University of Richmond Law Review

Volume 22 | Issue 3 Article 2

1988

Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-1987

Michael J. Herbert
University of Richmond

Domenic E. Pacitt

ARTICLES

DOWN AND OUT IN RICHMOND, VIRGINIA: THE DISTRIBUTION OF ASSETS IN CHAPTER 7 BANKRUPTCY PROCEEDINGS CLOSED DURING 1984-1987

*Michael J. Herbert**
*Domenic E. Pacitti***

I. INTRODUCTION

An explosion of interest in the practical workings and economic significance of the bankruptcy system has, in recent years, led to many efforts to study that system through data other than that contained in reported cases.[1] In some key respects, the mere artic-

* Associate Professor of Law, T.C. Williams School of Law, University of Richmond; B.A., John Carroll University, 1974; J.D., University of Michigan, 1977.

** Law Clerk for the Honorable Rosemary Gambardella, U.S. Bankruptcy Court, District of New Jersey; B.A., Lycoming College, J.D., 1984; T. C. Williams School of Law, University of Richmond, 1987.

The authors gratefully acknowledge the financial support provided by the University of Richmond Faculty Research Committee for the case file research that is the primary basis of this article.

1. A non-comprehensive list of some recent work in this vein includes U.S. GEN. ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY REFORM ACT OF 1978—A BEFORE AND AFTER LOOK (1983) [hereinafter GAO REPORT]; CREDIT RESEARCH CENTER, KRANNERT SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, CONSUMER BANKRUPTCY STUDY, MONOGRAPH NOS. 23 AND 24 (1982) [hereinafter PURDUE STUDY]; Schuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288 (1983); Schuchman & Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1 (1982); Woodward & Woodward, *Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study*, 88 COM. L.J. 309 (1983). By far the most ambitious current project is the ongoing "Consumer Bankruptcy Project" of Professors Sullivan, Warren and Westbrook of the University of Texas and Professor Warren of the University of Pennsylvania. They have already used their work to shred many of the conclusions of the Purdue Study. *See* Sullivan, Warren & Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WIS. L. REV. 1091; Sullivan, Warren & Westbrook, *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1087. For preliminary findings from their overall study, see Sullivan, Warren & Westbrook, *Folklore and Facts: A Preliminary*

ulation and analysis of legal rules is no longer satisfactory. Indeed, it has been argued that such analysis is sometimes scarcely relevant.[2] This article is intended to add a little more information to that already compiled regarding the actual nature and function of modern American bankruptcy law. It further attempts to place this information into the context of the ongoing debate over the uses and purported abuses of that law.

A. *The Bankruptcy Debate*

The crux of the bankruptcy debate is a simple one. Should the focus of bankruptcy law be upon distributing the debtor's assets to creditors or upon granting the debtor discharge of indebtedness? In other words, is the primary goal of the bankruptcy proceeding maximization of return to creditors or the forgiveness of the debtor's obligations? It is not a new debate. It existed in a rather different form throughout the 1780's as a struggle between "hard money" lenders and paper money debtors—a struggle that made its way into the debates over the federal Constitution.[3] The debate has since repeatedly appeared, in its "modern" context, as witnessed by the following Congressional oratory from the 1860's:

> Of what advantage can it be to creditors or to the country that so many tens of thousands of the active men of this country should be held in thralldom?
>
> . . . .
>
> The law formerly in force by which a creditor could keep his debtor in prison for an indefinite period, without relief, has been abolished in all Christian countries. But there may be a punishment of death without the knife, and an imprisonment without the bolts and bars of the jail.[4]

Report From the Consumer Bankruptcy Project, 60 AM. BANKR. L.J. 293 (1986) [hereinafter *Folklore and Facts*].

2. *See, e.g.*, Breitowitz, *New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of "Substantial Abuse,"* (pts. 1 & 2) 59 AM. BANKR. L.J. 327 (1985), 60 AM. BANKR. L.J. 33 (1986).

> One who does nothing more than peruse the provisions of the [Bankruptcy] Code, however, would be blissfully unaware of the economic realities of the typical consumer proceeding . . . . [F]or all practical purposes, the priority and distribution provisions of Chapter 7 are virtually a dead letter since, in over 90% of all cases, there are no assets available for distribution after exemptions are claimed.

Id. at 59 AM. BANKR. L.J. 335.

3. *See, e.g.*, R. MORRIS, THE FORGING OF THE UNION: 1781-1789, at 154-59 (1987).

4. CONG. GLOBE, 38th Cong., 1st Sess. 2638 (1864) (remarks of Rep. Jenckes).

An equally strong response from the creditor's point of view can also be found, such as this from the 1980's:

> Mr. Chairman, for the last couple of years in going home, I have been getting many complaints from owners of small businesses about the large number of persons taking bankruptcy. It was pointed out to me that a number of these persons taking bankruptcy had good jobs. They could pay their obligations, but it was the easier route to go chapter 7 and take bankruptcy and not worry about their debts.
>
> . . . .
>
> Well, something is wrong when the bankruptcy laws encourage people to take bankruptcy and then a small businessman goes before the courts and they tell him, "We can't help you at all."[5]

The debate has taken on new life during the last two decades because of the struggle over revision of bankruptcy law. The general perception is that those who thought bankruptcy should stress discharge, and thus be the ultimate form of consumer protection, won the first round of revision. The Bankruptcy Code,[6] enacted in 1978 and effective in 1979, purportedly tipped the scales heavily toward debtors, especially consumer debtors. There is no doubt that it attempted, with some success, to encourage debtors to use Chapter 13 reorganization rather than Chapter 7 liquidation by making Chapter 13 especially attractive, and in the opinion of some, too attractive.

