See id.* at 827 (comparing means-testing to indentured servitude or “mass peonage”).

312. *See supra* note 23.

not add to the large volume of literature debating the finer points of the various bankruptcy bills.³¹³ This Article focuses on a more fundamental argument made against an explicit means-test: that means-testing would greatly increase the cost of filing for bankruptcy and thereby make bankruptcy relief unavailable to many Americans.³¹⁴ Although this argument is presented within the specific context of the reforms pushed by the consumer credit industry, it reflects a more fundamental question about the proper role of bankruptcy and non-bankruptcy law. Any inquiry into the consumer's financial condition will lengthen a proceeding and make it more expensive. Society must choose the correct balance between accuracy and cost. This balance may be difficult to reach because it is unlikely that a single system would fit all consumers. Proceedings designed to collect enough facts to identify high-income consumers who have an ability to repay some of their debts without undue hardship may be so costly as to price the poor out of bankruptcy altogether. However, this effect on the poor need not cause us to abandon information-based means-testing, at least in the abstract, as long as lower-income consumers can be given adequate relief under non-bankruptcy law.

A. *Non-Bankruptcy Debt Relief as Temporary Relief*

Even if the law presumed that consumers who do not file for bankruptcy should repay their debts in full, it need not presume that they should repay their debts immediately. For example, a consumer may be able to pay a judgment entered against her out of her future earnings, but she may lack the funds necessary to pay the judgment now. Of course, if credit markets

313. For example, critics argue that the proposed reforms would make bankruptcy too meager, either by requiring consumers to repay over too many years or by providing for living expenses that are unreasonably low. See Letter of Sept. 7, 1999, *supra* note 21. Note that this view is somewhat contradicted by emerging economics literature that suggests that consumer welfare would increase if the generosity of debt relief were restricted. See *supra* note 135. Critics also allege that the reforms would impose an excessively rigid test of a consumer's ability to pay and that bankruptcy is better served by the more discretionary standard of existing law. See Letter of Sept. 7, 1999, *supra* note 21. This is another manifestation of the rules versus discretion debate. Another argument raised in the letters to Congress is that all consumers must retain easy access to a bankruptcy discharge to further the ability of family law creditors to pursue deadbeat dads. *Id.* Fundamentally, the argument is that the bankruptcy discharge strengthens the hand of family law creditors because general obligations are dischargeable while family law claims are not. See 11 U.S.C. § 523 (2000). Of course, one might well question why the law cannot strengthen the hand of family law debtors by reforming non-bankruptcy law or making other changes that are more specific to deadbeat dads. For example, in recent years the federal government has passed a significant amount of legislation designed to increase the ability of family law creditors to collect, including imposing a requirement that states garnish the wages of all non-custodial parents even if these parents have never missed a payment. See Family Support Act of 1988, Pub. L. No. 100-485, § 101(b), 102 Stat. 2343 (1988) (requiring that states implement immediate wage withholding for all child support orders issued or modified after January 1, 1994, unless both parents or the court arrange a different plan). A full discussion of family law obligations is beyond the scope of this Article, however, because of the unique issues that these obligations present.

314. See, e.g., Letter of Sept. 7, 1999, *supra* note 21 ("The trick is identifying the real abusers at an acceptable cost, without unfairly burdening those 'honest but unfortunate' debtors who legitimately need chapter 7 bankruptcy relief."). *But see* Jones & Zywicki, *supra* note 19 (arguing that the administrative costs imposed by the bankruptcy reforms would not unduly burden lower-income bankrupt consumers).

functioned perfectly, the consumer could borrow against her future income to pay this judgment. However, the consumer may be unable to do so, perhaps in part because bankruptcy and other debt relief laws prevent her from effectively promising to repay this loan in full. Recognizing that the consumer may need to pay her judgment over time, the law may sensibly restrict the rate at which the consumer must repay.

