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CHAPTER 7 BANKRUPTCY PETITIONERS' REPAYMENT ABILITY UNDER H.R. 833: THE NATIONAL PERSPECTIVE[*]

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Executive Summary

This study analyzes the effects of the needs−based bankruptcy provision of the "Bankruptcy Reform Act of 1999" ("H.R. 833") [1] on chapter 7 filers. This study, and an earlier study by Ernst & Young LLP (Ernst & Young 1998b), are the only studies to date that evaluate repayment capacity on a *national basis*.

The analysis is based on a stratified random sample that is nationally representative for calendar year 1997. This sample is comprised of over 2,100 chapter 7 bankruptcy petitions, which were selected from each of the 90 bankruptcy districts in the nation.

Key study findings are:

- 10% (approximately 100,000) of 1997 chapter 7 filers are likely to have been impacted by the needs−based provision of H.R. 833 and required to file chapter 13. [2] (See Chart 1).
- These filers would have had the ability to repay 53%, or almost $3 billion, of their unsecured non−priority debts over five years. These filers could have repaid $7 billion of their total chapter 7 debt, including secured, unsecured and priority debt. This assumes that their income remains unchanged relative to expenses and liabilities during the sixty month repayment period.
- The filers likely impacted by H.R. 833 are higher income filers:
- The median gross income of likely impacted filers is more than twice that of chapter 7 filers not impacted ($51,974 vs. $21,204), and is 46% higher than the 1996 United States national median income for all households ($35,492).

The needs−based bankruptcy provision in H.R. 833 is likely to impact higher income petitioners with demonstrated ability to repay their debts. For purposes of this analysis, the filers likely to be impacted and required to enter a chapter 13 repayment plan are those who are subject to creditor motions and who meet the repayment ability presumption criteria.

Median Income Test

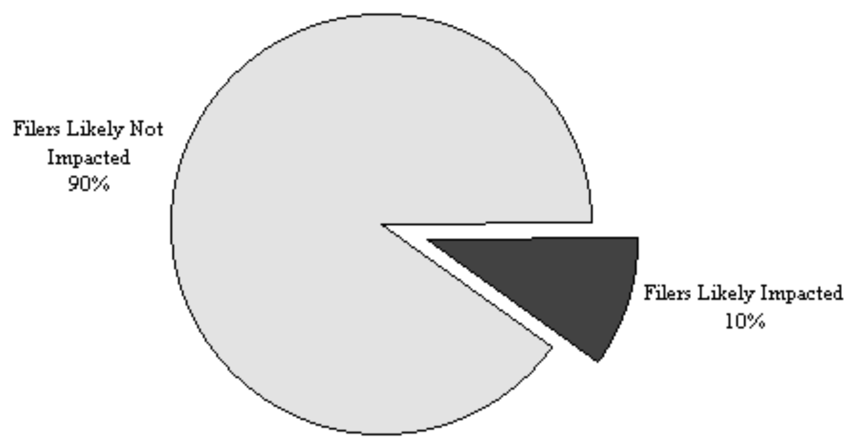
Debtors with incomes below the national median (adjusted for family size) would not be subject to creditor motions and therefore would likely not be impacted. Conversely, creditors may bring motions against petitioners with incomes in excess of the family median. [3]

Repayment Ability Presumption

H.R. 833 assumes that "abuse exists" regarding chapter 7 debtors with the ability to repay at least 25% or $5,000 of their unsecured non−priority debts within five years, after paying for secured and priority debt payments and living expenses. [4] These filings either must be dismissed or converted to chapter 13, unless a debtor can demonstrate extraordinary circumstances that require an adjustment of income or expenses, and such adjustment causes the debtor's repayment capacity to fall below the lesser of 25% or $5,000.

Thus, likely impacted filers are those earning above the national median who are presumed to be abusive.

It is important to emphasize that this analysis only measures the needs−based provision of H.R. 833. This pending House legislation contains numerous other provisions (e.g. financial counseling, random audits, verification of income, etc.) that would reduce bankruptcy losses. Quantifying the impact of these other provisions is beyond the scope of this study.



Source: Ernst & Young, "Chapter 7 Bankruptcy Petitioners' Repayment Ability Under H.R. 833: The National Perspective."

Introduction

In 1998, personal bankruptcy filings reached an all−time high of almost 1.4 million. [5] The record levels of filings in recent years contrast sharply with the state of the overall economy, which has grown steadily and experienced low levels of unemployment and high consumer confidence. The dichotomy between the healthy economy and the number of filings has focused attention on current bankruptcy laws. Reform proposals are being considered by Congress, and their impact on the number of bankruptcy filers and debt repayment in the bankruptcy system are important factors to consider in the public policy debate. [6]

While several previous research studies have investigated petitioner repayment capacity, this study and Ernst & Young's March 1998 study (Ernst & Young, 1998b) are the only studies that evaluate repayment capacity comprehensively on a *national basis*. [7] The national database of 1997 bankruptcy petitions, herein referred to as the "1997 Visa national bankruptcy database," includes more than 2,100 chapter 7 bankruptcy filings. [8] This study calculates the effects of the needs−based bankruptcy provision of H.R. 833, the Bankruptcy Reform Act of 1999.

The needs−based provision of H.R. 833 would likely impact chapter 7 petitioners, requiring them to file under chapter 13 if their income exceeds the national median (adjusted for family size), [9] and they possess the ability to repay either $5,000 or 25% of their unsecured non−priority debts within five years, after making secured and priority debt payments and covering living expenses. If the law had been in effect in 1997, 10% of chapter 7 filers would likely have been impacted by the needs−based provision and required to file chapter 13.

This study is divided into five sections, beginning with this introduction. Section I provides a general description of the 1997 Visa national bankruptcy database. Section II presents key findings about the impact of the needs−based provision. Section III details calculations on repayment ability under the needs−based provision of H.R. 833, and is followed by concluding comments.

I. Description of the 1997 Visa National Bankruptcy Database

Since 1993, as a service to its member financial institutions, Visa has maintained a national bankruptcy notification service ("BNS") which records virtually all non−business bankruptcy filings. This study began by taking a sample from the 1997 BNS, which included all eleven federal court circuits and ninety district courts. The sample was drawn in two stages: the first stage sample was extracted from a computer file by Visa, based on Ernst & Young's specifications; the second stage sample was randomly selected from this file by Ernst & Young statisticians. [10]

The first stage sample was designed to have sample sizes of approximately 500 chapter 7 petitioners for each of the ninety federal districts in the United States. [11] This sample of 43,730 cases was drawn randomly in each district to ensure that the monthly sample was proportionate to the actual monthly volume in that district. The second stage sample consisted of about 2,200 petitions, 200 of which were chapter 7 asset cases. In the second stage sample, the district sample sizes were determined by allocating the total sample in proportion to each district's volume within each month of filing. This was supplemented by sampling additional observations from the smallest districts, so that each had a minimum of about a dozen cases. [12] Table 1 shows the distribution of petitions by chapter that were finally selected in the first and second stages of sampling.

