

# Empiricism in Bankruptcy

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## BOOK REVIEW

### Empiricism in Bankruptcy

BOOK REVIEW OF TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *As We Forgive Our Debtors*

Robert A. Hillman†

Reflecting the “consumer revolution” of the 1970s,<sup>1</sup> the Bankruptcy Reform Act of 1978 (“the Reform Act”)<sup>2</sup> contained numerous measures designed to solidify the fresh-start policy of consumer bankruptcy. Eligibility for a discharge, for example, basically required either the liquidation of the debtor’s often valueless, non-exempt assets in Chapter 7,<sup>3</sup> or the good-faith proposal of a plan to repay all or a portion of debts from future income in Chapter 13.<sup>4</sup> Influenced by theories of consumer incompetence at measuring the risks and consequences of default and by perceptions of aggressive creditor behavior, Congress perceived a national interest in rehabilitating debtors.<sup>5</sup>

Following enactment of the Reform Act, the number of consumer bankruptcy filings increased dramatically.<sup>6</sup> Predictably, creditor interests claimed the Reform Act invited abuse by debtors who were capable of paying their debts. Moreover, a study of consumer bankruptcy substantiated this allegation.<sup>7</sup> In response, Congress

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<sup>1</sup> H.R. REP. NO. 595, 95th Cong., 2d Sess. 116 (1978); Charles G. Hallinan, *The “Fresh Start” Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 71-89 (1986).

<sup>2</sup> Pub. L. No. 95-598, 92 Stat. 2549 (1978).

<sup>3</sup> 11 U.S.C. §§ 721-728 (1988); TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* 25-35 (1989) [hereinafter *DEBTORS*].

<sup>4</sup> 11 U.S.C. §§ 1321-1330 (1988). Chapter 13, therefore, shielded the debtor’s assets from creditors. *DEBTORS*, *supra* note 3, at 33-39. Both Chapters 7 and 13 envision some repayment to secured creditors. *Id.* at 138.

<sup>5</sup> H.R. REP. NO. 595, 95th Cong., 2d Sess. 116 (1978).

<sup>6</sup> The number of consumer bankruptcies has more than doubled in the last ten years. *DEBTORS*, *supra* note 3, at 3.

<sup>7</sup> CREDIT RESEARCH CENTER, KRANNERT GRADUATE SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, *CONSUMER BANKRUPTCY STUDY* (Monograph Nos. 23-24 1982). This study reported that in 1981 debtors could have paid over \$1 billion of discharged debt and that almost one-third of the debtors could have paid “‘a significant part’” of their debts. *See DEBTORS*, *supra* note 3, at 5-6 (quoting the study).

passed pro-creditor amendments in 1984 narrowing debtor protection. Under the new rules, courts could deny a Chapter 7 discharge if relief would constitute "substantial abuse" of the chapter.<sup>8</sup> In addition, the debtor must devote all "disposable income" to creditor payments pursuant to a Chapter 13 plan.<sup>9</sup>

Professors Sullivan, Warren, and Westbrook now join the fray with the publication of *As We Forgive Our Debtors*, an empirical study of consumer bankruptcy debtors and creditors. The authors report that few of the consumer debtors in their study could pay their debts and that income interruptions best explain these debtors' travails.<sup>10</sup> In consequence, they infer that few consumer debtors "abuse" bankruptcy.<sup>11</sup> The authors present an alternative explanation for the boom in consumer bankruptcies during the 1980s: irresponsible lending by the credit industry.<sup>12</sup>

*As We Forgive Our Debtors* is an important contribution to the consumer bankruptcy debate. As the authors point out, Congress drafted the Reform Act without adequate information concerning either the circumstances of, or the individuals involved in, consumer bankruptcy.<sup>13</sup> This book helps fill the void. It is loaded with vital data that inform the issues and clarify potential responses to the consumer bankruptcy problem.

*As We Forgive Our Debtors* is clearly written as well. The authors carefully explain their methodology in the text; their arguments and conclusions are distinct and understandable. A section on "policy implications" concludes each chapter, highlighting the significance of that chapter's data. Readers will find useful information in plentiful (but unimposing) statistical tables and in comprehensive footnotes.

Although the authors have painstakingly collected and analyzed their data and have enriched the debate about consumer bankruptcy, the book also illustrates some of the inevitable limitations of empirical work. While they often engage in strong advocacy, the authors readily acknowledge the inability of their data to reflect fully an accurate picture of consumer bankruptcy. In addition, their data fail to resolve such pressing normative issues as whether debtors

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<sup>8</sup> 11 U.S.C. § 707(b) (1988) (substantial abuse test).

<sup>9</sup> 11 U.S.C. § 1325(b)(1) (1988) (disposable income test).

<sup>10</sup> See *infra* notes 27-49 and accompanying text.

<sup>11</sup> DEBTORS, *supra* note 3, at 63 ("almost all debtors are in deep financial trouble"); *id.* at 212 (no more than "about 3-9% of the [Chapter 7] debtors . . . are suspects for further . . . investigation").

<sup>12</sup> *Id.* at 322-25.

<sup>13</sup> *Id.* at 15-17. The authors point out that the government still does not publish statistics concerning the amount of debt discharged in bankruptcy, the incomes and assets of debtors, the types of creditors, or the future prospects of parties that go through bankruptcy. *Id.* at 4.