In theory, wider use of Chapter 13 should have led to an increase in creditor satisfaction with the bankruptcy system because Chapter 13 holds out at least the promise of a greater recovery.[7] In practice, however, creditors did not always receive more in Chapter 13 proceedings than they did in Chapter 7 proceedings.[8] This fact disturbed some creditors and commentators, who thought that the benefits of Chapter 13 were being squandered because no quid-pro-quo was required.

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5. 130 CONG. REC. H1812 (daily ed. March 21, 1984) (remarks of Rep. G.V. Montgomery).

6. In this article, "Code" or "Bankruptcy Code" refers to Title 11 of the United States Code, 11 U.S.C.A. §§ 101-1330 (West Supp. 1987).

7. *See, e.g.*, Girth, *The Bankruptcy Reform Process: Maximizing Judicial Control in Wage Earners' Plans*, 11 U. MICH. J.L. REF. 51, 58-60 (1977).

8. *See, e.g.*, Corish & Herbert, *The Debtor's Dilemma: Disposable Income as the Cost of Chapter 13 Discharge in Consumer Bankruptcy*, 47 LA. L. REV. 47, 49 (1986).

Coupled with this disappointment over the impact of the new Chapter 13 was a concern that Chapter 7 was being used too freely by those who "could pay" their debts.[9] These problems in turn led to a slight tightening of the standards for both Chapter 13 and Chapter 7 discharge in the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA).[10] Unresolved, however, was the fundamental question of whether liquidation bankruptcy (Chapter 7) is a significant tool for the collection and distribution of assets.[11]

B. *Scope of This Article*

This article explores the utility of Chapter 7 liquidation as a device for distribution of assets to creditors. Specifically, it examines the extent to which Chapter 7 proceedings actually provide direct asset distribution from the debtor to the debtor's creditors. The primary question it addresses is both simple and deliberately limited. In what manner, and to what degree, does Chapter 7 presently act as a method of asset distribution? Except in passing, it does not tackle broader questions about the possibility of changing the focus of Chapter 7 from the liquidation of current assets to the allocation of future income, a change which would expand the Chapter's distributionary role. Nor does it comprehensively attempt to define classes of debtors who appear to be "abusing" the bankruptcy system.[12] The segregation of data by debtor group is made largely for the purpose of demonstrating the slight differences in the distributional pattern between those groups.

For purposes of this article, "distribution" refers to the entire division of the debtor's property, including payments to creditors, retention of assets by the debtor through the exercise of exemption

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9. This was at the heart of the Purdue Study, which asserted that $1,100,000,000 of debt was "unnecessarily" discharged each year. PURDUE STUDY, *supra* note 1, at 88-91.

10. Pub. L. No. 98-353, 98 Stat. 333 (1984). *See generally* Black & Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. RICH. L. REV. 845 (1985); Breitowitz, *supra* note 2; Corish & Herbert, *supra* note 8; Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59 (1986); Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM. & MARY L. REV. 91 (1985).

11. For the most comprehensive recent study of the history and theories underlying bankruptcy discharge, see Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49 (1986).

12. In these respects, this article differs sharply from the work of Sullivan, Warren & Westbrook, *supra* note 1.

rights[13] and significant transaction costs. It does not encompass rights that cannot be quantified, such as a creditor's retention of rights with regard to a non-dischargeable debt. It also does not bother with such modest but unreported transaction costs as filing fees. Nor, does it necessarily encompass all of the attorney's fees.[14]

Because of its somewhat narrow scope, this article does not discuss distributions that are neither (1) a result of the bankruptcy laws nor (2) a result of the exercise in the bankruptcy proceeding of non-bankruptcy rights.[15] Most significantly, it does not encompass payments made to creditors "outside" of bankruptcy.[16]

II. Data Used In This Article

The original data used in this article were gathered by examining and abstracting certain files of the United States Bankruptcy Court for the Eastern District of Virginia, Richmond Division, in Richmond, Virginia. The files examined in this study are those of all cases closed in that court from October, 1984, through January, 1987 (the study period). Detailed information was assembled with regard to every case that was closed as a Chapter 7 proceeding.

The authors chose to examine the files of closed cases because the focus of this examination is on the actual distribution of assets in bankruptcy. The court's filing system permits a fairly detailed analysis of asset distribution in each closed case. However, since only closed cases were used in the data base, virtually all the cases

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13. Strictly speaking, exemptions are not part of the bankruptcy distribution scheme because in Virginia, exemptions are generally the creatures of state law. *See infra* notes 62-65 and accompanying text. They are, however, included in this analysis because without their inclusion, it is impossible to evaluate the "fairness" of the bankruptcy distribution scheme.

14. The information regarding attorney's fees was sketchy at best and appeared unreliable. Frequently, no payment of attorney's fees was reported. Since it is a probable assumption that the attorney's fees in most cases were slight, their omission should not significantly distort the findings.

15. An example of those rights are those contained in the exemption laws or those under personal property or real property security laws that led to an abandonment of collateral by the trustee to a secured creditor.

