BAPCPA 10 Years Later: the Effectiveness and Necessity of Bankruptcy Reforms Remain In Question

By Kent Durning

In April 2005, the Bankruptcy Abuse Prevention Consumer Protection Act (“BAPCPA”) was signed into law, representing the most extensive revisions to the bankruptcy code in 35 years. The BAPCPA was the product of more than a decade of legislative efforts. Its stated purpose was to curb perceived consumer abuse of the bankruptcy system. At the time of its enactment, many bankruptcy practitioners, judges and others questioned whether such a drastic change to the law was necessary and expressed concern about the impact the BAPCPA would have on consumers and the system as a whole. Ten years later, numerous studies have explored the effect of three of BAPCPA’s more controversial provisions—means testing, mandatory credit counseling and restrictions of the automatic stay for repeat bankruptcy filers—and conclude that stay restrictions appear to have worked to a limited extent, but means testing and credit counseling do not appear to have worked at all.

The BAPCPA’s Legislative Background

In 1996, one million consumers in the United States filed for bankruptcy relief. News of this unwelcome milestone was received with some consternation, particularly because the U.S. economy during the late 1990s seemed to be prospering with the dot-com boom, rising income levels and falling unemployment. Over the following years, myriad commentators analyzed the rising bankruptcy rates with differing theories about the causes and solutions to the “bankruptcy problem”—including whether the rising bankruptcy rates were simply a byproduct of changes in lending practices rather than consumer abuse of the bankruptcy system.

Between 1997 and 2005, numerous bills intended to address consumer bankruptcy abuse were presented to the house or senate floors. Consumer lending businesses are widely reported to have been the dominant lobby behind these bills. Without much empirical support, the refrain of those supporting the proposed legislation was that consumers were more carelessly incurring debt than ever before and were increasingly willing to seek bankruptcy relief as a “first resort” to dodge creditors without first trying to repay debts despite having the means to do so.

Finally, in 2005, the BAPCPA was signed into law. Statements by President George W. Bush, in the House Judiciary Committee report accompanying BAPCPA, and by other members of Congress make clear that the BAPCPA’s enactment was premised on the idea that consumer debtors were abusing the bankruptcy system.

The BAPCPA Generally

The BAPCPA changed too much in the bankruptcy code to mention the changes comprehensively here. Some changes affected all parties to the bankruptcy process (debtors, creditors and trustees) in both business and consumer cases. However, the vast majority of the new provisions—and the most controversial—apply only to consumer bankruptcies.

A debtor’s case is deemed a “consumer” case when the majority of debts were incurred for personal or household purposes. Consumer bankruptcies principally fall under two chapters of the bankruptcy code: Chapter 7 or Chapter 13. In a Chapter 7 liquidation case, a debtor’s equity interest in non-exempt assets is liquidated and the proceeds are used to pay his or her creditors on a pro-rata basis. Typically, a debtor receives a discharge of most unsecured debts (with exceptions) and exits bankruptcy within a few months of the filing, with no bankruptcy-related restrictions on the use of post-petition income.

In a Chapter 13 reorganization, a debtor repays a portion of debts with disposable income over a three- to five-year repayment plan. The debtor’s net disposable income is calculated by reducing gross income by the amount of reasonable monthly expenses. Upon completion of all monthly plan payments, the debtor receives a discharge of most remaining unsecured debts (with some exceptions) and exits
bankruptcy. Typically, more debt gets paid through a completed Chapter 13 case than a Chapter 7 case, but Chapter 13 cases are also more likely to be dismissed without a discharge because a debtor has more bankruptcy-related obligations over a longer period of time, the failure of which could prompt dismissal.

Three of the BAPCPA’s more dramatic and controversial changes involved new requirements for consumer debtors or restrictions on protections available to consumer debtors.

1. The Automatic Stay and Repeat Bankruptcy Filers
One perceived form of consumer bankruptcy abuse that the BAPCPA sought to curb was debtors who file bankruptcy in order to invoke the protections of the automatic stay after having had a previous case dismissed for failure to complete bankruptcy requirements. In brief, the automatic stay stops creditor efforts to collect prepetition debts and to seize control of a debtor’s assets through, e.g., foreclosure, garnishment or eviction. The automatic stay is important for an orderly administration of a debtor’s assets for the benefit of all similarly-situated creditors.

To address this perceived abuse, the BAPCPA amendments limit the automatic stay in two ways. First, if a debtor has had a bankruptcy case pending within the prior year that was dismissed, the automatic stay in a newly-filed case will only remain in effect for 30 days. In order to have the stay extended, the debtor must file a motion requesting that relief and overcome a presumption that the latest filing was not in good faith. The second stay limitation provides that, for a debtor who has had two or more bankruptcy cases pending within the prior year that were dismissed, the automatic stay does not go into effect at all until the debtor petitions the court to implement the stay and overcomes a presumption that the latest case filing was not in good faith.