"abuse" bankruptcy in sufficient numbers to justify reform or whether the law should fault the credit industry for its easy-credit policy. Despite these lingering doubts and unanswered questions, the reader will gain a much clearer picture of the people and the challenges of consumer bankruptcy.

## 1

## THE FINDINGS

Various criteria may be used to evaluate the success of an empirical project. Was the authors' hypothesis clear and distinct? Did they compile pertinent information? Was their methodology sound? Does their data support their conclusions?

Based on these measures, Sullivan, Warren, and Westbrook's contribution is significant.<sup>14</sup> To test whether debtors abuse bankruptcy, the authors investigated who is utilizing bankruptcy, why they are employing it, and who are their creditors. For example, what are the debtors' occupations? How much do they earn? Are they struggling to make ends meet or are they irresponsible "high rollers"? Can they pay their debts once they have incurred them? Do banks and other creditors aggressively market credit without regard to the nature of their debtors and the probability of repayment?

To answer these and other questions, the authors sampled about 150 Chapters 7 and 13<sup>15</sup> bankruptcy filings by natural persons in 1981 in each of the federal judicial districts in Texas, Illinois, and Pennsylvania,<sup>16</sup> for a total sample of 1502 debtors.<sup>17</sup> The authors obtained their information from the bankruptcy forms completed by the sample debtors.<sup>18</sup> Their data supply a wealth of information

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<sup>14</sup> I leave a technical critique of the author's methodology to others more qualified than myself.

<sup>15</sup> See *supra* notes 3-4 and accompanying text.

<sup>16</sup> The authors did not study random federal districts from around the United States. Instead, they studied debtors in all the districts in each of three states. Although the same state law applied to all debtors within each state, various districts "seemed to represent very different local bankruptcy systems." DEBTORS, *supra* note 3, at 18. The authors selected Texas, Illinois, and Pennsylvania "because they varied in interesting ways," such as exemption policy, economic viability (contrasting "the booming Sunbelt and the decaying Rustbelt"), and unemployment rates. *Id.* at 18-19.

<sup>17</sup> The authors gathered information from 1547 bankruptcy cases. They eliminated information from 18 cases because they were too incomplete. They also eliminated 27 "outliers," extreme cases that would skew the entire study. *Id.* at 64. Fifty-eight percent of the cases sampled were joint bankruptcy filings by married couples. The authors therefore studied information from 2409 individuals in bankruptcy. *Id.* at 17.

<sup>18</sup> The forms include information on the debtors' "assets, income, debts, employment, migration history," and on the creditors. *Id.* at 20. For a list of the information on the forms, see *id.* at 17-18. The authors collected the data between 1983 and 1986. *Id.* at 19. Not all of the cases were complete within that time frame. *Id.*

that contradicts the view that consumers abuse bankruptcy. As a result, no legislator, commentator, or lawyer involved in consumer bankruptcy can afford to ignore these data.<sup>19</sup>

### A. Who Are The Debtors?

The authors found that the debtors were similar to the general population in many ways. For example, about 90% of the debtors in the sample were wage earners, as compared to 92% of the general population.<sup>20</sup> Furthermore, the wage-earning debtors "work[ed] in the same occupations and industries as most Americans."<sup>21</sup> Surprisingly, the debtors' rate of unemployment at the time of filing was comparable to the nationwide rate in 1981, about 7%.<sup>22</sup> Fifty-two percent of the debtors owned their homes, compared to 64% of the general population.<sup>23</sup> Except in rare cases, the debtors were not burdened with unusual amounts of medical debt.<sup>24</sup> Only a few debtors (about 8%) had filed for bankruptcy previously,<sup>25</sup> laying to rest fears of an army of repeat bankruptcy players. Finally, the debtors' credit card debt was not extraordinary.<sup>26</sup>

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<sup>19</sup> *As We Forgive Our Debtors* has already stimulated a symposium. See *As We Forgive Our Debtors*, 65 IND. L.J. 1 (1989). The contributors elaborate upon several interesting issues raised by the book.

<sup>20</sup> *Id.* at 85. Self-employed debtors comprised 10.4% of the sample and 7.3% of the general population. *Id.* at 111. Another 9.6% of the sample were formerly self-employed. *Id.* Thus, about 20% of the debtors may have failed as entrepreneurs. These debtors were responsible for 45% of the total debt. *Id.* at 118.

<sup>21</sup> *Id.* at 85. The sample included 18% craftworkers, 11% professional or technical workers, 9% nonfarm laborers, 12% semiskilled workers, and 12% managers or administrators. *Id.* at 86. Only 73% of the debtors set forth information on both occupation and industry. *Id.* at 104 n.4. This statistic worries Professor Girth. See Marjorie L. Girth, *The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals*, 65 IND. L.J. 17, 30 (1989).

<sup>22</sup> DEBTORS, *supra* note 3, at 86. An additional 10% of the sample either did not respond or responded unclearly to the employment question. *Id.* at 86; see also *infra* note 33.

<sup>23</sup> DEBTORS, *supra* note 3, at 129. The mean value of the debtors' homes was \$50,000; the mean value for the general population's homes was \$56,100. *Id.*

The homeownership debtors earned less and owed more than homeowners in the general population. Their average net worth was \$-13,337. *Id.* at 141. Sullivan, Warren, and Westbrook hypothesize that the homeowners' fortunes fell after they purchased their homes. *Id.* at 135.