This theory fits well with the putative structure of a non-bankruptcy collections system that protects some portion of the consumer's income and assets from attachment but *usually* allows a diligent creditor to retain her judgment indefinitely.³¹⁵ This theory fits less well with the empirical evidence that suggests that a substantial portion of the debts that creditors must write off as uncollectible are not discharged in bankruptcy.³¹⁶ Nor does this theory fit with the fact that non-bankruptcy laws effectively render some consumers "judgment-proof" by exempting all of their income and assets from their general creditors.³¹⁷

B. Limited Relief and the Serial Discharge

As explained above, the limit on the number of times that a consumer can obtain a bankruptcy discharge in a given period may play an important role in ensuring that consumers use bankruptcy only when they are in need of debt relief.³¹⁸ Unfortunately, consumers who have filed for bankruptcy remain subject to the same risks that caused their initial financial distress. Society may wish to offer some non-bankruptcy debt relief to those consumers who are unable to obtain a discharge in Chapter 7 because of their previous filing. This explanation for the relief offered by non-bankruptcy collections law is incomplete because society can, and does, offer bankruptcy relief to consumers who have recently received a discharge. Although these consumers are barred from Chapter 7, they are free to file again in Chapter 13.³¹⁹

315. See Crandall, *supra* note 149, at 6-227.

316. See *supra* note 4 and accompanying text.

317. See Kovac, *supra* note 304, at 677 (discussing judgment-proof debtors).

318. See *supra* notes 298-300 and accompanying text.

319. 11 U.S.C. § 1328 (2000). It is noteworthy that the ability of a debtor to receive subsequent bankruptcy protection is tied to the choice of bankruptcy relief. That is, a consumer who receives a discharge in Chapter 7 cannot receive another discharge in Chapter 7 for six years. 11 U.S.C. § 523 (2000). On the other hand, a consumer who receives a discharge in Chapter 13 can immediately file for relief under Chapter 7 as long as she has repaid at least seventy percent of her unsecured claims and made her "best effort." See *id.* This divergence fits well with the theory of punishment. There is little point in punishing a debtor if one actually verifies that the debtor cannot repay her debts, and perhaps the "best effort" standard ensures that the consumer is truly destitute. However, one should not place too much emphasis on this divergence as Chapter 13 plans appear to have a fairly high failure rate. See *supra* note 32.

C. *Non-Bankruptcy Law as a Cheaper Form of Debt Relief*

A generation ago the typical bankrupt was described as a member of the lower or working class,³²⁰ and scholars reacted to this fact in one of two ways. Some prominent bankruptcy scholars argued for the reform of non-bankruptcy collection laws, such as wage garnishment, in the hopes that the poor would find debt relief without burdening the bankruptcy courts.³²¹ Others argued that bankruptcy law should be greatly simplified to lessen the burden that courts face when processing consumer bankruptcies; some scholars even argued that bankruptcy should be largely controlled by an administrative agency.³²² Today the calls for the reform of our non-bankruptcy collections laws seem to have fallen by the wayside,³²³ and our nation's law professors generally argue that bankruptcy must remain a fairly simple process so that the poor may find adequate relief.³²⁴

Today the popular conception of the bankrupt consumer is changing. Newspaper reports of celebrity bankrupts provide anecdotal evidence that some of the wealthy (or at least formerly wealthy) make use of bankruptcy protection.³²⁵ More importantly, recent studies of American bankrupts reveal that most are drawn from the middle class³²⁶ and that they represent a cross-section of the general population.³²⁷ Just as the financial resources of Americans differ markedly, however, so do the resources of bankrupt

320. See, e.g., STANLEY & GIRTH, *supra* note 63, at 42 ("The typical debtor interviewed in these districts was an industrial worker, earning a little over \$100 a week.").

321. See, e.g., *Consumer Credit Protection Act: Hearings on H.R. 11601 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking & Currency, 90th Cong. 721 (1967)* (Vern Countryman arguing for limitations on garnishment to "relieve the Federal bankruptcy system of the burden of cases where bankruptcy petitions are filed only to avoid garnishment.").

322. See, e.g., STANLEY & GIRTH, *supra* note 63, at 4 ("All bankruptcy cases except reorganizations of corporations would be handled by a newly established administrative agency.").

323. *But see* Kovac, *supra* note 304, at 763 (arguing that garnishment laws should be made more generous to relieve bankruptcy courts of the large number of filings).