Table 1. First and Second Stage Sample Sizes

Chapter 7	First Stage Sample	Second Stage Sample
Asset Cases	2,051	196
No−Asset Cases	41,679	2,024
Total	43,730	2,220

Note: The first stage and second stage samples were obtained as described in the text. The second stage sample is also referred to in this report as the "final selected sample".

The U.S. bankruptcy courts were the source for all petitions obtained for the 1997 sample database. A listing of the cases to be included in the final sample was sent to an outside vendor, who obtained the designated petitions from the applicable court. The petitions obtained were then copied and transmitted for data entry at Visa, where virtually all of the information on the petitions was captured. During the data gathering process, Ernst & Young monitored all steps – including the selection of a subsample of cases for independent reprocessing.

The sampling was highly successful, as indicated in Table 2, which connects the sample to the population about which inferences are to be made. Columns 1 and 2 show the total number of 1997 chapter 7 petitions by circuit, first as obtained from BNS (Column 1), and then as obtained from official sources (Column 2). [13] Column 3 shows the universe of 1997 petition filings after eliminating cases that are estimated to be dismissed. Column 4, designated "Final Selected Sample," corresponds to the "second stage sample" discussed earlier and summarized in Table 1. Lastly, Column 5 consists of the sample determined usable. [14] The differences between Columns 4 and 5 are quite small; overall, the usable sample was approximately 97% of the final selected sample.

Table 2. Total and Admissible Chapter 7 Petitions by Circuit: Population and Sample Data for 1997 (Fifty States and District of Columbia Only)

Federal Circuit	BNS Count of Petitions	Official Count of Petitions	Total Petitions, Excluding Dismissals	Final Selected Sample	Usable Sample
	(Column 1)	(Column 2)	(Column 3)	(Column 4)	(Column 5)

Total	925,654	952,446	941,263	2,220	2,142
First	29,632	33,059	32,406	71	63
Second	72,195	72,747	72,646	167	167
Third	55,304	61,927	61,035	131	128
Fourth	74,821	79,145	78,091	196	186
Fifth	57,276	58,142	57,205	149	139
Sixth	102,406	107,916	106,620	231	201
Seventh	87,672	93,947	93,148	199	190
Eighth	57,069	57,669	57,276	152	152
Ninth	243,528	241,167	237,256	558	556
Tenth	56,016	56,362	55,990	141	140
Eleventh	89,735	90,365	89,590	225	220
Note: The columns are derived as discussed in the text and related footnotes. The information shown for 11 circuits includes only courts in the fifty states and the District of Columbia. For display purposes, the District of Columbia has been combined with the Fourth Circuit.					

II. Key Findings

The analysis in this section focuses only on the needs−based provision of H.R. 833. This provision likely impacts petitioners with both monthly income above the national median and the ability to repay either $5,000 or 25% of unsecured non−priority debts within five years, after first paying secured and priority debts and paying for living expenses. [15]

A. Share of Filers Likely Impacted

The share of 1997 chapter 7 filers likely to be impacted by the needs−based provision of H.R. 833 is provided in Table 3. As shown, 10% of 1997 chapter 7 filers would probably have been required to file under chapter 13, if H.R 833's needs−based bankruptcy provision was in effect in 1997.

For purposes of this analysis, chapter 7 filers are considered to be likely impacted by H.R. 833 if they are eligible for creditor motions (that is, they have income above the national median) and they meet the abuse presumption. H.HChart 2 shows the cumulative percentage of filers likely impacted by each criterion used to determine a petitioner's need for relief under the proposed legislation. As shown:

- 19% of 1997 chapter 7 filers had income above the national median, adjusted for family size.
- 10% of filers had both income above the national median *and* the ability to repay either $5,000 or 25% of their unsecured non−priority debts within five years after making secured and priority debt payments and paying for living expenses.

The estimate that 10% of filers are likely to be impacted under the needs−based provision is reliant on petitioners' reported 1997 income at the time of filing. If reported 1996 income was used instead, the share of likely impacted filers would rise to 14%. Accordingly, the present estimate of 10% is conservative. Section IV provides more details on this issue.

Table 3. Ability to Repay Debt under H.R. 833's Needs−Based Bankruptcy Provision: 1997 Chapter 7 Filers Likely Impacted by the Provision	
	1997 National Average
Chapter 7 Filers Likely Impacted [1/]	10%

Debt Repayable over 5 yrs. by Ch. 7 Filers Likely Impacted: 1/	
Total Debt 2/	55%
Secured and Priority Debt 2/	56%
Unsecured Non−priority Debt	53%

Note: Repayment rates from the 1997 Visa national bankruptcy database were calculated on the basis of: petitioners' reported income; a combination of petitioners' reported expenses and IRS allowances as proposed under H.R. 833; and priority and secured debt payments. See assumptions in text, and repayment methodology described in Section III.

1/ Chapter 7 filers are likely impacted by H.R. 833's needs−based bankruptcy provision if they have: income greater than the national median for families of comparable size and can repay either $5,000 or 25% of their unsecured non−priority debts within five years, after making secured and priority debt payments and payments for living expenses. The 1996 national median income data by family size were obtained from the U.S. Bureau of the Census for families with more than two members (1997a) and for families of one (1997b).