16. More precisely, this article does not deal with payments (1) not recorded in the case files or (2) recorded as having been made separately from the bankruptcy proceeding. There are undoubtedly some cases in which the debtor or a relative or friend of the debtor made payments to a creditor that are not reflected in the court files. Since the bankruptcy proceeding was not the conduit for these payments, and since there could be no reliable measurement of such payments from the information in the files, this article makes no effort to take them into account.

examined were filed prior to the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA).[17] This means that this study cannot reflect any changes that may have occurred in the distributional pattern as a result of BAFJA. It also means that the information concerning the debtor's income and expenses which is required by BAFJA in consumer cases[18] was not available with regard to the cases studied. This lack of information is irrelevant to the central question of the study, but, as noted above, significantly limits its scope.[19]

Some other significant limitations in this data should be noted. First, most of the numbers used were rounded off either by the court or by the authors. For example, all amounts of money were rounded to whole dollars. Second, for the purpose of calculating the time it took for the proceedings to be closed, only whole months were counted. Third, because of gaps in the recorded data, certain assumptions had to be made. When a case provided for no payment on unsecured claims, the file often did not state the amount of allowed unsecured claims.[20] Therefore, the scheduled unsecured claims were assumed to be the amount of the allowed unsecured claims.[21]

Also, in some cases there were priority non-administrative claims scheduled but no payment was made. If, in addition, no payment was made on general unsecured claims, it was assumed that the allowed amount of the priority non-administrative claims equalled the scheduled amount, unless otherwise stated in the file.[22] Conversely, if payments were made on general unsecured claims, it was

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17. Pub. L. No. 98-353, 98 Stat. 333 (1984). This was largely because of the unexpected length of time these cases required. *See infra* note 70 and accompanying text. Most of BAFJA became effective in October, 1984. PUB. L. No. 98-353, § 553, 98 Stat. 333, 392 (1984).

18. *See* Morris, *supra* note 10, at 99-100.

19. *See supra* notes 13-16 and accompanying text.

20. Of course, the claims actually allowed might or might not equal those scheduled. *See* Bankruptcy Code, 11 U.S.C.A. § 502 (West Supp. 1987).

21. The rationale for this assumption was that there were probably some general unsecured claims allowed in the case, but their amount could not be precisely determined unless the court stated an allowed amount. Thus, the least inaccurate datum available with regard to each such case was the scheduled amount of the unsecured claims. It is important to note, however, that scheduled unsecured claims usually exceeded allowed claims by a significant amount in those cases in which both figures were available. Thus, this assumption probably results in an overstatement of unsecured claims in an undeterminable amount.

22. This was based on the assumption that there must have been some non-administrative claims; otherwise, none would have been scheduled.

assumed that the scheduled amount was in error and that there were no allowed priority non-administrative claims because the payments on the general unsecured claims could not properly have been made if there had been any unpaid priority claims.

Lastly, there were a few cases in which significant secured debt was scheduled but no payments with regard to such debt were made and no property was shown as abandoned. It is likely that in some of these cases there was either an unrecorded abandonment of collateral or a reaffirmation of secured debt. The figures used in this article, however, include only the collateral shown by the file to have been abandoned or that securing a reaffirmed obligation. Thus, it is probable that the amounts shown for property abandoned or subject to reaffirmed debt are understated. While this apparent practice of occasional informal and unrecorded abandonment is technically improper, its discovery was not unexpected by the authors.

Three minor caveats should also be noted. First, it was not always clear whether a file related to a "business" or a "non-business" proceeding; ambiguities were resolved by assuming that the proceeding was a business proceeding. Since this problem related to only a few cases, all relatively routine in their distributional structure, the assumption had no significant impact on the analysis of the data.

Second, seven of the cases were commenced under the Bankruptcy Act.[23] For reasons unknown, these cases were recorded under a significantly different system which did not provide as much data as the system used for Bankruptcy Code cases. The paucity of data in Bankruptcy Act cases makes it impossible to determine the exact effect on the analysis of the overall data.

Third, it appears to have been the custom of the bankruptcy court to limit the allowed amount of administrative claims to funds available. There were, therefore, no unpaid administrative claims in any case. Had administrative costs been measured "objectively," they would probably be higher than indicated by the data used in this article.[24]

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23. Bankruptcy Act, ch. 541, 30 Stat. 544 (1898), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

24. This does not mean that the data regarding the "cost" of the proceeding to creditors and debtors given in this article is necessarily unreliable. It does mean, however, that those costs can only be viewed as the direct costs to the participants, not the overall costs of the system. For this data, see *infra* notes 49-56, 89-99 and accompanying text.

This article reviews in detail the data from those Chapter 7 cases for which files were available and in which some property was distributed to creditors. Of the 208 cases closed during the study period, files on 205 could be located. Of those 205, one was a consolidated case (and therefore not dealt with separately in this article), and, as noted above, seven were filed under the Bankruptcy Act. The 204 identifiable, unconsolidated cases in which some distribution to creditors was made will be referred to as the "asset cases."[25]

Further study was made of those cases that were originally filed by consumer debtors under Chapter 7 of the Bankruptcy Code. Of the asset cases, 104 were identifiably filed by a consumer debtor or debtors[26] and were originally filed under Chapter 7 of the Code. Consumer Chapter 7 cases have been perhaps the most controversial during the last few years,[27] and certain statistics for, and some analysis regarding these cases are given separately.

Two other subgroups are identified for the limited purposes of determining the average exemptions given the debtor, the average amount of debt discharged, and the "cost" of discharge in bankruptcy proceedings. These are: (1) all the cases in which the debtor was an individual or an individual and spouse (non-corporate cases);[28] and (2) all the cases in which the debtor was an individual or an individual and spouse in a "business" rather than a consumer bankruptcy (proprietorship cases).[29] Neither the non-corporate cases nor the proprietorship cases include cases filed under the Bankruptcy Act; both include cases originally filed under Chapters 11 and 13.