Studies since the BAPCPA was enacted are mixed regarding whether the new automatic stay limitations have served their purpose. Some indicate that the new stay limitations have not reduced the incidence of repeat filings, but have simply caused debtors to wait longer before filing a second bankruptcy petition. One such study identifies a 40% reduction in cases to which the new stay limitations apply and opines that this reduction represents the debtors who had some ability to control when they filed a bankruptcy petition and elected to delay the filing in response to the BAPCPA’s new stay limitations. Supporters of the BAPCPA might conclude that a debtor is abusing the system when filing a bankruptcy case before it is absolutely necessary. Under that view, the BAPCPA’s new stay revisions have been effective because debtors who filed a petition before absolutely necessary are now waiting longer to do so. Critics of that view might argue that those 40% were not necessarily abusive filings, even though the debtor was able to struggle outside of the bankruptcy system longer; the delay in filing may have simply eroded assets available for all creditors or prolonged the strife in consumer households that a bankruptcy filing ultimately helps relieve.

As for the remaining 60%, the presumption against continuation or imposition of the stay appears to have little impact. A 2015 study found that 98% of the motions seeking to extend the temporary 30-day stay were granted; a similar study reviewing motions seeking to impose the automatic stay where there was more than one bankruptcy case in the prior year found that such motions were granted 93% of the time. To critics, these numbers might suggest that the incredibly high frequency with which debtors overcome the presumption of bad faith show that reports of abusive debtor conduct in the context of repeat bankruptcy filings were overblown, and the new law only adds complexity and expense with no justification. Supporters of the BAPCPA might argue that the 40% of debtors who elected to delay filing as a result of the new stay provisions, discussed above, would not have been able to satisfy the presumptions against creating or extending the automatic stay, and for this reason the BAPCPA has served its purpose.

2. Mandatory Pre-Bankruptcy Credit Counseling
Another more controversial BAPCPA amendment imposes mandatory pre-bankruptcy credit counseling for consumer debtors. The BAPCPA’s proponents alleged that consumers were filing bankruptcy as a “first resort” when alternatives might be available and even impugned consumer bankruptcy lawyers for advising bankruptcy filings when unnecessary or inappropriate. To address this perceived abuse, BAPCPA imposed a new requirement that debtors obtain personalized credit counseling from
pre-approved credit counseling agencies before filing a petition. This 60- to 90-minute counseling session includes preparation and analysis of a debtor’s budget and advice regarding options available to address debt issues.

Post-BAPCPA studies on the effectiveness of prepetition credit counseling are mixed. The United States Government Accountability Office concluded that this credit counseling is merely an “administrative obstacle” and not an educational tool that meaningfully benefits consumers. When the credit counseling is a pre-bankruptcy requirement, it may be received too late to affect the outcome. Another post-BAPCPA study, however, notes that the average level of debt for repeat post-BAPCPA bankruptcy filers is higher, which could indicate that the pre-bankruptcy credit counseling has been somewhat effective in weeding out some prospective bankruptcy filers whose debt levels were low enough that they could address debt issues outside of bankruptcy. It is unclear, however, whether that increase in average debt levels is due to a reduction in bankruptcy filings with debts too low to justify bankruptcy relief or whether that increase is simply caused by other BAPCPA provisions that have resulted in longer waiting periods between bankruptcy filings.

3. The Means Test

Probably BAPCPA’s most significant—and most controversial—change is the creation of the “means test,” designed to divert debtors from Chapter 7 liquidations to Chapter 13 reorganizations. Any Chapter 7 debtor with gross household income above the median household income level for similarly-sized households in the area (according to data from the U.S. Census Bureau) must submit to the means test. This change was premised on the widely-promoted notion that a meaningful number of “abusive” consumer debtors were electing a Chapter 7 bankruptcy despite having sufficient income to be able to repay a meaningful amount of debts with disposable income through a Chapter 13 repayment plan.

The means test begins with a debtor’s gross income from all sources, reduced by both presumed and actual living expenses in order to reach a calculation of surplus income that would be theoretically available to pay towards debt reduction over a period of years. Many of the “expenses” used by the means test are not a debtor’s actual expenses, but are derived from expense guidelines generated by the Internal Revenue Service. If this surplus income is above a certain threshold, then the debtor is deemed to earn sufficient income (i.e., to have the “means”) to repay a meaningful portion of debts, the bankruptcy case is presumed abusive, and the Chapter 7 case is subject to dismissal or conversion to a bankruptcy under another chapter of the Bankruptcy Code—most often a Chapter 13.

The most extensive studies regarding the effects of BAPCPA have concluded that it did not achieve its stated goal of forcing debtors to stay out of the bankruptcy system or to repay a greater percentage of debts through a Chapter 13 reorganization. Studies comparing pre- and post-BAPCPA consumer bankruptcy cases have found that the income profile of the consumer debtor has remained generally the same, but the average debt loads have increased. Given the relatively consistent income levels but increased debt loads, these studies conclude that debtors have simply delayed seeking bankruptcy relief longer. This result is inconsistent with the stated purpose of the BAPCPA to reduce consumer abuse. If the means test performed as it was intended, the income level of average consumer bankruptcy filers should have dropped—reflecting that higher income consumers were repaying more debt rather than filing for bankruptcy relief—but it did not.