2/ Repayment of secured debt is shown over sixty months. For housing debt, repayment is taken as stated by the petitioner unless the outstanding balance would have been paid off in less than sixty months. All other non−housing secured and priority debt is amortized over sixty months. In practice, petitioners may continue to repay outstanding secured debts beyond the sixty month repayment plan, which would increase the share of secured and total debt repaid

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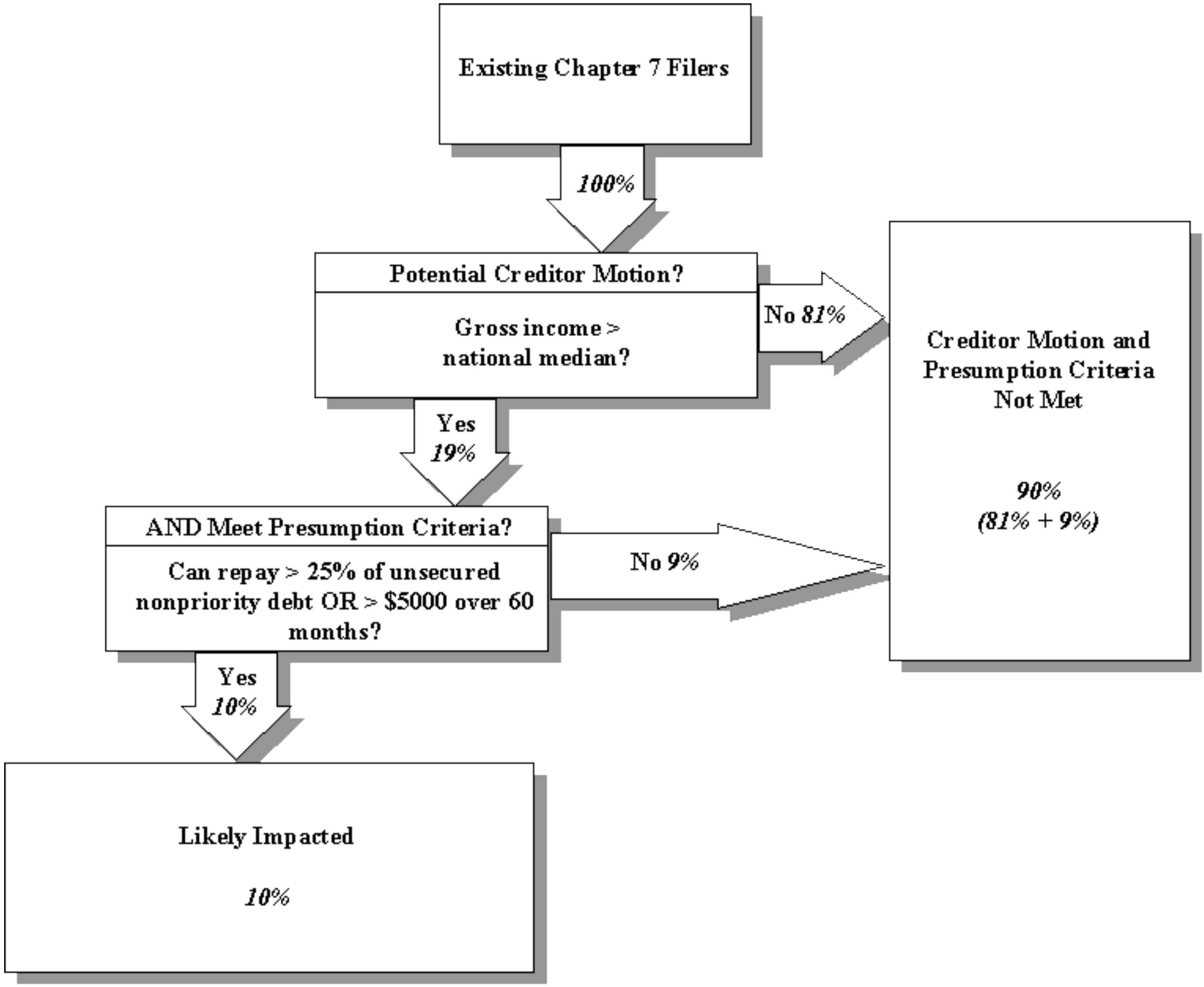
Chart 2. H.R. 833 Needs−Based Process



Source: Ernst & Young, "Chapter 7 Bankruptcy Petitioners' Repayment Ability Under H.R. 833: The National Perspective."

B. Debt Repayment Capacity

The 1997 chapter 7 filers likely impacted by H.R. 833 would have had the ability to repay 55% of their total debts, if income remained unchanged relative to expenses and liabilities during the sixty month repayment period. [16] When broken down by type, the corresponding repayment figures are 56% for secured and priority debt owed, and 53% for unsecured non−priority debt owed. These figures are shown in Table 3.

In dollar terms, the estimated amounts of debt repayable by these filers are $4 billion in secured and priority debt, and $3 billion in unsecured non−priority debt, over the five year repayment period. In other words, the 10% of chapter 7 filers likely to be impacted could repay about $7 billion of the $75 billion (or 9%) of total chapter 7 debt at risk within five years. Of the $7 billion repayment, trustees would receive between $93 and $249 million, with the remaining funds to be received by creditors. [17]

Additional details regarding the distribution of repayment ability across debtors are provided in Table 4. As shown, about 5% of chapter 7 filers could repay all their unsecured non−priority debts, even after allowing for secured and priority debt repayments and living expenses. About 4% had the ability to repay all their debts, and also had incomes above the national median, adjusted for family size.

Table 4. Ability of Chapter 7 Filers to Repay Unsecured Non−Priority Debt Under H.R. 833's Needs−Based Provision						
	Share of Filers:			**Percentage of Debt Repayable in 60 Months by Actual Chapter 7 Filers Likely Impacted:**		
Share of unsecured non−priority debt repayable	All Chapter 7 Filers	Chapter 7 filers with ability to repay > 25% or $5K over 60 months	Likely Impacted Chapter 7 Filers	Total Debt	Secured & Priority Debt	Unsecured Non−priority Debt
Less than 25%	86%	2%	2%	7%	9%	4%
25−49.9%	5%	5%	3%	14%	16%	11%
50−74.9%	3%	3%	2%	8%	8%	9%
75−99.9%	1%	1%	1%	4%	4%	4%
100% or more	5%	5%	4%	22%	19%	25%
Total	100%	16%	10%	55%	56%	53%
See footnotes to Table 3 for further explanation.						
Note: Totals may not add up due to rounding.						