324. See *supra* note 24.

325. See, e.g., Philip Shenon, *Home Exemptions Snag Bankruptcy Bill*, N.Y. TIMES, Apr. 6, 2001, at A1 ("[S]everal other celebrities . . . in Florida and Texas [declared bankruptcy] in recent years and held onto large homes. The actor Burt Reynolds kept his \$2.5 million Florida home, Valhalla, after declaring bankruptcy in 1996 . . . Bowie Kuhn, the former baseball commissioner, bought a \$1 million five-bedroom, five-bath home . . . Former Gov. John B. Connally of Texas declared bankruptcy in 1987 with \$49 million in debts . . .").

326. See SULLIVAN, WARREN & WESTBROOK, *supra* note 27. Some define middle class based on income. See, e.g., Christine Dugas, *Middle Class Barely Treads Water*, USA TODAY, Sept. 15, 2003, at http://www.usatoday.com/money/perfi/general/2003-09-14-middle-cover_x.htm (last visited Sept. 26, 2004) (stating that "middle class families" are "often broadly defined as those earning \$25,000 to \$99,999"). However, Sullivan, Warren & Westbrook look to a range of indicators beyond income or wealth. See SULLIVAN, WARREN & WESTBROOK, *supra* note 27, at 28-33. In fact, it is quite difficult to define the term "middle class," and, according to the authors, "The most important point to make about the American middle class is that most Americans believe that they are in it." *Id.* at 28. Indeed, Sullivan, Warren & Westbrook define "middle class" in a way that includes themselves. See *id.* at 1 ("Stolid middle-class people, such as ourselves . . .").

327. See, e.g., *Bankruptcy Becoming Prosperity's Partner Largely Declaration of the Middle Class*, CHI. TRIB., July 5, 1998, at 6 (quoting Elizabeth Warren, "[bankrupt debtors] are middle-class—that's what's scary about this . . . They are not marginal workers. They are you and me, they are our neighbors.").

Americans.³²⁸ There is little reason to believe that the same system of debt relief is appropriate for every American.³²⁹

Fortunately, the law does not provide the same Procrustean insurance to every consumer.³³⁰ Just as wealthier individuals typically purchase insurance policies that guarantee a higher standard of living for themselves, each of the various forms of debt relief tends to allow wealthier individuals to maintain a higher standard of living after default than their less fortunate peers.³³¹ Yet the law must also create a system that recognizes the differences between consumers in the procedure that it applies, as well as in the generosity of relief that it affords. Perhaps the law could tailor the procedure employed within a single system of debt relief to the consumer's particular circumstances. Depending on some empirical assumptions, however, the parallel systems of debt relief may allow the law to accomplish this task more cheaply.

1. *Would All Consumers Bargain for the Same Procedure for Dispensing Debt Relief?*

There seems to be a general consensus in this country that our bankruptcy system should not force the very poor to repay their debts. Though sometimes referred to as "mean-spirited,"³³² each of the iterations of bankruptcy reform legislation offered by the credit industry over the past few years has purported to exempt those with an income below a designated threshold from the new means-testing provisions.³³³ The latest iteration exempts all those who earn less than the median income of similarly sized households in the state in which they live.³³⁴ Perhaps such exemptions are designed merely to appeal to populist sentiment, but it is worth asking whether there is a more rational reason to support these exemptions.

One cannot simply claim that, by definition, lower-income consumers lack the income necessary to repay their debts. In 2001, the median income for a household of four ranged from a low of \$46,596 in New Mexico to a high of \$82,879 in Maryland.³³⁵ Obviously, many Americans who earned

328. As one would expect, bankrupt Americans tend to have significantly less income and wealth than solvent Americans. See SULLIVAN, WARREN & WESTBROOK, *supra* note 27, at 59-69 (describing the income and assets of bankrupt Americans). However, it is clear that at least a few bankrupt debtors have, or at least once had, substantial incomes. See *supra* note 325. Other bankrupt debtors never enjoyed such a lavish lifestyle. See Kovac, *supra* note 304, at 677.