III. Analysis of the Data

A. *Prevalence of No-Asset Chapter 7 Proceedings*

All statistical analyses show that Chapter 7 remains the most used chapter of the Code. Moreover, the great bulk of Chapter 7 proceedings are so-called "no-asset" cases.[30] This study confirms

25. Of these cases, 57 were joint cases; there were thus 261 debtors.

26. Forty-four cases were "joint" cases; there were thus 148 debtors involved in the consumer Chapter 7 cases.

27. The studies mentioned *supra* note 1 deal primarily with consumer Chapter 7 bankruptcy.

28. There were 161 such cases; 57 were joint. There were thus 218 debtors in these cases.

29. There were 41 such cases; 13 were joint cases. There were thus 54 such debtors.

30. *See, e.g.*, GAO Report, *supra* note 1, at 56-57 (97% of Chapter 7 cases are no-asset).

those findings. As might be expected, the prevalence of Chapter 7 proceedings is very high among a sample of closed cases. There are two simple reasons for this. First, most bankruptcy cases are commenced under Chapter 7.[31] Second, some cases originally filed under the reorganization chapters (Chapters 11, 12, and 13) end up under the liquidation chapter (Chapter 7) because they are voluntarily or involuntarily converted.

During the study period, a total of 4,892 cases were closed in the bankruptcy court. Of these, 4,723 were closed under Chapter 7, 167 under Chapter 13 and 2 under Chapter 11. In percentage terms, 96.55% of the cases were closed under Chapter 7, 3.41% under Chapter 13 and .04% under Chapter 11.

Of the 4,723 Chapter 7 cases, there were 4,515 in which no assets were distributed, and, as noted above, there were 208 cases in which at least some assets were distributed. In percentage terms, 95.6% of the Chapter 7 cases were cases in which nothing was distributed. Of all the cases closed during the study period, 92.3% were no-asset Chapter 7 proceedings and 4.25% were Chapter 7 proceedings in which some assets were distributed.

B. *Distribution in Asset Chapter 7 Cases*

1. Secured Claims

By definition, allowed secured claims are always paid in full unless the holder of the secured claim agrees otherwise.[32] The files do not indicate whether any such agreements were made, although in a number of files the amount paid on secured claims was considerably less than the amount of secured claims scheduled.[33] This may only indicate the relative inaccuracy of the schedules. If so, all of the figures relating to unsecured debt are understated by an un-

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The term "no-asset" is imperfectly defined. It is variously used to describe a case in which no assets are distributed to unsecured creditors and one in which no assets are distributed to creditors. As used in this article, the term refers to cases in which no distribution of any kind is made through the bankruptcy proceeding to anyone except the debtor. Thus, even cases in which the only recorded distribution made to creditors was for the cost of the proceeding itself will be considered the asset cases.

31. *See, e.g.*, BUREAU OF THE CENSUS, U. S. DEPARTMENT OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 510 (10th ed. 1987) (244,650 of 364,536 bankruptcy cases were filed under Chapter 7 between July 1, 1984 and June 30, 1985).

32. Bankruptcy Code, 11 U.S.C.A. §§ 361, 363, 725 (West Supp. 1987).

33. For example, in *In re* Powers, No. 83-00904-R (filed Bankr. E.D. Va. June 3, 1983), the schedules listed $48,327 of secured debt which was not finally accounted for.

determinable amount. In 178 of the 204 asset cases, it was possible to determine the disposition of secured claims. Of the 178 cases, there were secured claims listed in 146 cases (representing 82% of the cases involving secured claims and 71.6% of the asset cases). In only eleven of those cases (7.5% of the cases involving secured claims, 5.4% of the asset cases) was any distribution made on secured claims through the bankruptcy proceeding. In 142 cases (97.2% of the cases involving secured claims, 69.6% of the asset cases), at least some collateral was abandoned by the trustee or at least some of the secured debt was reaffirmed.[34] The total exceeds 100% because in several cases some secured claims were paid through the bankruptcy proceeding while others were dealt with by abandonment of collateral or reaffirmation.

Three of the most striking statistics in this study are the stated value of abandoned collateral as a percentage of the total collateral (96.6%),[35] the stated value of abandoned collateral as a percentage of the stated value of all assets available for distribution (80.9%)[36] and the stated value of all abandoned and distributed collateral as a percentage of the stated value of all assets available for distribution (83.8%).[37] As large as these percentages are, there is some possibility that they are actually *understated* because of unreported abandonments.[38] In any event, all of these figures indicate that the formal distributional work of the bankruptcy system in Chapter 7 cases is relatively slight.[39] Most of the debtor's property is abandoned to secured creditors or secures reaffirmed debt; a fraction more is distributed—perhaps unnecessarily—to secured creditors;[40] still more will be retained by the debtor because of exemptions. The Chapter 7 trustee administers, on average, less than

34. All of the collateral abandoned or subject to reaffirmed debt is referred to collectively as "abandoned collateral."

35. The files showed $12,180,070 of collateral; of this, $11,765,752 was abandoned or dealt with through reaffirmation.

36. There was a total of $14,540,405 in property; of this, $11,765,752 was abandoned by the trustee.

37. Of the $14,540,495 in assets, $12,180,070 was dealt with in one of these ways.

38. *See supra* notes 17-24 and accompanying text.

39. Of course, the filing of bankruptcy may actually trigger the distribution of property to secured creditors who might or might not have repossessed their collateral if no bankruptcy had been filed. Thus, the bankruptcy might have been an informal cause—or at least occasion—for property distribution.