<sup>24</sup> *Id.* at 168 ("at most only 1% to 2% of the debtors in bankruptcy are demonstrably there because of catastrophic medical losses"); see also *id.* at 170.

<sup>25</sup> *Id.* at 192.

<sup>26</sup> *Id.* at 189. All-purpose credit card debt surprisingly accounted for only 3% of the total debt. *Id.* at 306. According to the authors, credit card "junkies" consisted of, at most, 15% of the wage earners in the sample. *Id.* at 184-85.

Sullivan, Warren, and Westbrook also present interesting data concerning homeowners, entrepreneurs, women, and other debtor sub-groups. For example, women debtors earned significantly less than male debtors. *Id.* at 151. The mean income for families in bankruptcy headed by a male was \$18,000; the mean income for such families

Despite these similarities to the general population, the debtors earned less than their counterparts in each occupation.<sup>27</sup> Since the debtors apparently did not occupy the lowest paying jobs within their respective occupations,<sup>28</sup> the authors hypothesize that significant income interruptions may explain the salary deficiencies.<sup>29</sup> The Chapter 7 wage earners<sup>30</sup> short job tenure,<sup>31</sup> volatile income,<sup>32</sup> and even their rate of unemployment,<sup>33</sup> the authors assert, substantiate their hypothesis that "a majority" of these debtors suffered from a serious interruption in income before bankruptcy.<sup>34</sup>

## B. Can The Debtors Pay?

Not surprisingly, Sullivan, Warren, and Westbrook found that their sample debtors were in poor financial shape at the time of their filings.<sup>35</sup> Both the mean (\$15,779) and median (\$14,974) family incomes of the debtors were less than two-thirds of the national figures.<sup>36</sup> Although debtors in the sample and the general population had comparable home-mortgage debt,<sup>37</sup> the median non-mortgage consumer debt in the sample was \$10,800, compared to

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headed by a single female was \$10,600. *Id.* at 152. See generally Zipporah Batshaw Wiseman, *Women in Bankruptcy and Beyond*, 65 IND. L.J. 107 (1989).

<sup>27</sup> DEBTORS, *supra* note 3, at 91.

<sup>28</sup> *Id.* at 91-95. The similarity of occupational prestige between the debtors and the general population tends to rebut the theory. *Id.* at 91. The authors also "standardized" the debtors' income data to reach this conclusion. *Id.* at 91-95.

<sup>29</sup> "If a plumber makes \$20,000 a year, a plumber laid off for four months would make only \$14,300 . . ." *Id.* at 95.

<sup>30</sup> The authors looked at the Chapter 7 debtors because they were required to report more income information. *Id.* at 96.

<sup>31</sup> The median job tenure was 1.5 years for the Chapter 7 debtors in the sample, compared to 3.2 years for all workers over 16 years of age. *Id.* at 96.

<sup>32</sup> Forty-two percent of the Chapter 7 wage-earning debtors had income swings of more than 20% during the two years before filing. *Id.* at 100. More than half of these swings were income increases. *Id.* at 99. Nevertheless, these debtors' incomes were so low in 1979 (the median 1979 income was \$11,000) that the authors conclude that the data "are consistent with the hypothesis of income interruption due to unemployment or layoff." *Id.* at 99.

<sup>33</sup> The authors included both unemployed and "probably unemployed" wage earners among the ranks of the unemployed for purposes of their "income interruption" hypothesis. *Id.* at 96.

<sup>34</sup> *Id.* at 100.

<sup>35</sup> *Id.* at 64-77. Nevertheless, the authors' study proves much more than the obvious. Although the conclusion that most debtors are in poor financial shape when they file for bankruptcy may not be surprising, the nature of the debate about consumer bankruptcy—do debtors abuse bankruptcy?—makes the authors' findings relevant and important.

<sup>36</sup> *Id.* at 65. The median national family income in 1981 was \$22,400. The national mean was \$25,800. *Id.* Nevertheless, 14% of the debtors had incomes above the national mean. *Id.*

<sup>37</sup> The median home-mortgage debt nationally in 1983 was \$21,000, whereas the median home-mortgage debt within the sample was \$23,714. *Id.* at 68-69.

\$2,400 in the general population in 1983 (the closest year for which statistics were available for comparison).<sup>38</sup> The average debtor had \$23,034 of secured debt and \$15,498 of unsecured debt, the latter figure alone nearly equaling the average debtor's annual income.<sup>39</sup> The median debtor-family owed debts equal to about one year and five months' worth of income.<sup>40</sup> More than three-quarters of the debtors were insolvent, with debts exceeding their assets.<sup>41</sup> In fact, the median debtor had a net worth of \$-8,100, whereas the median net worth of a person in the general population in 1983 was \$24,600.<sup>42</sup>