C. Debt and Income Profiles of Filers Likely Impacted and Not Impacted Under H.R. 833

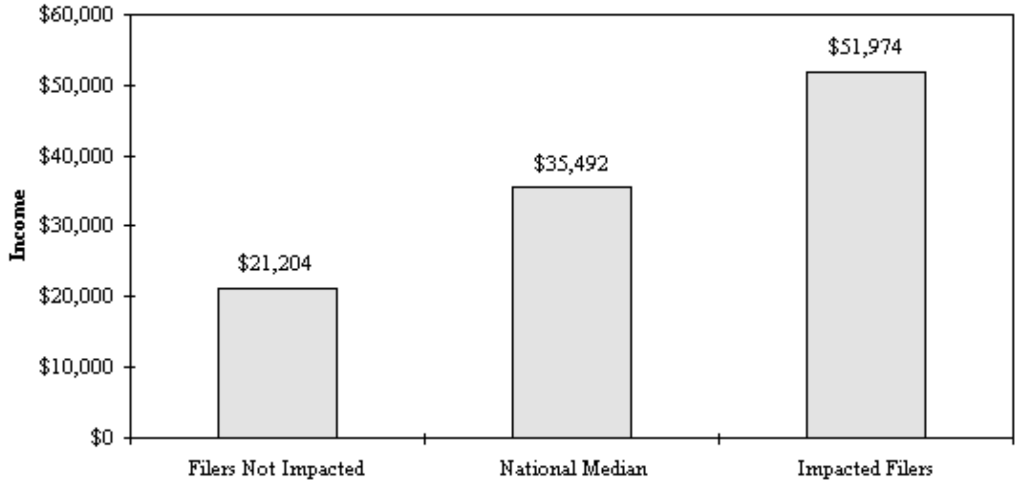
Filers likely impacted in 1997 under H.R. 833 had median incomes ($51,974) considerably above the 1996 national median income ($35,492) for all households. [18] Filers not impacted by the provision earned less than half ($21,204) of the median earned by filers likely to be impacted. In addition, filers impacted had more unsecured non−priority debt ($39,085 at the median) than filers not impacted ($23,472 at the median). Chart 3 displays these results. Not surprisingly, likely impacted filers also had higher repayment capacity than the typical chapter 7

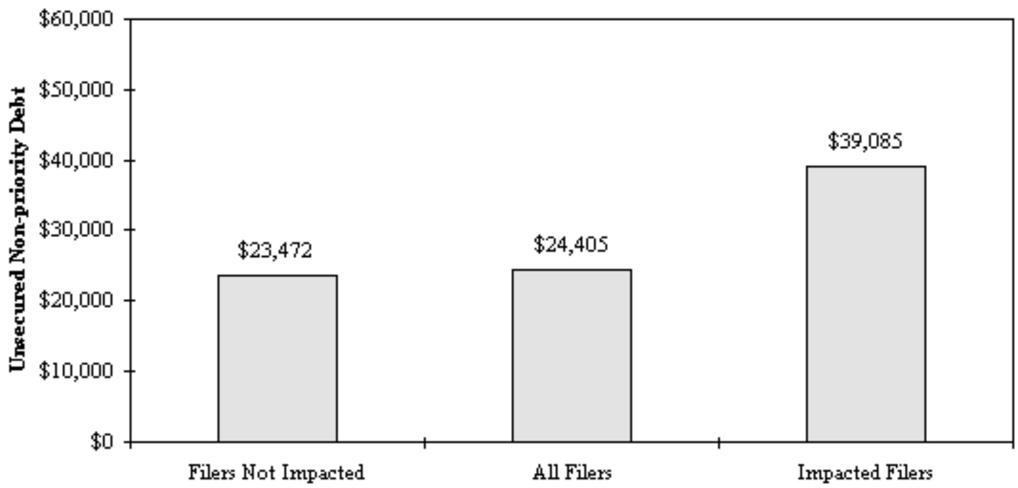
filer: the median amount of unsecured non−priority debt that impacted filers could repay over five years was $21,372; the comparable figure for all chapter 7 filers was zero.

D. Expenses of Filers Likely Impacted Under H.R. 833

The ability of filers to repay unsecured non−priority debt under the needs−based test was assessed on the basis of their incomes and expenses. The expenses of filers can be broadly classified into two categories: (1) "actual expenses," which include expenses taken from Schedule J on the bankruptcy petitions and secured and priority debt repayment expenses based on the actual debt of debtors; and (2) "IRS standards," which include expenses used in the needs−based calculation and taken from the IRS expense allowances. For likely impacted filers, the majority of expenses used in the needs−based calculation were obtained from the actual expenses of individual debtors, rather than from the IRS standards. [19] Thus, the needs−based provision of H.R. 833 primarily reflects life−style decisions made by the debtors.

Chart 3. Median Income and Unsecured Non−Priority Debt Comparison





Source: Ernst & Young, "Chapter 7 Bankruptcy Petitioners' Repayment Ability Under H.R. 833: The National Perspective."

E. Comparison with Other Studies

The results of this study are consistent with several recently released studies. For example, earlier Ernst & Young analyses found that 12% of 1992/93 chapter 7 filers in four district courts, and 15% of 1997 chapter 7 filers across the United States, would have been impacted by the needs−based provision of H.R. 3150 [20] had it been in effect at the time. [21] All of these studies corroborate the 1997 Georgetown study conclusion that "[a] sizable minority of chapter 7 debtors could make a significant contribution toward repayment of their non−housing debt over a five year period." [22] The cumulative weight of all four studies supports a consistent finding – large numbers of chapter 7 filers have the ability to repay a substantial portion of their debts.

The American Bankruptcy Institute ("ABI") study, by Marianne Culhane and Michaela White, reported somewhat less repayment capacity; the authors found that 3% of filers in their 1995 sample of seven districts would have been impacted. [23] Both this study and the ABI study estimate the impact of different needs−based provisions. However, the studies differ on a critical interpretation of the legislative proposal with respect to the treatment of automobile debt. The ABI study assigned debtors with cars the greater amount of the IRS automobile ownership allowance or debtor's monthly automobile debt payments. [24] In fact, the debtors in the ABI study were provided the IRS ownership allowance even if they had no car loan. [25] This approach is inconsistent with the needs−based test in H.R. 833. [26] Instead, the needs−based provision requires that debtors be allowed to deduct the average monthly payments, on account of secured debts, over the sixty month repayment period. [27] In conformity with the provision, this study amortized automobile debt over sixty months. This approach should more accurately reflect the legislative language in H.R. 833.