329. See *supra* notes 326-27 and accompanying text.

330. See *infra* Part IV.C.

331. See *Non-Procrustean Bankruptcy*, *supra* note 42.

332. 147 CONG. REC. S7721, 7725 (daily ed. July 17, 2001) (statement of Sen. Wellstone criticizing the bankruptcy reform legislation as a "harsh, mean-spirited piece of legislation").

333. See Jones & Zywicki, *supra* note 19, at 183-207.

334. H.R. REP. NO. 108-975, § 102(h)(2).

335. U.S. CENSUS BUREAU, MEDIAN INCOME FOR 4-PERSON FAMILIES, BY STATE, at <http://www.census.gov/hhes/income/4person.html> (last visited Sept. 27, 2004). Median income for all families is a little lower and ranges from \$30,982 in West Virginia to \$58,759 in New Jersey. See U.S. CENSUS BUREAU, MEDIAN HOUSEHOLD INCOME (IN 2003 INFLATION-ADJUSTED DOLLARS) HOUSEHOLDS (STATE LEVEL), at <http://www.census.gov/acs/www/Products/Ranking/2002/R07T040.ht>

less than the median income of their state did not recently experience one of the misfortunes that bankruptcy is defined to insure against, and thus there is no reason to presume that they could not repay their debts. As a result, the vast majority of lower-income Americans repay their debts in full—that is why so many Americans with below median income are able to obtain credit.³³⁶

One could argue that consumers with an income that falls below some threshold should not repay their debts because doing so would lower their consumption below the minimal level that society tries to guarantee for all of its citizens and, thus, this repayment imposes costs on society generally. Society does provide social assistance to the poor, and these programs are often justified on the theory that wealthy citizens care about the standard of living of the poor.³³⁷ Moreover, these social insurance programs may induce the consumer to borrow too much, and society may have an incentive to discourage borrowing either by exempting some of the debtor's income from attachment or by imposing restrictions on the rate of interest that creditors may charge.³³⁸ Yet this argument is not fully in accord with the view that bankruptcy should not means-test Americans with incomes below the applicable median because our system of social welfare is just not that generous. The argument may explain why limitations on garnishment fully exempt an amount of take-home pay equal to thirty times the federal minimum wage,³³⁹ because individuals who earn only this amount may well be tempted to leave their jobs and apply for social assistance. Yet few could argue with a straight face that if a resident of Maryland (as the sole money-maker of a family of four) earning close to \$83,000 per year is asked to repay anything to her creditors she will quit work and decide to live off of unemployment insurance. Even if she qualified for Maryland unemployment insurance, it would pay her no more than \$280 per week.³⁴⁰

A better justification for refusing to means-test those who earn less than the median income is that it is not cost effective to investigate their ability to pay. This argument can be more clearly explained using the optimal contracts literature in which a debtor wishes to borrow from a creditor and the parties are free to negotiate whatever contractual terms they wish. The cen-

m (last visited Sept. 27, 2004).

336. For example, almost twenty-five percent of Americans with income below the twentieth percentile had some credit card debt and this amount rose to more than fifty percent for Americans with income between the fortieth and sixtieth percentile. See Ana M. Aizcorbe, Arthur B. Kennickell, & Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, FED. RESERVE BULL., Jan. 2003, at 22, available at <http://www.federalreserve.gov/pubs/bulletin/2003/03bulletin.htm#jan>.

337. See, e.g., Harold M. Hochman & James D. Rodgers, *Pareto Optimal Redistribution*, 59 AM. ECON. REV. 542, 543 (1969).

338. See, e.g., Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 307-09 (1995); Jackson, *supra* note 1, at 1402.

339. E.g., 15 U.S.C. § 1673 (2002).

340. See ECONOMIC POLICY INSTITUTE, *ISSUE GUIDE ON UNEMPLOYMENT INSURANCE*, at http://www.epinet.org/content.cfm/issueguides_unemployment_index (last visited Sept. 24, 2004).

tral problem in this literature is that the debtor's future wealth is uncertain and the creditor cannot costlessly observe the debtor's actual wealth at the time of repayment, and thus cannot costlessly verify the debtor's need for relief. The central problem in these models is the opossum problem.