Can debtors in such financial straits pay their debts? Sullivan, Warren, and Westbrook think not. The authors studied the wage earners in their sample who filed in Chapter 7 or 13. They excluded the self-employed or formerly self-employed, who were generally less able to repay their debts than the wage earners.<sup>43</sup> The authors report that over 87% of the Chapter 7 wage earners could pay nothing by selling all of their assets other than their homes.<sup>44</sup> In addition, more than 90% of the Chapter 7 wage earners who owned homes could pay nothing if they sold their homes.<sup>45</sup> According to the authors' calculations, only about 9% of the Chapter 7 wage earners could pay all their debts in three years by contributing up to 40% of their incomes to a hypothetical Chapter 13 repayment plan while living on a low budget.<sup>46</sup> About 16% of the wage earners actually utilizing Chapter 13 could pay all their debts in three years by contributing up to 40% of their incomes to repayment while living

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<sup>38</sup> *Id.* at 66, 68-69. Nonmortgage consumer debt averaged \$20,600 per family in the sample, compared to \$5,400 in the general population. *Id.*

<sup>39</sup> *Id.* at 64, 69. Extreme cases skew these figures, of course. The median amount of unsecured debt for the sample was \$7,052. *Id.*

<sup>40</sup> *Id.* at 74. The authors combined both spouses' incomes for family members. *Id.* at 73. The mean debt was much higher (three years and two months), showing that extreme cases raised the debt/income ratio. *Id.* at 74.

<sup>41</sup> *Id.* at 71. But 16% had a positive net worth of more than \$5000. *Id.* at 71-72. The standards utilized by debtors for measuring the value of their assets are unknown.

<sup>42</sup> *Id.* at 71. The mean net worth of the debtors was \$-13,900; the mean net worth of the general population in 1983 was \$66,100. *Id.* The 1983 survey omitted automobiles and home furnishings. *Id.* at 70.

<sup>43</sup> *Id.* at 201.

<sup>44</sup> *Id.* at 203. The authors assumed \$5000 of exempt property for each debtor. *Id.*

<sup>45</sup> *Id.* at 205. This assumes a homestead exemption of \$10,000 and a market value return of 70% for the homes. *Id.* at 204.

<sup>46</sup> *Id.* at 212. The authors determined each Chapter 7 wage earner's income and subtracted projected federal income taxes, home mortgage and other payments to secured creditors, and the fee to the hypothetical Chapter 13 trustee. Sullivan, Warren, and Westbrook also deducted a "low" household budget based on statistics published by the Bureau of Labor Statistics. The low budget was not a "poverty" budget, but applied a minimal standard rather than average costs. The low budget for 1981, before taxes, was \$15,323. The authors applied the remainder of the income to the unsecured debt. *Id.* at 210.

on the same low budget.<sup>47</sup> The latter finding, together with other studies supporting the relative lack of success of Chapter 13 payment plans,<sup>48</sup> lead the authors to conclude that the benefits of Chapter 13 may be outweighed by the costs of "waste[d] money and mental anguish" suffered by debtors attempting to perform impossible plans.<sup>49</sup>

### C. The Creditors

Sullivan, Warren, and Westbrook found that the creditors were a diverse group.<sup>50</sup> They included members of the consumer credit industry such as credit card issuers, banks, private mortgage companies, savings and loans, gasoline companies, stores, finance companies, credit unions, and car finance companies.<sup>51</sup> Other creditors included family members, co-workers, doctors, utility companies, and tort victims.<sup>52</sup>

Although the creditors were a mixed group, members of the consumer credit industry loaned nearly 87% of the wage earners' debt.<sup>53</sup> Banks extended the largest amount of credit (22.9%), of which more than two-thirds was secured, followed by private mortgage companies (17.4%), savings and loans (14.2%), general finance companies (13.9%), and stores (10.8%).<sup>54</sup> The latter, which lent exclusively on an unsecured basis, represented the largest unsecured lenders, holding almost 37% of the unsecured debt.<sup>55</sup> As a whole, not surprisingly, long-term creditors and those making large loans were secured to a far greater extent than short-term and small-loan creditors.<sup>56</sup>

From their data, the authors conclude that the best criterion for predicting the risk of bankruptcy is the ratio of debt to income.<sup>57</sup> Nevertheless, the authors assert that few consumer-credit-industry

<sup>47</sup> *Id.* at 214. The authors could not report actual final results of the Chapter 13 cases because many of their cases had not been completed when analyzed. *Id.* at 215. This weakens their conclusion. See Girth, *supra* note 21, at 39-40; see also *infra* note 75.

<sup>48</sup> *E.g.*, *Hearing Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong., 1st Sess. 36, 52 (1981) (statement of Claude Rice), cited in DEBTORS, *supra* note 3, at 229 n.33.

<sup>49</sup> DEBTORS, *supra* note 3, at 223. *But see* Girth, *supra* note 21, at 38-48.

<sup>50</sup> DEBTORS, *supra* note 3, at 273.

<sup>51</sup> *Id.* at 302.

<sup>52</sup> *Id.* at 274.

<sup>53</sup> *Id.* at 303. The debt totaled \$27,768,100, of which over \$10,000,000 was unsecured. *Id.* at 304. Reaffirmations by debtors and Chapter 13 pay-back plans reduce the actual amount of unsecured-debt losses. *Id.* at 319.

<sup>54</sup> *Id.* at 307.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 312 (large loans); *id.* at 309 (long-term loans).