40. Given the secured creditors' ability to seize property by self-help or through appropriate state court actions, it is difficult to see that the receipt of a distribution in the bankruptcy proceeding provided a benefit otherwise unavailable to them. They would presumably have gotten their collateral whether or not the bankruptcy had been filed.

a fifth of the Chapter 7 debtor's assets. Chapter 7 bankruptcy is thus, to a significant degree, merely the division of the debtor's property between the debtor and secured creditors.

These figures change only slightly when the sample is reduced to the 104 consumer Chapter 7[41] cases. In those cases, the stated value of abandoned collateral was 97.2% of all collateral.[42] The stated value of abandoned collateral was 72.4% of all assets available for distribution.[43] Finally, the stated value of all abandoned and distributed collateral was 74.5% of all assets available for distribution.[44]

What cannot be determined from the files is the amount of secured debt disallowed because the collateral was worth less than the debt.[45] In only a few cases was there any explicit disallowance. In others, however, there may have been a formal or informal agreement that the debt was partially unsecured.[46] The spottiness of the data makes it impossible to estimate how many "secured" creditors turned out to be unsecured and thus unpaid. However, this does not significantly distort the data because creditors whose claims proved to be unsecured would presumably obtain no more than the value of their collateral with regard to their secured claims whether or not there were bankruptcy proceedings.[47]

2. Priority Unsecured Claims

As one might expect, distributions on priority claims were generous in the asset cases. In 203 of the 204 asset cases, it was possible to determine the distributions made to holders of priority claims. In 160 cases (78.8% of the asset cases), all priority claims were

41. *See supra* text accompanying notes 26-27.

42. Of the $2,264,006 worth of collateral, $2,201,409 was abandoned or secured reaffirmed debt.

43. Of the $3,039,122 in property, $2,201,409 was abandoned or secured reaffirmed debt.

44. $2,264,006 of $3,039,122 in assets.

45. *See* Bankruptcy Code, 11 U.S.C.A. § 506 (West 1979), under which an allowed secured claim cannot exceed the value of the collateral securing the claim in most bankruptcy proceedings; *cf. id.* § 1111(b).

46. This could explain the few cases in which secured debt was scheduled but not shown to be satisfied and the many cases in which the collateral abandoned was markedly less than the scheduled secured debt.

47. It is possible, of course, that a bankruptcy trustee may be more vigilant in valuing collateral than general unsecured creditors, state law receivers or state law assignees for benefit of creditors; to the extent the trustee is, of course, bankruptcy would provide less to the undersecured creditors than would state court proceedings.

paid in full. In the remaining 43 cases, the payouts ranged from a low of 2.4% to a high of 90%, with a median payout of 20.4%.

The total of all priority claims was $1,442,375; $587,380 was distributed on account of this priority debt, giving a mean payout of 40.7%. Since, as noted above, the court only allowed administrative claims if there were funds available,[48] the losses fell entirely upon the priority claims that were non-administrative. There were a total of $1,063,710 of such claims; $208,715 was distributed with regard to those claims (19.6%).

The total costs of administration were apparently modest. Of the $14,540,495 of property available in the proceedings, only $378,665 was expended for administration of the 204 asset case estates. This amounted to a mere 2.6% of the assets available. Thus, bankruptcy appears to be an exceedingly cheap collection device. However, the amount of property actually administered by the trustee was much smaller than the amount available because most of the available property was abandoned to secured creditors and much of the rest was exempt. The property administered (including exempt property) was valued at $2,774,743. Excluding exempt property, the property administered was valued at $1,723,009. If the former figure is treated as the base, the administrative costs amounted to 13.65% of the value of property administered; if the latter figure is treated as the base, the percentage of administrative costs to value of property administered would be 22%.

The administrative costs were a substantial percentage of the distribution on general unsecured claims as well as the distribution on general unsecured and non-administrative priority claims. They were 52.5% of the former[49] and 181% of the latter.[50] The amount distributed with regard to *all* unsecured claims (priority and general unsecured) was $1,308,691. Of this amount, 28.9% was paid for administration of the estates.[51] The total amount distributed to all secured and unsecured claims was $1,723,009. As noted above, of this amount, 22%[52] was paid for administration of the estates.

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48. *See supra* notes 17-24 and accompanying text.

49. The administrative costs were $378,665; $721,311 was distributed on general unsecured claims.

50. $208,715 was distributed with regard to non-administrative priority claims.

51. $378,665 of the total $1,308,691 was distributed with regard to administrative claims.

52. $378,665 of $1,723,009.

These figures are perhaps most significant. The bankruptcy is, presumably, for the benefit of the creditors. A 22% collection "fee" is not insignificant. Even if the proceeding is supposed to be equally for the benefit of unsecured creditors and the debtor, and the costs are thus allocated to the distributions to both, the costs of administration (which would then be 13.65%) remain significant. However, these costs are modest in comparison with the attorney's fees that would presumably be charged in regular collection proceedings.[53]

The figures for the consumer Chapter 7 cases are not markedly different. The costs of administration were 41.6% of the general unsecured claims paid[54] and 221% of the non-administrative priority claims paid.[55] The amount distributed with regard to all unsecured debt was $227,850. Of this amount, 25.9% was paid for administration of the estate. The total amount distributed to all secured and unsecured claims was $290,447. Of this amount, 20.3% was paid for administration of the estate.