In some models the creditor is able to verify the debtor's wealth (and hence her ability to repay) by expending some fixed cost, for example by auditing the debtor's accounts.³⁴¹ In other models the creditor verifies a debtor's inability to pay by imposing a punishment roughly equal to the shortfall in repayment.³⁴² Regardless, the contract they choose is roughly the same. Following some technical assumptions,³⁴³ one finds that the optimal contract is a simple debt contract that demands the payment of some fixed amount (the face value of the debt) whenever the debtor's wealth is above some level. By requiring that the debtor repay the same amount whenever the debtor is sufficiently well-off, the contract avoids the need for an inquiry or punishment in most cases.

When the debtor's income falls below this fixed amount, the contract allows the debtor to pay less than the face value of the debt and calls on the creditor (or a court) to verify the debtor's inability to repay in full. The creditor can verify the debtor's claim of distress by investigating her financial condition. If the debtor correctly reports her financial condition, she is allowed to keep some fixed amount for her own consumption and is asked to repay with anything in excess of this amount.³⁴⁴ Alternately, the creditor can verify by imposing a penalty equal to the shortfall in repayment.³⁴⁵

In a recent article, Professor Kelly Welch adds to this analysis by allowing the parties to include both verification and punishment in their contract.³⁴⁶ Critically, the cost of gathering information is assumed to be fixed. By contrast, the cost of punishment declines as the debtor's wealth moves closer to the full repayment point because the short-fall in repayments is smaller and the creditor need only impose a punishment sufficient to ensure that the debtor cannot repay in full. Thus the optimal contract may contain three regions. If the debtor's wealth is above some point, the debtor repays in full. If it is a little below this amount, the debtor makes a partial repayment and the creditor imposes a punishment equal to the shortfall. If the debtor's wealth falls below an even lower threshold, the creditor no longer punishes the debtor but instead conducts an inquiry to verify that the debtor has indeed suffered some misfortune.³⁴⁷

341. See, e.g., Robert M. Townsend, *Optimal Contracts and Competitive Markets with Costly State Verification*, 21 J. ECON. THEORY 265 (1979).

342. See, e.g., Douglas W. Diamond, *Financial Intermediation and Delegation Monitoring*, 51 REV. ECON. STUD. 393 (1984).

343. The literature generally assumes that the lender and borrower cannot contract for randomly imposed investigations. See, e.g., Douglas Gale & Martin Hellwig, *Incentive-Compatible Debt Contracts: The One-Period Problem*, 52 REV. ECON. STUD. 647 (1985).

344. See *id.* at 654-55.

345. See Diamond, *supra* note 342.

346. See, e.g., Welch, *supra* note 22.

347. See *id.*

This “tipping point” between punishment and information depends on the cost of conducting an inquiry. If it is very costly to investigate, the contract may rely almost exclusively on punishment to verify a debtor’s claim for debt relief. Note too that the cost of the inquiry is relative to the size of the loan and the scale of a debtor’s resources. Therefore, if the cost of conducting an inquiry into the debtor’s finances is sufficiently large, it may never be cost effective to conduct such an inquiry of some debtors, namely the poor.

This literature provides some interesting intuition about the role of bankruptcy and non-bankruptcy law in debt collection. For example, Professor Welch argues that the bankruptcy system uses information to verify that a debtor cannot repay while non-bankruptcy law uses punishment.³⁴⁸ The debtor may indeed experience more punishment under non-bankruptcy law; the automatic stay in bankruptcy may put a stop to the harassing telephone calls and letters that the debtor receives,³⁴⁹ but it is not at all clear that the most common form of bankruptcy, Chapter 7, uses a greater amount of information to verify a debtor’s inability to pay. To the extent that the “substantial abuse” provision is truly a “dead letter,”³⁵⁰ non-bankruptcy law seems to conduct a greater inquiry into a debtor’s ability to pay because it considers the debtor’s income when determining how much the creditor can garnish.³⁵¹ As discussed below, however, this theory may help justify the structure of the bankruptcy reform proposals.