<sup>57</sup> *Id.* at 313. An additional factor is sharp changes in income shortly before bankruptcy. *Id.* at 314.

creditors lending to wage earners seek that information on their credit applications.<sup>58</sup> Nor do many creditors systematically review their short-term loans before making additional extensions of credit.<sup>59</sup> The creditors apparently have concluded that the costs of determining whether debtors are bad credit risks outweigh the benefits.<sup>60</sup>

#### D. Summary of the Authors' Conclusions

*As We Forgive Our Debtors* finds that consumer debtors in bankruptcy represent a cross-section of Americans, living above the poverty line, but earning less than others in comparable jobs. Although their medical debt is relatively insignificant, many have suffered income interruptions shortly before bankruptcy. The debtors have serious financial difficulties and, for the most part, are unable to pay their debts. Sullivan, Warren, and Westbrook suggest that members of the consumer credit industry, the source of most of the spiraling debt, do not systematically employ the best information when determining the likelihood of loan repayment.

## II

### THE LIMITS OF THE DATA

Although providing a wealth of information, the authors' data fail to resolve some key questions.<sup>61</sup> As already mentioned, the study examined cases filed in only three states.<sup>62</sup> As the authors point out, there are benefits to investigating all of the judicial districts in individual states. For example, if the rate of filings in Chapters 7 and 13 depended on economic incentives, one would expect a consistent proportion of Chapter 7 and 13 filings in each judicial district within a sample state, where statutory incentives such as asset exemption levels in Chapter 7 are constant and where, according to the authors' data, there are no important economic distinctions among the debtors.<sup>63</sup> Nevertheless, the rate of filings of Chapter 7 and Chapter 13 proceedings varied dramatically among federal judicial districts within each sample state.<sup>64</sup> Utilizing this and other

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<sup>58</sup> *Id.* at 316; *see also id.* at 313-14. The authors assume that significant lending took place within two years before bankruptcy, when the debtors had "terrible debt/income ratios." *Id.* at 314. From this, they apparently conclude that many creditors must not consider debt/income ratios at all. *Id.* at 318.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 318-25.

<sup>61</sup> The authors are well aware of this. *See, e.g., id.* at 200.

<sup>62</sup> *See supra* notes 16-17 and accompanying text.

<sup>63</sup> DEBTORS, *supra* note 3, at 247.

<sup>64</sup> *Id.* at 18, 247.

clues,<sup>65</sup> the authors contribute the valuable insight that “local legal cultures,” including the advice of local lawyers and judges, most often account for a debtor choosing either Chapter 7 or 13, rather than the economic costs and benefits of each chapter.<sup>66</sup> This conclusion refutes the thesis that economic incentives necessarily affect behavior and casts doubt upon Congress’s assumption that it could steer affluent debtors into Chapter 13 through economic inducements. Despite such important contributions made possible by the authors’ methodology, Sullivan, Warren, and Westbrook’s data obviously are not representative of conditions throughout the United States. We must therefore be cautious in drawing any general conclusions about bankruptcy.

In addition, the data are somewhat dated; the project studied 1981 filings<sup>67</sup> and therefore does not measure the effects of the 1984 or later amendments to the Reform Act. The authors can hardly be criticized for this deficiency, however, considering the time commitment involved in gathering and analyzing the data and writing the book. Moreover, the study is still timely because its conclusion that few 1981 debtors in the sample abused bankruptcy offers ammunition to those who suggest that the 1984 pro-creditor amendments, still in force, were unnecessary or even wrong-headed.<sup>68</sup> Of course, data directly measuring the benefits and costs of the 1984 reforms—Do they weed out the perhaps few offenders? Do they increase the costs of adjudication? Do they turn away deserving debtors?—would better measure the wisdom of the 1984 amendments.

The authors’ data disprove one common suspicion and confirm another about the reasons debtors build up large amounts of debt, which they are ultimately unable to pay. Crushing medical bills do not appear to explain most bankruptcies.<sup>69</sup> Income interruptions, on the other hand, apparently play a major role on the path to bankruptcy.<sup>70</sup> Additional information concerning the causes of the inter-

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<sup>65</sup> For example, the authors found that debtors in states that exempt few assets from Chapter 7 liquidation did not utilize Chapter 13 more frequently than debtors in states with generous Chapter 7 exemptions. *Id.* at 240-41.

<sup>66</sup> *Id.* at 246-52. Professor Whitford urges the abolition of Chapter 13 on the basis of this data. See William C. Whitford, *Has the Time Come To Repeal Chapter 13?*, 65 *IND. L.J.* 85 (1989).

<sup>67</sup> See *supra* note 16 and accompanying text.

<sup>68</sup> If fewer than 10% of debtors can pay their debts, tests such as whether a Chapter 7 discharge would be “substantial abuse,” invite costly, but arguably unnecessary, judicial intervention. See *infra* notes 97-99 and accompanying text. In addition, the authors’ data contradict an assumption of the 1984 amendments that incentives, such as a more generous discharge, *DEBTORS*, *supra* note 3, at 38, can induce debtors to file under Chapter 13. *Id.* at 19; see *supra* notes 63-66 and accompanying text.

<sup>69</sup> *DEBTORS*, *supra* note 3, at 168.

<sup>70</sup> *Id.* at 100. The authors concede, however, that less than 50% of the debtors

ruptions—for example, how many debtors were fired and how many unwisely terminated their employment themselves?—and about the debtors' day-to-day budget decisions would help to complete the picture of why debtors' circumstances result in bankruptcy.