Another extensive study found that distributions to unsecured creditors in the average post-BAPCPA Chapter 13 case have actually decreased. That study did not purport to identify a cause for the decline. However, a post-BAPCPA decline in the distributions to unsecured creditors suggests that the means test has not pushed more “can-pay” debtors into Chapter 13, because if it did, the distributions to unsecured creditors would likely increase.

Impact and Cost of BAPCPA

The BAPCPA has resulted in an increased cost to consumer debtors. A 2010 study found that the median “access costs” after BAPCPA for consumer debtors increased 39% ($1,147) for a Chapter 13 case and 55% ($499) for a Chapter 7 case. This study also notes that the increased cost impacts the lowest income debtors disproportionately because, to the most needy, a slight increase in access costs can
be prohibitive. The above-median debtors—those “can pay” debtors that many BAPCPA provisions were supposed to target—are less likely to be impacted by increased access costs.

Others parties to the system also borne increased costs. A 2008 GAO study of the costs of implementing the BAPCPA during its first two years found that the United States Trustee Program incurred costs of approximately $72.4 million, and the Federal Judiciary incurred costs of approximately $48 million.

**Was There A Bankruptcy Abuse Problem Before BAPCPA?**

Although one million consumer bankruptcy filings in 1996 was a gaudy number that captured public attention, consumer filings had been steadily climbing since the early 1980s. The following chart, provided courtesy of University of Illinois College of Law Professor Robert Lawless, tracks historical bankruptcy filings and reflects this trend.

![Annual U.S. Bankruptcy Filings, per 1,000 Persons, 1900 - 2014](chart.png)

This chart represents the number of total U.S. bankruptcy filings since 1900 per 1,000 persons. The data represent twelve-month intervals ending June 30 of each year, the end of the government's fiscal year historically and the time frame for which early data are available. The chart uses total U.S. bankruptcy filings because of shifting definitions of "consumer" and "business" bankruptcy.

Although BAPCPA proponents contended that the increase in filings through the 1990s was due to abusive bankruptcy practices by “can pay” debtors, several studies of bankruptcy filing rates have found a strong correlation between bankruptcy filings and the availability of consumer credit.

A 1997 Congressional Budget Office study concluded that the incidence of consumer bankruptcy closely tracks household debt levels and, contrary to indicating abusive conduct, increased consumer bankruptcies during periods of national economic growth should be expected because household debt generally increases with economic expansion. Several similar studies of various periods between the 1930s and 1990s have concluded that the bankruptcy filing rates correlate strongly to consumer debt levels and credit card defaults, and that bankruptcy rates are driven by economic conditions rather than by consumer reactions to favorable bankruptcy laws.

A 1998 study by the Federal Deposit Insurance Corporation reached a similar conclusion, noting that levels of consumer debt—the single biggest predictor of bankruptcy filing rates—have steadily climbed since the early 1980s, when consumer credit interest rates were deregulated.

The following chart, also courtesy of Professor Robert Lawless, reflects the correlation between the availability of consumer credit and the rates of consumer bankruptcies.
This data supports the proposition that increased bankruptcy rates in the 1990s was tied to rising consumer debt, particularly for lower-income borrowers most prone to insolvency. The Federal Reserve’s 1997 Survey of Consumer Finance reported that debt burdens were growing for families with incomes below $10,000. Similarly, a Dow Jones & Co. report found an increase in subprime lending from $80 billion in 1992 to $150 billion in 1996. Although losses through default and bankruptcy can be substantial to sub-prime lenders, these studies note that often losses are outstripped by effective sub-prime interest rates of 18% to 40%, which can make the subprime market profitable for lenders in the short term.

Studies have also documented that, factoring for inflation, Chapter 7 debtor income was actually decreasing during the late 1990s, while debt-to-income ratios were consistent. This data indicates that, rather consisting of “can pay” debtors who elected bankruptcy over trying to pay creditors, the increasing Chapter 7 bankruptcy filings during this period were comprised of increasingly lower income debtors with higher levels of debt. In a six-year period spanning the enactment of the BAPCPA, debtors’ median home mortgage balances increased almost twice as much as the median value of their homes. During that same six-year period, despite static income levels, consumer debtors’ median unsecured debts increased more than 43%.

**Conclusion**

The majority of studies conclude that the enactment of the BAPCPA has not changed the profile of the typical consumer bankruptcy debtor, and instead debtors are simply staving off bankruptcy longer before filing. Post-BAPCPA debtors have higher debt levels and lower net worth, and the average distributions in Chapter 13 cases have decreased, suggesting the means test has not resulted in more payments to creditors by “can pay” debtors. Given the substantial increased access costs to consumer debtors, there is more evidence to suggest that the BAPCPA may simply be causing needy debtors to delay seeking bankruptcy relief. Correlations between consumer lending and bankruptcy rates suggest that the rising bankruptcy filings in the 1990s might have had more to do with consumer lending practices than abusive bankruptcy filings. If true, the BAPCPA’s impact on bankruptcy filing rates would likely not justify the substantial BAPCPA-related costs to trustees, the judiciary, and consumer households struggling with debt.

Please feel free to contact the author for references to studies mentioned here and other resources.

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