2. *Steering Consumers into the Procedure Most Appropriate for Them*

The basic claim of the previous section is that different consumers would choose different procedures for determining how much they should repay after default because it is more cost effective to investigate a wealthy individual’s ability to repay. This lesson is in accord with our intuition. It is obviously more reasonable to conduct a thorough inquiry into the earnings and expenses of a consumer with a six-figure income than someone living near the poverty line.

For decades the consumer credit industry has advocated the adoption of an explicit “means-test” in bankruptcy.³⁵² Fundamentally, such a test would try to assess a consumer’s ability to repay her debts based on an investigation of the consumer’s financial condition, and this investigation would entail costs that are appropriate for some but not for others. For example, if, at the time of borrowing, a consumer could specify the procedure for resolving

348. *See id.*

349. *See supra* note 36 and accompanying text.

350. *See Zywicki, supra* note 223, at 423 (“Similarly, lawyer and former law professor George Wallace has observed, ‘There are over 300 bankruptcy judges out there, and, in most of their courts, § 707(b) is simply a dead letter.’”).

351. *See, e.g.,* 15 U.S.C. §1673 (2002) (exempting the greater of thirty times the federal minimum wage or seventy-five percent of the debtor’s take-home pay).

352. *See Countryman, supra* note 310, at 820-27 (chronicling this struggle).

a default, it is possible that a highly paid professional borrowing a substantial amount would agree to a costly investigation into her finances. If, however, the consumer earns an amount barely in excess of minimum wage, she would never agree to such an expensive investigation; she would rely on less costly forms of verification in the event of default.

Of course, society could implement a bankruptcy system that applies different levels of inquiry to different consumers. One may believe that trustees currently use the “substantial abuse” provision³⁵³ to scrutinize those few consumers with significant incomes while ignoring all others. Yet such an approach can only mitigate, not eliminate, the trade-off between accuracy and cost because a system must find some way of determining which consumers to subject to further investigation.

Many bankruptcy scholars have criticized the proposed reforms for failing to exempt those consumers with an income below the applicable median from the added procedural requirements.³⁵⁴ While these scholars may be correct in criticizing the proposed reforms, their criticism presumes that courts can easily determine the consumer’s income, a presumption that is sharply contradicted by the available evidence on the accuracy of bankruptcy filings. One study conducted by a bankruptcy judge suggests that ninety-nine percent of bankruptcy filings contain at least one serious internal inconsistency.³⁵⁵ Furthermore, forty-three percent of filings show a marked imbalance between stated income and expenses that implies either that the consumer has misstated one or the other, or that the consumer will return to financial distress shortly after filing for bankruptcy.³⁵⁶ Society could improve the accuracy of the reported income by forcing the consumer to produce further documentation to support her claim (such as tax returns from previous years), but such documentation may be costly for the consumer to collect. In fact, the pending bankruptcy legislation’s requirement that the consumer file tax returns is one of the more criticized portions of the legislation.³⁵⁷

Society could try to shift the costs of conducting the investigation to the creditors by, for example, requiring little initial information from the con-

353. 11 U.S.C. § 707(b) (2000).

354. See, e.g., Braucher & Mooney, *supra* note 24, at 7 (stating that the proposed legislation’s requirement that all debtors calculate a prospective ability to pay “would create a hurdle at the front end for all, even those who clearly lack the ability to repay.”); Tabb, *supra* note 23, at 18 (“One glaring flaw is that all individual debtors would be required to file a means test calculation with their schedules, even though studies estimate that less than a quarter of those debtors actually would be subjected to means testing.”).

355. See Steven W. Rhodes, *An Empirical Study of Consumer Bankruptcy Papers*, 73 AM. BANKR. L.J. 653, 678 (1999).

356. See *id.* (finding that forty-three percent of debtors report income that is not within ten percent of expenses). Of course, this may merely mean that debtors have inflated their expenses or that they are likely to land in financial distress again.