The limits of the data also make Sullivan, Warren, and Westbrook's test of ability to pay somewhat unpersuasive. As already mentioned, the authors considered whether their wage earners could repay *in full* in three years while living on a low budget.<sup>71</sup> The authors use this approach primarily because of the uncertainties inherent in tests of less than full repayment. For example, Sullivan, Warren, and Westbrook point out that it is impossible to ascertain the portions of less than 100% repayment that debtors would apply to secured and unsecured debt and, therefore, the amount of interest that the debtors would have to pay on the secured debt.<sup>72</sup> In addition, the authors are wary of a test involving partial repayment of Chapter 7 debt because some debtors in Chapter 7 already reaffirm some of their debts and make other informal repayments. Without knowing the amounts of such actual repayments, the authors believe that any data on partial repayment by Chapter 7 debtors would be meaningless.<sup>73</sup> Sullivan, Warren, and Westbrook also employ their test of complete repayment to Chapter 13 debtors because the authors did not follow these debtors until their cases were closed.<sup>74</sup> The authors therefore were unable to report the percentage of Chapter 13 debtors who actually successfully completed their plans.<sup>75</sup>

Notwithstanding the uncertainties inherent in Sullivan, Warren, and Westbrook's own test of full repayment,<sup>76</sup> the results of their inquiry convince that few debtors could pay even a substantial portion of their debts.<sup>77</sup> I doubt, however, that the test results will persuade bankruptcy's critics that the 1984 amendments, designed to police debtors, are useless. Many critics assert that debtors should be required to attempt at least *some* repayment out of future earnings.<sup>78</sup> To these analysts, a debtor may abuse bankruptcy if she receives a Chapter 7 discharge when she could pay 50% or even a

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suffered income swings of more than 20% in the two years before bankruptcy. *Id.* at 101.

<sup>71</sup> See *supra* notes 46-47 and accompanying text.

<sup>72</sup> DEBTORS, *supra* note 3, at 208-09.

<sup>73</sup> *Id.* at 209-10.

<sup>74</sup> See *supra* note 47.

<sup>75</sup> Only 32% of the debtors' plans had already failed at the time of the authors' study. *Id.* at 215.

<sup>76</sup> The authors build many assumptions into their test. See, e.g., *supra* note 46.

<sup>77</sup> DEBTORS, *supra* note 3, at 224.

<sup>78</sup> See, e.g., Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953 (1981). Sullivan, Warren, and Westbrook admit that their conclusions are "laden with

smaller percentage of her debts while living on a low budget. Obviously, data suggesting that most debtors cannot repay 100% of their debts in three years will not deter these critics. In fact, these commentators may turn the data against the authors and claim that if about 9% of the Chapter 7 wage earners could repay 100% of their debts in three years, many more could have repaid at least something.<sup>79</sup>

Finally, Sullivan, Warren, and Westbrook conclude that the credit industry could reduce bankruptcy losses by making more careful lending decisions.<sup>80</sup> They assert more than once that many creditors fail to collect crucial information, such as the debtors' debt burden, and fail to utilize properly the information they do gather.<sup>81</sup> These conclusions, however, are not supported directly by empirical data; the reader must accept them largely on faith.<sup>82</sup>

Despite the limits of the authors' data, *As We Forgive Our Debtors* contributes a wealth of information about the plight of consumer bankruptcy debtors. At minimum, the book shifts the burden of proof to those who counsel the need for stricter bankruptcy entry requirements to discourage abusive debtors.

### III

#### CONCLUSION: NORMATIVE DECISIONS AND THE LIMITS OF EMPIRICAL DATA

Although Sullivan, Warren, and Westbrook recognize that some debtors are irresponsible,<sup>83</sup> the reader cannot help but suspect that the authors assign most of the blame for the explosion in consumer bankruptcies to creditor lending strategies.<sup>84</sup> After all,

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normative assumptions" about how much debtors should be required to sacrifice. DEBTORS, *supra* note 3, at 220; see Part III of this review.

<sup>79</sup> Occasionally, the authors seem unduly influenced by their data. After reporting their findings concerning ability to pay, the authors over-generalize that debtors "cannot pay." See, e.g., DEBTORS, *supra* note 3, at 304. A few sentences later they qualify the point by indicating that some debtors could repay a portion of their debts. Nevertheless, they surmise that many debtors are already repaying anyway; therefore, it would not be worth the costs to "push" debtors to repay more. *Id.* at 304-05.

The authors also suggest that their repayment-plan figures present too favorable a picture of the possibility of successful repayment, but they fail to point out that the picture portrayed by their data also may be bleaker than reality. For example, they mention that some of the 9% of debtors who seemingly have the ability to pay might encounter future misfortune and ultimately fail to repay as well. *Id.* at 212. But, by the same reasoning, conditions also may improve for at least some of the 91% whom they believe cannot pay.

<sup>80</sup> *Id.* at 322-23.

<sup>81</sup> E.g., *id.* at 313, 316, 317.

<sup>82</sup> See *supra* notes 58-60 and accompanying text. For additional examples of the limitations of the data, see *supra* notes 31-33, 41-42, 44-45, 70 and accompanying text.