F. Issues of Interpretation

The following points about the analysis of the impact of the needs−based provision contained in H.R. 833 should be noted: [28]

1. As defined by H.R. 833, the repayment calculations assume all secured and priority debt is paid first, [29] whether reaffirmed or not. The remaining repayment ability of the debtor is stated as a share of total unsecured non−priority debt. [30]
2. The calculations use petition data submitted by petitioners −− that is, all of the data were taken from the actual petitions, as filed by debtors. While submitted under oath, these data are unaudited, unless the petition is challenged by a creditor or trustee. Some have suggested that chapter 7 filers may have an incentive to exaggerate their financial distress by overstating expenses and understating income.
3. H.R. 833 provides that chapter 13 plans can be adjusted over the repayment period to reflect changes in circumstances. [31] However, to "score" the proposed legislation, the repayment calculations assume that the petitioners' future income relative to expenses and liabilities during the five year period is the same as their current income relative to expenses and liabilities, as reported on the bankruptcy petition. [32] For petitioners whose income relative to expenses and liabilities increases over the five year period, this assumption would underestimate repayment ability. Conversely, the assumption would overestimate the repayment ability of petitioners whose income relative to expenses and liabilities declines during the five year period. [33]
4. The needs−based test does not incorporate trustee fees incurred in chapter 13 filings. [34] In practice, trustee fees would be borne after the administration of the needs−based test. Hence, these fees would not be included as priority debt payments when the needs−based test is administered. While trustee fees would not be included when administering the needs−based test, their subsequent imposition would lower debt repayment by debtors. Consequently, the estimated amount of repayable debt includes estimates for these expenses. While this approach accurately reflects the needs−based test in H.R. 833, including trustee fees would not have any significant impact on the share of filers likely impacted. Testing the sensitivity of the results to the inclusion of trustee fees as part of the needs−based test revealed that the share of likely impacted filers is 10%, whether or not trustee fees are included. [35]

III. Methodology for Calculation of Repayment Ability Under H.R. 833

A. Basic Calculation

The needs−based repayment measure is based on the following formulas:

1. Repayable Amount	Projected Monthly Net Income x 60
• Projected Monthly Net Income	Current Monthly Total Income − Monthly Expenses
• Current Monthly Total Income	Current monthly income on Schedule I. For joint filers, income and deductions included spousal income and deductions.
• Monthly Expenses	Transportation Expenses + Housing and Utility Expenses (for non−homeowners) + Mortgage Debt Service, Utility and Home

	Maintenance Payments (for homeowners) + Other Living Expenses + Other Necessary Expenses + Secured Non−mortgage Debt Service Payments + Priority Debt Payments + Business Expenses

"Current monthly total income" is defined by H.R. 833 as "the average monthly income from all sources derived which the debtor, or in a joint case, the debtor and the debtor's spouse, receive without regard to whether it is taxable income, in the 180 days preceding the date of determination." [36] The current petition schedules do not capture average income over the 180 days prior to filing. Analysis of the data revealed that, on average, current monthly income on Schedule I was lower than the prior year's (1996) income from employment, business and other sources from Form 7 divided by 12. Current monthly income from Schedule I was therefore used as a conservative approach which underestimates the amount of repayment ability under H.R. 833. Repayment calculations were also done using prior year's income. Using 1996 income, the fraction of chapter 7 filers likely impacted by the needs−based provision would have risen to over 14%. It is reasonable to expect that the average income over the six months prior to filing would lie within the range represented by current monthly income and prior year's income.

The repayable amount as described above was calculated for households meeting the minimum income requirements specified by H.R. 833, i.e., only households whose income exceeded 1996 median national income for families of comparable size, as reported by the Census Bureau. While family size data is not currently required on bankruptcy petitions, family size was estimated and included in the database. For individual petitions, family size was determined by adding one to the number of dependents listed on Schedule I. For joint petitions, two was added to the number of dependents listed. Filers were considered likely to be impacted under the plan if their repayable amount exceeded either $5,000 or 25% of their unsecured non−priority debt (finance company and personal loans, credit card loans, student loans, and other miscellaneous debts) and if their income exceeded the national median adjusted for family size.

B. Expense Items

The monthly expense items are described in detail below. The 1997 IRS National Collection Standards were used for food, housekeeping supplies, apparel & services, personal care products and services and miscellaneous expenses. [37] Local IRS standards were used for housing, utilities and transportation expenses. [38]

1. Housing and utility expenses

IRS standard expenses for housing and utilities are determined according to the county and family size. [39] Since H.R. 833's needs−based bankruptcy provision would allow the IRS standard expense in the absence of mortgage payments, [40] non−homeowners [41] will be allowed the IRS standard housing and utility expense for the relevant county and estimated family size. Conversely, homeowners will be allowed to deduct their actual mortgage payments (discussed below), home maintenance expenses, and utility expenses for electricity, heating, water, sewer and telephone, as reported on Schedule J.

2. Transportation expenses

IRS standards for automobile operating costs and public transportation are determined by census region; [42] there are also IRS standards for a number of large cities. [43] The reported county was used to assign petitioners' transportation expenses. If the county was in a metropolitan statistical area that contained one of the cities with separate IRS transportation expense, then the transportation expense for that city was used. Otherwise, the petitioner was assigned the transportation expense for the appropriate region. IRS transportation expenses also consider the number of vehicles owned by an individual. [44] IRS standards generally allow for necessary or income producing expenses. [45] There is no provision on the bankruptcy petitions for indicating whether a petitioner's vehicle meets this test. Therefore, transportation expenses were assigned to petitioners based on the number of vehicles reported on the petition, regardless of whether or not all of the vehicles were necessary. The only exception was for debtors with a family size of one who had more than one vehicle. In this case, it seems reasonable to allow transportation expenses based on one vehicle.

The IRS standards also include allowances for automobile ownership costs. [46] These allowances are intended to cover automobile debt payments. However, H.R. 833 specifically excludes IRS standards that are "payments for debts," and instead requires debtors to deduct the average monthly payments, on account of secured debts, over the sixty month repayment period. [47] Therefore, automobile debt was amortized over sixty months, along with secured non−mortgage debt, as described below.

3. Other living expenses

The IRS national standards for living expenses include allowances for housekeeping supplies, apparel and services, personal care products and services, food, and miscellaneous items. [48] These expenses are determined according to household gross monthly income and the number of individuals in the household. [49] Accordingly, all petitioners were assigned these expenses based on their gross income and estimated family size.

4. Other necessary expenses

The H.R. 833 provision also allows filers to claim "other necessary expenses" based on IRS guidelines. [50] Consistent with the needs−based bankruptcy provision, the following reported monthly expenses were deducted from monthly income: alimony, charity, child care, health insurance, medical expenses, taxes, and payroll deductions (payroll taxes, social security, insurance, union dues, and other taxes not deducted from wages or included in home mortgage payments). All of these items were taken as reported *by the petitioner* on Schedules I and J. As a conservative approach, all charitable expenses were used, even though the IRS limits the type of charitable contributions which are allowed. [51] Similarly, all taxes were used as listed on Schedule J. It is likely that some petitioners listed their monthly payments for back taxes on Schedule J. For such filers, the calculation would count monthly back tax payments twice: once as shown on Schedule J, and once on the basis of calculated monthly back tax payments based on amortization of priority debt (see section on "Priority and Secured Non−Mortgage Debt Payments" below). All of these conservative approaches tend to underestimate the share of debtors impacted and the amount of debt repayable under the needs−based provision.