It is likely that the debtor, and at least some of the creditors incurred significant costs in pursuing pre-bankruptcy collection. They will also be required to pay costs and attorney's fees with regard to the bankruptcy. Thus, even the stated figures surely underestimate the creditor's recovery costs and (to a much smaller extent) the debtor's retention costs.[56] These additional costs cannot be accurately evaluated. It is virtually certain, however, that they significantly reduce the amount of property distributed to creditors and retained by the debtor.

C. *General Unsecured Claims*

It is generally assumed that little or nothing is paid upon general unsecured claims in Chapter 7 proceedings.[57] This assumption proved correct in this study. Even in asset Chapter 7 proceedings,

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53. Of course, this comparison is only valid if there were not significant attorney's fees paid outside of bankruptcy. If there were—and it is likely there were—the 22% or 13.65% of additional fees may make bankruptcy a much more expensive tool for asset distribution than non-bankruptcy collection proceedings.

54. $59,079 was paid for costs of administration; $142,098 was paid on unsecured claims.

55. $26,673 was paid on non-administrative priority claims.

56. Since the costs of administration come out of the assets available to creditors—assets the debtor cannot keep anyway—only the debtor who can pay debts in full actually "pays" anything for administration of the estate. Thus, there are hardly any debtors for whom bankruptcy imposes any direct costs.

57. *See, e.g.*, GAO REPORT, *supra* note 1, at 56-57.

only a small fraction of general unsecured debt is paid. In the 204 asset cases reviewed in this study, there were unsecured claims in the amount of $22,699,663. Of this amount, $721,311 was paid—only 3.2% of the claims. In the 104 consumer Chapter 7 cases, the payment percentage on unsecured claims was significantly higher, although still quite small. The claims totalled $1,012,868; the distribution with regard to those claims was $142,098, or 14% of the claims.

Another way of looking at unsecured claims is to consider the amount of the debtor's assets that went to pay such claims. In asset cases as a whole, 5% of the property available to the trustee was distributed to pay unsecured claims ($721,311 of $14,540,495). In spite of the fact that a much higher percentage of the general unsecured claims was paid in the consumer Chapter 7 proceedings, the percentage of the debtor's assets paid on unsecured claims in those cases was slightly lower than in the asset cases as a whole. Of the $3,039,122 available, 4.7% ($142,098) was paid with regard to unsecured claims.

D. *Exempt Property*

Property exempt from execution is of course returned to the debtor,[58] unless it is subject to a non-avoidable security interest.[59] While in one sense exempt property is not "distributed" (since it merely remains in the debtor's hands), as noted above, exemptions describe part of the overall distribution of the debtor's assets.[60] Thus, the amount of property retained by the debtor is an important consideration in bankruptcy policy. Indeed, the fact that some debtors can and do claim substantial exemptions has been a reason for asserting that bankruptcy law is unfair to creditors.[61]

Since Virginia does not permit debtors to elect the so-called "federal" exemptions,[62] it is generally true in Virginia that the

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58. Bankruptcy Code, 11 U.S.C.A. § 522(b) (West Supp. 1987).

59. Certain security interests and other liens can be avoided under various sections of the Bankruptcy Code. *E.g.*, *id.* § 547 (preferences); *id.* § 522(f) (certain non-possessory interests in exempt property).

60. *See supra* note 13 and accompanying text.

61. *See, e.g.*, 2 PURDUE STUDY, *supra* note 1, at 95-102.

62. Bankruptcy Code, 11 U.S.C.A. § 522(b)(1) (West Supp. 1987) permits states to "opt out" of the list of federal exemptions granted in § 522(d) of the Code—that is, to prohibit their residents from using those exemptions. True to its history, Virginia was one of the first states to opt out. VA. CODE ANN. § 34-3.1 (Repl. Vol. 1984).

bankruptcy proceeding does not "create" this aspect of asset distribution. Generally, the same amount of the debtor's assets would be retained by the debtor in state court proceedings.

The Fourth Circuit Court of Appeals has found one provision of the Bankruptcy Code[63] to have the effect of increasing Virginia's "homestead" exemption in certain husband and wife joint bankruptcy cases.[64] To this limited extent, bankruptcy will increase the amount of assets retained by the debtor. The authors did not attempt to determine from the files the number of cases in which the Bankruptcy Code increased the debtors' exemptions or the amount by which such exemptions were increased.[65]

In the asset cases, $1,051,734 of assets were found to be exempt property not subject to security interests (exempt non-secured property). This was 7.2% of the debtors' available property.[66] This percentage was strikingly higher in the consumer Chapter 7 cases. In those cases, $547,266 worth of assets were exempt non-secured property amounting to 18% of the debtors' available property.[67] In addition, in the non-corporate cases, $1,051,734 of assets were exempt non-secured property—14.3% of the debtors' available property.[68] Finally, in the proprietorship cases, $464,324 of assets were exempt non-secured property; this was 14.1% of the debtors' available property.[69]

IV. Duration of Proceedings

One minor statistic surprised the authors considerably—the average length of the proceedings. In theory, Chapter 7 bankruptcy is supposed to be simple and, therefore, swift. In fact, the cases in

63. Specifically, Bankruptcy Code, 11 U.S.C.A. § 522(m) (West Supp. 1987) which states, in pertinent part: "this section [Exemptions] shall apply separately with respect to each debtor in a joint case."

64. *In re* Cheeseman, 656 F.2d 60 (4th Cir. 1981). For a detailed discussion of the *Cheeseman* case, see Comment, In re Cheeseman: *A Judicial Revision of Virginia's Homestead Exemption Laws*, 16 U. Rich. L. Rev. 391 (1982).