<sup>83</sup> DEBTORS, *supra* note 3, at 11, 332.

<sup>84</sup> See, e.g., *id.* at 322-25.

the authors describe a world of debtors earning a third less than their counterparts in the same jobs, handcuffed by income interruptions and a volatile economy, and *unable* to repay loans made by the consumer credit industry without adequate investigation.<sup>85</sup> Nevertheless, the authors concede that their data alone cannot determine the appropriate legal approach to the consumer-debt problem.<sup>86</sup> To fashion a response, lawmakers must consider many normative issues. *As We Forgive Our Debtors* helpfully frames these issues and highlights this normative dimension of bankruptcy.<sup>87</sup>

The first question confronting social engineers is whether to relieve obligors at all. Sullivan, Warren, and Westbrook assume the propriety of a "safety valve . . . to release the pressures" of a free market economy.<sup>88</sup> Although the reader may ultimately agree with their conclusion, it is not self-evident. Lawmakers must consider the host of moral, instrumental, and process concerns that govern our law of obligations.<sup>89</sup> For example, they must consider whether the need to ensure the certainty and stability of such obligations outweighs the interest in relieving those who suffer from the dislocation of changed circumstances.<sup>90</sup>

Assuming that some relief is appropriate, is bankruptcy law the correct vehicle?<sup>91</sup> Sullivan, Warren, and Westbrook acknowledge that bankruptcy is only one of several measures that "soften the stresses" of the market.<sup>92</sup> With many alternatives at their disposal, lawmakers must confront the dilemma of choosing the best approach or approaches. One possibility, for example, would be to eliminate the bankruptcy discharge (while preserving bankruptcy's distributional function).<sup>93</sup> Instead, the law could protect people by providing better job and catastrophe insurance. One obvious effect of such a move would be to substitute taxpayers for creditors as the

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<sup>85</sup> "The bankruptcy laws are generally serving the people they are designed to serve: people in serious, even hopeless financial trouble, who need either a fresh-start discharge from their debts or at least some protection from their creditors and a breathing spell while they try to repay." *Id.* at 77.

<sup>86</sup> *E.g., id.* at 9, 220.

<sup>87</sup> *Id.* at 9.

<sup>88</sup> *Id.* at 334. "Every machine must have give in the joints or it will destroy itself, and bankruptcy is part of the give in a free market society." *Id.*

<sup>89</sup> *See, e.g.,* Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. — (Nov. 1990) (forthcoming).

<sup>90</sup> The authors nicely contrast our national dislike of broken promises with our allegiance to "[r]ebirth and a fresh start." DEBTORS, *supra* note 3, at 8.

<sup>91</sup> "American law is by far the most generous in the world in granting discharges to both individuals and businesses." *Id.* at 334.

<sup>92</sup> *Id.* at 328; *see also id.* at 333.

<sup>93</sup> Bankruptcy's priority rules eliminate costly creditor rivalry. *See* Hillman, *supra* note 89.

group most directly bearing the burden of the debtors' default.<sup>94</sup> This may appeal to those who do not condemn the creditors' lending practices.<sup>95</sup> Alternatively, lawmakers could create more effective contract doctrines permitting reformation of contract obligations in exigent circumstances.<sup>96</sup> This approach might be appropriate, for example, when only one or a few obligations stymie a debtor and bankruptcy would be costly and stigmatizing. Ultimately, resolving which legal techniques to apply to consumer debt depends on the overall costs and benefits of each solution. Sullivan, Warren, and Westbrook could hardly be expected to supply information on the costs and benefits of every possible approach to the debtors' crises. Instead, *As We Forgive Our Debtors* initiates the inquiry by supplying useful information relevant to bankruptcy's benefits and costs.

Assuming that bankruptcy discharge is an appropriate measure, lawmakers still must consider whether they could improve this technique. Should bankruptcy incorporate a relatively bright-line rule of discharge or should it utilize a standard that invites case-by-case judicial analysis? The debate about the propriety of rules and standards, of course, is not new.<sup>97</sup> Rules reduce the costs of administration but increase the possibility of injustice in individual cases; standards alleviate the latter concern but invite inconsistent application and increase the costs of adjudication. The "substantial abuse" and "disposable income" tests of the 1984 amendments evidence a move toward utilizing standards in bankruptcy jurisprudence.<sup>98</sup> Sullivan, Warren, and Westbrook criticize such tests, however, on the traditional grounds mentioned above.<sup>99</sup>

In addition to questions pertaining to the bankruptcy process, reformers confront substantive improvement questions. For example, does bankruptcy require the appropriate amount of debtor sacrifice, or are too many debtors abusing the law? Debtor "sacrifice" encompasses at least the following issues. Sullivan, Warren, and Westbrook's data demonstrate that couples in bankruptcy are typi-

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<sup>94</sup> Creditors, of course, may raise interest rates to absorb the losses of bankruptcy so that all borrowers would pay for the losses.

<sup>95</sup> See *infra* notes 105-15 and accompanying text.

<sup>96</sup> See, e.g., Robert A. Hillman, *Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 DUKE L.J. 1.

<sup>97</sup> For a discussion of the paradox of rules and standards in the context of bankruptcy, see generally Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3 (1986).

<sup>98</sup> See *supra* notes 8-9 and accompanying text.