5. Mortgage Debt Service, Utility and Home Maintenance Payments

As discussed in the section on housing and utility expenses above, mortgage debt payments were allowed only for homeowners. Two adjustments were made to the reported mortgage debt payment amount: (a) if income after non−debt−payment expenses was insufficient to make the entire mortgage payment reported, then the available income was used instead, and (b) if 85% of reported current monthly mortgage payments multiplied by sixty was greater than 110% of the outstanding mortgage debt, the outstanding mortgage debt was repayable in less than sixty months, and the average monthly mortgage payment was calculated by dividing 110% of the outstanding balance by sixty. [52] In addition, homeowners were allowed utility expenses for electricity and heating, water, sewer and telephone, and home maintenance expenses for repairs and upkeep, as reported on Schedule J.

6. Priority and Secured Non−Mortgage Debt Service Payments

Secured and priority debt was amortized over sixty months by dividing the total secured and priority debt by sixty (10% was added to outstanding amounts of secured non−mortgage debt and back taxes to allow for interest). [53] H.R. 833 allows for amortization of priority debt by dividing the outstanding priority debt by sixty. [54] Estimated attorney fees payments were included as priority debt payments. Attorney fees were calculated for each individual debtor as the difference between the $1,281 average total attorney fees for chapter 13 plans [55] and the amount paid up front by individual debtors, as reported on their petitions.

7. Business Expenses

Debtors were also allowed business expenses as reported on Schedule J. However, these expenses were only allowed for petitioners that reported business income on Schedule I.

Conclusions

The results presented in this report indicate that large numbers of 1997 U.S. chapter 7 filers had the ability to repay large portions of their debts. In particular, this study shows that:

- 10% of 1997 chapter 7 filers would likely have been impacted by the needs−based provision of H.R. 833, had it been in effect in 1997.
- These filers could have repaid 55% of their total debts over five years. When broken down by type of debt for filers likely impacted, the corresponding repayment figures are 56% for secured and priority debt owed, and 53% for unsecured non−priority debt.
- An estimated $7 billion of chapter 7 debt could have been repaid within five years by the filers likely impacted.

Filers who likely would have been impacted by H.R. 833's needs−based provision had relatively higher incomes:

- Impacted filers had median gross annual income of $51,974, compared to $21,204 for those unaffected.
- Impacted filers also had more unsecured non−priority debt ($39,085 at the median) than those not impacted ($23,472 at the median).

The 1997 findings corroborate the earlier study by Ernst & Young which used different databases and different methodologies. Taken together with this earlier work, the 1997 Visa national bankruptcy database continues to be a sound basis for action on bankruptcy reform.

FOOTNOTES:

[*] This study was funded by Visa U.S.A. and Mastercard International.Back To Text

[**] Tom Neubig is Ernst & Young's National Director of Policy Economics and Quantitative Analysis, and Gautam Jaggi and Robin Lee are managers with Ernst & Young's Policy Economics and Quantitative Analysis Group.Back To Text

[1] H.R. 833, 106th Cong. §§ 101−105 (1999).Back To Text

[2] The needs−based provision modeled in this report is based on H.R. 833, the "Bankruptcy Reform Act of 1999." *Id.* This provision is substantially different from the needs−based provision modeled in the March 1998 Ernst & Young report, which was based on H.R. 3150, the "Bankruptcy Reform Act of 1998", 105th Cong. (1998). *See* Tom Neubig et al., *Chapter 7 Bankruptcy Petitioners' Ability to Repay: The National Perspective, 1997* (visited Mar. 27, 1998) <http://www.ey.com/tax/eyecon/bankruptcy.asp> [hereinafter 1998b]. For additional details, see Sections II and III of this report.Back To Text

[3] For example, the 1996 national median income for a family of four was $51,518. *See U.S. Census Bureau Historical Income Tables−Families* (visited Mar. 27, 1999) <http://www.census.gov/hhes/income/histinc/f08.html> [hereinafter "1997a"]. Accordingly, families of four would not be subject to creditor motions unless their gross income exceeded $51,518. Families with more than four members are allowed an additional $583 for each family member. Thus, a family of six would only be subject to creditor motions if their gross income exceeded $52,684 ($51,518 + ($583 x 2)).Back To Text

[4] H.R. 833 at § 102(a)(2)(B)(ii).Back To Text

[5] *See U.S. Bankruptcy Filings 1980−1998* (visited Mar. 27, 1999) <http://www.abiworld.org/stats/newstatsfront.html>. Total Fiscal Year 1998 non−business filings were 1.39 million, consisting of one million chapter 7 filings, 390,000 chapter 13 filings, and approximately 860 chapter 11 filings. *See Annual U.S. Non−Business Bankruptcy Filings by Chapter for 1998* (visited Mar. 27, 1999) <http://www.abiworld.org/stats/98stateannualnonbuschapter.html>. Back To Text

[6] The needs−based bankruptcy measure of H.R. 3150 was passed by the House and the Senate in 1998, but a final vote on the Conference Report was not taken in the Senate before the end of the legislative session. The measure passed in the House on October 9, 1998, but the 1998 Regular Session adjourned on November 18, 1998, and there was no carryover of the bill. *See* H.R. Con. Res. 346, 105th Cong. (1998). H.R. 833, introduced in the 106th Congress, contains essentially the same needs−based provisions of the Conference Report accompanying H.R. 3150. *See* H.R. 833 at §§ 101−104 (1999).Back To Text

[7] *See* 1998b, *supra* note 2 (analyzing Bankruptcy Reform Act of 1998).Back To Text

[8] *See id.* at 5, table 2.Back To Text

[9] For example, in 1996 the national median income for all households was $35,492. *See U.S. Census Bureau Historical Income Tables − Households* (visited Mar. 27, 1999) <http://www.census.gov/hhes/income/histinc/h12.html> [hereinafter "1997b"]. For a family of four, the national median income was $51,518. *See* 1997a, *supra* note 3. Accordingly, a family of four would be likely impacted if their gross income exceeded $51,518 and they had the ability to repay either $5,000 or 25% of their unsecured non−priority debt over sixty months. The income threshold for families exceeding four members increases by $583 for each additional member. Therefore, a family of six would be likely impacted if the families' gross income was greater than $52,684 ($51,518 + ($583 x 2)), and the family met the other repayment requirements. Back To Text