357. See, e.g., Jean Braucher, *Means Testing Consumer Bankruptcy: The Problem of Means*, 7 FORDHAM J. CORP. & FIN. L. 407, 444 (2002) (“To summarize, all cases would cost more to process, for debtors and their attorneys and the system, even when debtors are below median income. Debtors, who are often disorganized, would have to get tax returns on file with the court to avoid dismissal.”).

sumer and insisting that the creditors pay for any discovery. Even if this were feasible, however, it would not really solve the fundamental problem because in a competitive market the consumer would pay in advance for this investigation in the form of higher interest rates. For many consumers it is just not appropriate to conduct any investigation into their financial affairs; it is better to “means-test” these consumers through punishment. The imposition of a filing fee and certain procedural requirements may serve a useful purpose in keeping these consumers out of bankruptcy and in our system of non-bankruptcy debt relief.

Some believe that the very purpose of the additional paperwork proposed by the pending legislation is simply to make bankruptcy more expensive so that fewer low-income consumers can file for bankruptcy.³⁵⁸ If true, this is clearly not a sound justification for the reforms. Even if one decides that these consumers should be priced out of bankruptcy, one should not do so by imposing additional paperwork requirements. The increased paperwork will raise the cost of filing not because it represents a windfall for bankruptcy attorneys but because it will take them longer to complete their job. In short, if this paperwork is not necessary, then the time it takes to complete the work is wasted and the additional cost of hiring an attorney serves solely as a pecuniary penalty that benefits no one. Not only do pecuniary penalties fail to distinguish those consumers who can pay their debts from those who cannot, but such a pecuniary penalty is also a highly inefficient means of forcing lower-income consumers to choose other forms of debt relief. One could just as easily price these consumers out of the bankruptcy system by raising the filing fee (thus benefiting the courts) or imposing some minimal repayment requirement (thus benefiting the creditors).

The claim that non-bankruptcy law can perhaps provide debt relief at a lower administrative cost than bankruptcy law runs counter to the earlier claim that it is more expensive for the consumer to litigate his ability to pay with each creditor individually than to settle this question once in a bankruptcy proceeding. Yet non-bankruptcy law need not use the same method to evaluate the consumer’s ability to pay. In the extreme, society could structure non-bankruptcy law so that the parties would not seek a judicial inquiry into the consumer’s ability to pay unless such inquiry is likely to be cost effective.

Society may be able to structure non-bankruptcy debt relief laws so that higher-income debtors seek relief in bankruptcy while lower-income debtors do not. Assume, for example, that society exempts a significant amount of income from garnishment and that creditors have a good estimate of the

358. See, e.g., Eric A. Posner, *Commenting on Means Testing Consumer Bankruptcy by Jean Braucher*, 7 *FORDHAM J. CORP. & FIN. L.* 457, 461 (2002) (“Another problem with limiting discharge is that for lower income individuals the amounts at stake are too small to be worth the cost of monitoring the Chapter 13 plan. This, I take it, is the reason for limiting the ‘abuse’ test to higher income debtors, and using paperwork and other costly requirements in order to deter lower income debtors [from filing].”).

consumer's financial resources at the time of borrowing. Creditors are likely to pursue consumers who once had significant income or assets, and a court may have to address the financial status of these consumers if they fail to repay. If, however, the consumer lacked significant non-exempt income or assets at the time of borrowing, many creditors may simply decide that since chances are slim that the debtor's circumstances have improved, it is not cost effective to pursue them in court after default. If true, the correct comparison is not the cost of one bankruptcy proceeding against the cost of multiple non-bankruptcy proceedings, but is instead the cost of one bankruptcy proceeding against no proceeding at all.

The parallel nature of debt relief presents both an opportunity and a question for proponents of more significant means-testing. It presents an opportunity because the existence of non-bankruptcy debt relief allows for greater flexibility in the design of the bankruptcy system. Society need not design a bankruptcy system to accommodate all consumers if it is willing to use non-bankruptcy laws to provide effective debt relief to those left out of the bankruptcy system. Yet this argument also presents a challenge because a primary argument in favor of means-testing is that it is designed to target the wealthy deadbeat rather than to make it more costly for the needy consumer to file.³⁵⁹ This argument would be more convincing if the proponents of means-testing also endorsed changes to non-bankruptcy law designed to accommodate those consumers who will no longer have sufficient access to bankruptcy relief.