65. This was for two reasons. First, the average amounts of exemptions per case and per debtor were, in general, rather small, *see infra* notes 73-77 and accompanying text, and apparently less than was available under state law alone, *see infra* note 73. Obviously, the impact of the federal law was comparatively slight. Second, for the purposes of this article, all exemptions are treated as part of the distribution structure; there is thus no reason to segregate the portion directly attributable to the bankruptcy proceeding.

66. The total of all the debtors' assets in the asset cases was $14,540,495.

67. The consumer Chapter 7 case debtors had $3,039,122 worth of property.

68. The debtors in the non-corporate cases had $7,337,243 worth of property.

69. The debtors in the proprietorship cases had $3,298,351 worth of property.

our sample were strikingly long-winded. The mean length of the asset cases was 43.65 months. Even more unexpected was the mean length of the consumer Chapter 7 cases, which was 48.7 months. This was astounding, if for no other reason than that the average length of Chapter 7 cases exceeded the permissible time period for payments under a Chapter 13 plan of reorganization by just over one year.[70] No reason for this apparently inordinate duration could be discerned from the case files.

V. Conclusions

The significance of much of the data depends upon the perspective of the analysis. Some of the figures clearly support the notion that bankruptcy provides an unfairly poor return on general unsecured claims. In the consumer Chapter 7 cases, for example, 18% of the available assets are retained by the debtor and only 4.7% are paid to the holders of general unsecured claims.[71] At least two striking statistics can be constructed from this data: (1) as between consumer Chapter 7 bankrupts and their general unsecured creditors, the bankrupt retains 79.4% of the available property while giving the creditors only 20.6% of the available property; and (2) consumer Chapter 7 bankrupts retain 283% more assets than they pay to their general unsecured creditors. These statistics can be made to appear all the more horrible by noting that they encompass only those cases in which *some* distribution to creditors was made and thus significantly overstate the allocation of assets to general unsecured creditors.

However, these numbers ignore the broader and more significant finding that nobody except secured creditors realizes much from the debtor's estate. In the cases studied, the secured creditors obtained possession through abandonment or retained an interest through reaffirmation of the overwhelming bulk of the debtors' assets.[72] There is no reason to believe that the distribution pattern of no-asset cases significantly changes this.

It is also worth noting that the per capita exemptions were relatively modest.[73] In the 161 non-corporate cases, the $1,051,734 of

70. Under Bankruptcy Code, 11 U.S.C.A. § 1322(c) (West 1979), the normal length of a Chapter 13 plan is three years.

71. *See supra* note 57 and accompanying text.

72. *See supra* notes 35-44 and accompanying text.

73. By way of comparison, it should be noted that Virginia's "homestead" exemption

exempt property was a mere $6,533 per case.[74] In the 104 consumer cases filed under Chapter 7, the $547,266 of exempt property amounted to a modest $5,262 per case.[75] Only in the 41 proprietorship cases were the exemptions markedly higher; the $464,324 of exemptions were $11,324 per case.[76] This suggests that exemption abuse, if it occurs at all, is more likely to be found among those businesspersons who file for Chapter 7 relief than among those consumers who file.[77]

Another important measure of the "fairness" of Chapter 7 is the total division of the property between the debtor and the creditors. This division is determined by calculating the ratio of all the debtor's property to the sum of all property abandoned to secured creditors, all property retained as collateral pursuant to reaffirmed loans and all distributions to all creditors (secured, priority, and unsecured). This fraction is then multiplied by the total of all the debtors' property and divided by the number of cases.

In the asset cases as a whole, there was $14,540,495 worth of property; of this, $13,488,761 (92.8%) went to creditors—$65,799 per case.[78] In the 161 non-corporate cases, there was $7,337,243 worth of property of which $6,285,509 (85.7%) went to creditors—$39,040 per case.[79] The amount of property that went to creditors in the consumer Chapter 7 cases was $2,491,856; this was 82% of all property available and $23,961 per case.[80] Finally, the creditors in the proprietorship cases received or retained $2,834,027 of the available $3,298,351—85.9% of the available

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permits most debtors to exempt $5,000 worth of *any* real or personal property. VA. CODE ANN. § 34-4 (Repl. Vol. 1984). In addition, a variety of other exemptions are allowed. The small margin by which average exemptions exceed the homestead exemption suggests that there is little manipulation or abuse by debtors, at least in asset cases. *Cf.* GAO REPORT, *supra* note 1, at 29-31 (most Chapter 7 debtors do not claim the maximum available exemptions).

74. This was $4,824 of exempt property for each of the 218 non-corporate debtors.

75. Since there were 148 debtors in those cases, the exemptions amounted to $3,698 per debtor.

76. Since there were 54 debtors in the proprietorship cases, each debtor received $8,599 in exemptions.

77. It should be noted that Sullivan, Warren & Westbrook's *Folklore and Facts*, *supra* note 1, at 308-09, suggests the possibility that proprietorship Chapter 7 debtors are a distinct group whose financial difficulties create more severe problems for their lenders than do consumer Chapter 7 debtors.

78. $51,681 per debtor.

79. $28,833 per debtor.