[10] As data for the entire year was not available until the middle of January 1998, the sample was drawn separately from two time periods. The first sample was completed on January 5, 1998 and related to the first eleven months of 1997. The sample for December 1997 was completed on January 16, 1998. Back To Text

[11] Certain districts had less than 500 chapter 7 filings. When this occurred, all available filings were selected. The initial sample taken at this stage was for potential use in later stages, when larger samples would be taken in certain target districts. Back To Text

[12] The second stage sample effectively started out as a stratified random sample by district with the selection probabilities equal – that is, a self−weighting sample. The number of chapter 7 asset cases selected was then doubled and the samples in the smaller districts were increased so that there was a minimum of twelve cases. At this point, the sample was judged too large and a systematic sub−sample was taken after sorting by district, chapter, and month of the filing. The final counts were then derived and are summarized in Table 1.Back To Text

[13] *See News Release: March 10, 1998* (visited Mar. 27, 1999) <http://www.uscourts.gov/Press_Releases/case97.html> (numbering total chapter 7 filings at 958,045); *see also Annual Filings for Districts in a Given Judicial Circuit* (visited Mar. 27, 1999) <http://www.abiworld.org/stats/newstatsfront.html> (providing total bankruptcy filings for each district within circuit). There was a net shortfall in coverage between the Visa BNS database and the official counts. This slight discrepancy of under 3% is not believed to be an important limitation to the analyses carried out in this report. In the table, the adjustments for net incompleteness have been made by circuit. *See* 1998b, *supra* note 2, at 23−24 (explaining undercoverage between two counts).Back To Text

[14] *See* 1998b, *supra* note 2, at 21−28 (describing methodology for this determination). Basically, the usable sample consists of all original selections, except identified dismissals, for which there was enough information to do the calculations under H.R. 3150. Aside from a small number of identified dismissals,

therefore, the cases excluded were either never obtained or too incomplete to use.Back To Text

[15] *See* infra Section III for a detailed description of the methodology used in determining the repayment calculations. Back To Text

[16] These figures understate the total debt repaid over the life of the loan. For example, a petitioner with a mortgage would most likely continue to make payments subsequent to the five year period required in the needs−based proposal. Back To Text

[17] The impact of trustee fees is difficult to estimate due to the wide variety of practices found in different districts. Fees typically vary and mortgage debts (and occasionally car payments) are not included as part of the repayment plan. Because of the uncertainty associated with chapter 13 trustee fees, the impact of such fees was estimated using different assumptions, and presented as a range. Using the national average, fees were estimated at 5.6% of debt payments. This percentage was applied to all debt repayments over sixty months, excluding mortgage debt repayments of filers with more than $20,000 in real estate debt. The result was a high estimate of $249 million in trustee fees. However, many consumers will choose not to file bankruptcy if they can repay all of their debts under the needs−based test, since these consumers would not get any debt relief under bankruptcy. Such filers would continue repaying their debts, but because they would not have to file bankruptcy, they would not incur any trustee fees. Thus, if it is assumed that all likely impacted filers with the ability to repay their debts choose not to file for bankruptcy, then the estimated trustee fee is reduced to $138 million. Additionally, if all secured debts were kept outside the repayment plans, the estimate would further decrease to $93 million. Back To Text

[18] *See* 1997b, *supra* note 9; 1997a, *supra* note 3 (stating household and family median incomes on annual bases). The needs−based provision utilizes family median incomes for families with more than two members, and utilizes household median incomes for single persons. For comparison purposes, household median income is preferable to family median income, as family median income does not include single person households. Back To Text

[19] The composition of expenses was not calculated for filers not impacted by the needs−based provision, since many either had expenses in excess of income or did not have sufficient income available to service all of their secured and priority debts. In these cases the actual expenses of debtors is understated, for comparison purposes, in this section. *See* infra Section III for further details on the repayment methodology. Back To Text

[20] H.R. 3150, 105th Cong. §§ 101, 102 (1998).Back To Text

[21] *See* Tom Neubig et al., *Chapter 7 Bankruptcy Petitioners' Ability to Repay: Additional Evidence from Bankruptcy Petition Files* (visited February 20, 1999) <http://www.ey.com/tax/eyecon/bankruptcy.asp> [hereinafter 1998a] (explaining that 11.8% of average chapter 7 filers would be impacted by H.R. 3150); 1998b, *supra* note 2, at 9, table 3 (finding 15% of 1997 chapter 7 filers would have been impacted by H.R. 3150). It should be noted that the methodologies used in both estimates are not directly comparable because of factors such as differences in data availability and the different cities and years covered by the samples. Additionally, the two previous Ernst & Young studies are not directly comparable to this report, as they estimate the impact of the earlier legislation with a different needs−based provision. For details on the methodological details, see the appendices in 1998a and 1998b and Section III of this report.Back To Text

[22] John M. Barron & Michael E. Staten, *Personal Bankruptcy: A Report On Petitioners' Ability−to−Pay*, 31, ¶ 4 (Oct. 6, 1997) <http://www.gsb.georgetown.edu/prog/crc/pdf/monograph33.pdf.html>. Back To Text

[23] *See* Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means−Testing Real Chapter 7 Debtors*, 7 Am. Bankr. Inst. L. Rev. (forthcoming Spring 1999) [hereinafter Creighton Study] (stating that only 3.6% of sample debtors "emerged as apparent can−pays").Back To Text

[24] *See id.* (explaining rationale behind transportation allowance).Back To Text

[25] *See id.* (explaining that to deny allowance, as Ernst and Young does, seriously understates necessary and foreseeable car−related expenses). Back To Text

[26] *See* H.R. 833, 106th Cong. § 102(a)(2)(B)(ii) (amending 11 U.S.C. § 707 and stating that debtor's monthly expenses exclude payments for debts.) However, the Creighton study interprets this section to include certain other debt. *See* Creighton Study, supra note 23 (explaining that allowance must be read to include not only current car debt, but also leasing, major repairs, and in some instances replacement of aging or damaged vehicles).Back To Text

[27] *See* H.R. 833, 106th Cong. § 102(a)(2)(B)(ii) (deducting from debtor's current monthly income debtor's average monthly payments on account of secured debt, which is calculated as "total of all amounts scheduled as contractually due to secured creditors in each month of the sixty months following the date of the petition, and dividing that amount by sixty months").Back To Text