<sup>99</sup> The authors characterize the substantial abuse test as "vague," which permits judges to apply it inconsistently. DEBTORS *supra* note 3, at 33; see also *id.* at 221. Further, they criticize an inquiry as to why both spouses are not working when a family seeks a discharge, viewing it as "intrusive and expensive." *Id.* at 159.

cally earning only one income.<sup>100</sup> Should spouses be required to work to help pay debts?<sup>101</sup> Should debtors be required to repay at least some of their debts from future earnings?<sup>102</sup> What is the appropriate minimum budget for debtors? Should the concept of sacrifice be tied to the parties' fault in creating the debt? For that matter, what conduct is blameworthy? "Sacrifice," "abuse," and "blameworthiness" are value-laden concepts; lawmakers' approaches to these issues inevitably shape the parameters of the bankruptcy safety net.<sup>103</sup> Despite their overall outlook, Sullivan, Warren, and Westbrook are ambivalent on some of these issues. For example, although the authors contribute the important point that income interruptions affect many debtors prior to bankruptcy, they occasionally refer to debtors as "irresponsible."<sup>104</sup> Moreover, their view on creditor practices is somewhat unclear.

Suppose a creditor concludes that the costs of evaluating whether debtors are bad credit risks outweigh the gains, and markets credit without investigating an overeager debtor's balance sheet.<sup>105</sup> Has the creditor engaged in commendable cost-benefit analysis and marketing techniques, or has the creditor unduly influenced a consumer addicted to consumption?<sup>106</sup> Sullivan, Warren, and Westbrook helpfully discuss why creditors may not engage in a more comprehensive investigation of their debtors. The authors explain that security interests,<sup>107</sup> reaffirmations,<sup>108</sup> Chapter 13 repayment plans, and other informal repayments may reduce outstanding debt to a level that renders additional precautions inefficient.<sup>109</sup> Creditors who decide to make high-risk loans without precautions, the authors surmise, may be making "entirely reasonable business decisions."<sup>110</sup>

100 *Id.* at 157.

101 *Id.* at 158-59.

102 *See id.* at 299. In other words, should Chapter 13 be mandatory? Whether an affirmative answer would swing the pendulum too far in favor of creditor interests is the subject of considerable debate. *See, e.g.,* Eisenberg, *supra* note 78, at 976-91; Steven L. Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*, 30 UCLA L. REV. 327, 345-64 (1982); *see also* Whitford, *supra* note 66.

103 *See* DEBTORS, *supra* note 3, at 8.

104 *E.g., id.* at 8, 11.

105 *See id.* at 302-25.

106 *See id.*; *see also* Robert E. Scott, *Rethinking the Regulation of Coercive Creditor Remedies*, 89 COLUM. L. REV. 730, 770 (1989) ("an inference of systematic exploitation of consumers . . . simply does not seem justified by the current evidence").

107 The average debtor in the authors' sample was indebted to 15 creditors of which 3 were secured creditors. DEBTORS, *supra* note 3, at 31.

108 About 19% of the authors' Chapter 7 debtors reaffirmed at least one of their debts. *Id.* at 32.

109 *Id.* at 319-20. The authors estimate that "industry exposure" was about \$2 billion in 1981, which is less than 1% of outstanding consumer debt that year. *Id.* at 320.

110 *Id.* at 321. For example, stores were the largest unsecured lenders in the au-

Without much elaboration, however, Sullivan, Warren, and Westbrook ultimately assert that lending without precautions is "irresponsible"<sup>111</sup> and worry that the practice probably increases the amount of consumer debt.<sup>112</sup> Perhaps influenced by contract law solidarity norms such as the duties of care and disclosure,<sup>113</sup> or persuaded on instrumental grounds that only creditors can contain spiraling and costly consumer debt, the authors believe that "responsible" lenders should police their prospective debtors. Such lenders should deny credit to those, although in poor financial shape, who are unable to withstand the pressures of our consumption-oriented society. A likely result of increased surveillance by the lending industry, of course, would be the reduction of available credit.<sup>114</sup> Ironically, the result of "responsible" lending therefore might be a reduced standard of living for those debtors suffering the plight brought home in Sullivan, Warren, and Westbrook's important book.<sup>115</sup>

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thors' sample. See *supra* text accompanying notes 54-55. The costs of these creditors requiring detailed credit applications may legitimately preclude the practice.

<sup>111</sup> *Id.* at 325. The authors also refer to the "pathology" of the consumer credit industry, *id.* at 3, and the "reckless" dispensing of credit cards. *Id.* at 188.

<sup>112</sup> *Id.* at 324-25. There is some debate, however, concerning whether rising debt is a cause for concern. *Id.* at 331; see also Lisa J. McIntyre, *A Sociological Perspective on Bankruptcy*, 65 *IND. L.J.* 123, 124-25 (1989).

<sup>113</sup> See generally Robert A. Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 *CORNELL L. REV.* 617 (1983).

<sup>114</sup> *DEBTORS*, *supra* note 3, at 323; see also *id.* at 290, 316. For helpful suggestions as to how Congress could construct disincentives to excessive lending, see Girth, *supra* note 21, at 55-57.

<sup>115</sup> On the other hand, perhaps debtors will be better off by avoiding high-interest credit. *Id.* at 323.