Of course, one could argue that non-bankruptcy debt relief laws are currently adequate for the task. One could debate whether non-bankruptcy exemptions of assets and income are sufficiently generous, whether collections practices are sufficiently regulated, and whether society needs to reform its statutes of limitations. Unfortunately, however, this debate would be informed by remarkably little empirical evidence. While a cadre of researchers continues to publish useful information on the workings of our bankruptcy courts,³⁶⁰ no one has taken a similar look at the non-bankruptcy collections process since David Caplovitz's study, thirty years ago.³⁶¹ While still useful, Professor Caplovitz's study predates many of the most important federal and state consumer protection laws and thus is unlikely to give an accurate representation of modern practice. Given that most consumer loans that are not repaid are not discharged in bankruptcy,³⁶² this lack of information on non-bankruptcy collections is troubling.

359. See, e.g., Jones & Zywicki, *supra* note 19, at 181-82.

360. See, e.g., SULLIVAN, WARREN & WESTBROOK, *supra* note 27.

361. See CAPLOVITZ, *supra* note 137.

362. See *supra* note 4 and accompanying text.

V. CONCLUSION

As the number of consumer bankruptcy filings continues to rise, one must not lose sight of the fact that bankruptcy is but one part of a larger system of debt relief. This Article argues that society *could* strengthen non-bankruptcy laws to provide debt relief roughly equivalent to the relief currently provided in bankruptcy.³⁶³ Moreover, if bankruptcy offers procedural advantages over non-bankruptcy law, society could adopt a bankruptcy system that achieves these advantages while still offering consumers the same relief that they would enjoy under non-bankruptcy law.³⁶⁴ Instead of doing so, however, society generally offers defaulting consumers some relief from their debts under non-bankruptcy law and greater relief if they file for bankruptcy.

Because bankruptcy is but a single part of a larger system of debt relief, the existing normative theories of consumer bankruptcy are incomplete. These theories may explain why society would offer debt relief, but not why this debt relief must be offered in a system that we call bankruptcy. Thus, the questions that have long dominated the corporate bankruptcy scholarship must be answered in the consumer context as well. What role does bankruptcy play in a larger system of debtor-creditor law? Why do the substantive rights of the participants in the bankruptcy process differ from their rights under non-bankruptcy debtor-creditor law? The standard explanations found in the corporate bankruptcy literature focus on bankruptcy's ability to employ a superior means of distributing the debtor's scarce assets among creditors. These theories have little relevance for a consumer bankruptcy system in which distributions to general creditors are practically non-existent.³⁶⁵

This Article argues that society may rationally offer consumers more generous relief in bankruptcy if bankruptcy serves to verify the consumers' insolvency and thus their need for debt relief. Thus, the debate over consumer bankruptcy reform should focus not on whether bankruptcy should involve means-testing, but rather on the form that the means-testing should take. Creditors, or the courts, can investigate a consumer's ability to repay her debts as they come due, but American bankruptcy law has largely shunned such investigations for most of its history. Rather, American bankruptcy law has largely employed forms of punishment to verify a consumer's inability to repay.

In deciding the method by which bankruptcy should means-test consumers, one must remain cognizant of the fact that many of these techniques can be employed by non-bankruptcy law as well. Non-bankruptcy debtor-creditor law may serve as a useful complement to bankruptcy by offering a parallel system of debt relief that mitigates some of the inevitable gaps in

363. See *supra* Part II.

364. See *supra* Part II.C.

365. See *supra* notes 9-10 and accompanying text.

the Bankruptcy Code. To the extent that bankruptcy forces the consumer to wait some period of time before receiving a subsequent discharge, non-bankruptcy law may help the consumer withstand further misfortune. To the extent that bankruptcy conducts an investigation into the consumer's ability to repay and thus becomes more expensive, non-bankruptcy law may provide relief to those who can no longer afford bankruptcy.

If non-bankruptcy debtor-creditor law is to continue to serve these roles, it may need to be reformed along with any reform of the Bankruptcy Code. Yet it is difficult to analyze the changes necessary to non-bankruptcy debtor-creditor law because this system has largely escaped empirical analysis for over thirty years. If we are to effectively evaluate the roles that bankruptcy and non-bankruptcy debtor-creditor law are to play in a larger system of debt relief, this omission must be rectified.