[28] *See* 1998b, supra note 2, at Appendix 2 (discussing procedures used in processing petitions and assessing importance of sampling error).Back To Text

[29] *See* H.R. 833 at § 102(a)(2)(B)(ii) (stating debtor's payments of secured and priority debts considered in determining whether granting relief would be abusive of provisions of title 11). The repayment calculations include interest on back taxes and secured debt. *See* infra Section III for further details. Back To Text

[30] *See* H.R. 833 at § 102(a)(2)(B)(ii) (noting that calculations deduct monthly expenses and no reference is made to reaffirmation or actual payment of such expenses).Back To Text

[31] *See* H.R. 833 at § 102(a)(2)(B)(ii) (stating "[i]n any proceeding brought under this subsection, the presumption of abuse may be rebutted only by demonstrating extraordinary circumstances that require additional expenses or adjustments of current monthly total income.").Back To Text

[32] *See* id.Back To Text

[33] This analysis examined two measures of income: current 1997 gross monthly income and income for calendar year 1996. The 1997 income was smaller, and thus the more conservative of the two figures, and was used as the starting point in the projections. As previously noted, 10% of 1997 chapter 7 filers likely would have been required to file chapter 13 under H.R. 833. Using 1996 income, the fraction of the chapter 7 filers likely impacted by the needs−based provision would have been over 14%.Back To Text

[34] *See* H.R. 833 at § 102(a)(2)(B)(ii) (noting that only expenses deductible are: expenses under Standards issued by Internal Revenue Service; debtor's monthly payments on account of secured debt; and debtor's expense for payments on priority debts).Back To Text

[35] *See* supra, Section II.B, for description of methodologies used in estimating trustee fees. Three different methods were used, and though these methods do have some impact on the share of filers impacted, after rounding, the estimate is that 10% of chapter 7 filers are impacted, regardless of the inclusion of trustee fees.Back To Text

[36] H.R. 833 at § 102(b)(1).Back To Text

[37] *See Collection Financial Standards* (Internal Revenue Service 1998) (visited Apr. 5, 1999) <http://www.irs.ustreas.gov/prod/ind_info/coll_stds/> [hereinafter "*Collection Financial Standards*"] (stating standards used to help determine taxpayer's ability to pay delinquent tax liability).Back To Text

[38] *See* id. (stating taxpayer allowed lesser of amount actually spent or Standard).Back To Text

[39] *See Collection Financial Standards − Allowable Living Expenses for Housing and Utilities* (Internal Revenue Service 1998) <http://www.irs.ustreas.gov/prod/ind_info/coll_stds/cfs−housing.html> (stating revised Local Standards include family size).Back To Text

[40] *See* H.R. 833 at § 102(a)(2)(B)(ii) (stating "[t]he debtor's monthly expenses shall be the applicable monthly expenses under National Standard [and] Local Standards... issued by the Internal Revenue Service").Back To Text

[41] The calculations assumed debtor is a homeowner if the debtor had a home or second mortgage debt on Schedule D and had real property on Schedule A that was either labeled a primary residence or a multiple family housing unit.Back To Text

[42] *See Collection Financial Standards − Allowable Living Expenses for Transportation* (Internal Revenue Service 1998) (visited Apr. 5, 1999) <http://www.irs.ustreas.gov/prod/ind_info/coll_stds/cfs−trans.html> (explaining that Operating Costs and Public Transportation Costs are provided by Census Region and Metropolitan Statistical Area (MSA)).Back To Text

[43] *See* id. (stating that once taxpayer's Census Region is ascertained, MSA standard may be applicable if taxpayer resides within the MSA county and city and if MSA does not apply then regional standard is utilized).Back To Text

[44] Information as to the number of vehicles was obtained by taking the larger of the number of personal property items identified on Schedule B as a vehicle or the number of secured debts identified on Schedule D as vehicle debt.Back To Text

[45] *See* Collection Financial Standards, supra note 37 (Internal Revenue Service 1998) (visited Apr. 5, 1999) <http://www.irs.ustreas.gov/prod/ind_info/coll_stds/> (explaining that under "Transportation" section monthly operating costs are taken into consideration).Back To Text

[46] *See* id. (explaining that ownership costs provide maximum allowances for lease or purchase of up to two automobiles).Back To Text

[47] *See* H.R. 833, 106th Cong. § 102(a)(2)(B)(ii) (1999) (stating payment of debts are excluded and instructing secured debts to be calculated on monthly basis over 60 months).Back To Text

[48] *See Collection Financial Standards − Allowable Living Expenses for Food, Clothing and Other Items* (Internal Revenue Service 1998) (visited Apr. 5, 1999) <http://www.irs.ustreas.gov/prod/ind_info/coll_stds/cfs−other.html> (charting monthly allowances for food, housekeeping supplies, apparel & services, personal care products & services, and miscellaneous items). Back To Text

[49] *See* id.Back To Text

[50] *See* H.R. 833 at § 102(a)(2)(B)(ii) (stating debtor's monthly expenses shall include "Other Necessary Expenses allowance (excluding payments for debts) issued by the Internal Revenue Service"). Back To Text

[51] *See* 26 U.S.C. § 170(b) (1994) (setting percentage limitations on deductions for charitable contributions); 26 U.S.C. § 170(c) (delineating to what entities charitable contributions can be made).Back To Text

[52] Mortgage payments were multiplied by 85% in order to remove from the payment amount taxes and mortgage insurance. The outstanding mortgage debt is exclusive of interest; thus the debt amount was "grossed up" 10%. This 10% "gross up" for accrued interest represents the ratio of remaining cumulative interest to outstanding principal for an 8%, 30 year amortized mortgage with two to three years left until its maturity.Back To Text

[53] The 10% future accrued interest on secured non−mortgage debt is the ratio of remaining cumulative interest to outstanding principal on a 9% four year automobile loan with two years until maturity. The 9% market interest rate was obtained from the *Federal Reserve Board Bulletin* (visited Mar. 27, 1999) <http://www.federalreserve.gov/pubs/bulletin/default.html>.Back To Text

[54] *See* H.R. 833 at § 102(a)(2)(B)(ii) (stating debtor's expenses for priority claims is calculated as total amount of debts entitled to priority divided by 60 months).Back To Text

[55] *See* Creighton Study, supra note 23 (deriving amount from study by National Association of Consumer Bankruptcy Attorneys (NACBA)).Back To Text