80. $16,837 per debtor.

property and $69,122 per case.[81] In short, creditors as a whole received a very high percentage of the debtors' fairly modest assets. That few of these assets go to pay unsecured claims is apparently much more a function of the prevalence of secured debt than the amount of exemptions given to the debtor.The data make clear that Chapter 7 is not a significant vehicle for asset distribution. Little is distributed (as opposed to abandoned) with regard to secured claims, and even the distributions that do occur would undoubtedly be made with or without Chapter 7.[82] The proceeding at most delays them.[83] Moreover, few of the proceedings provided for any reallocation of assets between claims by disallowing secured claims, avoiding preferential transfers or otherwise avoiding liens.[84]

Secured claims were disallowed in only twelve proceedings. Preference litigation was filed in only five proceedings. In only two cases were motions made to avoid liens. Moreover, the disallowance of a secured claim is not generally a creature of bankruptcy law. The only grounds under the Bankruptcy Code for disallowing a secured claim, that the granting of the security interest was a preference[85] and that the security interest is one that can be avoided to preserve certain exemptions,[86] are not grounds under the Uniform Commercial Code for disallowing a secured claim. Since only the latter two types of reallocation are unique to bankruptcy, in only seven cases was there clearly an effort to reallocate assets in a way that would not have been possible without the bankruptcy proceeding, and in only five of those cases was the effort successful.[87]

Thus, from the creditors' standpoint, it is not much of an exaggeration to say that Chapter 7 is virtually superfluous. What little money is allocated or distributed is almost always allocated and distributed the way it would have been had there been no Chapter

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81. $54,482 per debtor.

82. Presumably, of course, secured creditors would either be paid by the debtor or would repossess their collateral, thus achieving at least as good a "distribution" as they would in bankruptcy.

83. *See* Bankruptcy Code, 11 U.S.C.A. § 362 (West 1979 & West Supp. 1987) (automatic stay of actions against the debtor).

84. *See id.* §§ 547, 548, 549, 522(f) (regarding these avoidance powers).

85. *Id.* § 547.

86. *Id.* § 522(f). In Virginia, this is not an entirely true statement, because Virginia's specific exemption law provides a debtor with an almost identical right to avoid interests in the exempt property. VA. CODE ANN. § 34-28 (Repl. Vol. 1984).

87. The fact that the no-asset cases were not included in this sample is of course irrelevant. There could be no reallocation of assets since there was no allocation in the first place.

7 proceeding.[88] From a distributional standpoint, virtually all Chapter 7 proceedings are all-but-pointless preliminaries to the sharing of the debtor's meager assets.

For the debtor, of course, it is quite different because Chapter 7 discharges (albeit inefficiently[89]) very substantial amounts of debt. The debt discharged or unpaid[90] in the asset cases was $22,833,347, or $111,382 per case.[91] A total of $4,773,553 of debt was discharged in the non-corporate cases—$29,649 per case.[92] In the 104 consumer Chapter 7 cases, $1,007,681 of debt was discharged—a mere $9,689 per case.[93] The proprietorship cases provided for the discharge of $3,592,421— $87,620 per case.[94]

If administrative costs—the major costs borne by the debtor because of the bankruptcy[95]—are considered as the cost of this discharge, the costs prove quite small. In the asset cases, they were $1,856 per case.[96] In non-corporate cases, the cost was $662 per case;[97] in the consumer Chapter 7 cases, $568 per case;[98] and in the proprietorship cases, $821 per case.[99]

The figures become even more striking when the administrative costs are given as a percentage of the debt discharged. The debtors in the asset cases paid 1.7 cents in administrative costs per dollar of debt discharged or unpaid.[100] The non-corporate debtors paid

88. There may of course be some unmeasurable indirect effects. For example, the fact that in bankruptcy some preferences must be returned to the estate may have an impact on pre-bankruptcy creditor behavior that would not exist without bankruptcy. *But see* McCoid, *Bankruptcy, Preferences and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249 (1981).

89. Given the apparently unnecessary length of these cases, it is difficult to see Chapter 7 as particularly efficient at accomplishing anything. *See supra* note 70 and accompanying text.

90. In the corporate Chapter 7 cases, debt cannot be discharged. Bankruptcy Code, 11 U.S.C.A. § 727(a)(1) (West 1979). The unpaid debt, however, remains unpaid, and since there is no longer an economically viable entity from which the unpaid debt can be collected, it is in all but name discharged.

91. $87,484 per debtor.

92. $21,897 per debtor.

93. $6,809 per debtor.

94. $66,526 per debtor. As with exemptions, the raw figures point toward more problems with proprietors than consumers. *See supra* note 77 and accompanying text.

95. The debtor also incurs attorney's fees and filing fees. There may also be unmeasurable costs such as greater difficulty in subsequently obtaining credit.

96. $378,665 of administrative costs divided among 204 asset cases.

97. $106,652 of administrative costs; 161 cases.

98. $59,079 of administrative costs; 104 cases.

99. $33,649 of administrative costs; 41 cases.

100. $378,665 of administrative costs; $22,833,347 of debt discharged or unpaid.

2.2 cents per dollar of debt discharged;[101] the debtors in the consumer Chapter 7 proceedings paid 5.9 cents per dollar of debt discharged;[102] the debtors in the proprietorship cases paid, only .9 cents per dollar of debt discharged.[103] Chapter 7 thus appears an extremely cheap way to obtain debt relief for those debtors who have few unencumbered assets.

On the face of it, of course, these cost figures suggest that bankruptcy is an extraordinary investment opportunity for debtors. Such a conclusion would be superficial. The debtors only receive a "cheap" discharge because their non-exempt assets are insufficient to pay their debts. For example, a debtor who could pay, from non-exempt assets, 90% of $10,000 in debts and who paid $800 to discharge the remainder would have paid 80 cents per dollar discharged—hardly the deal of the century. Or, to put it another way, debtors who cannot pay their debts do not "gain" anything from the discharge because their creditors could never have collected what they owed,[104] nor can the debtors spend the debt discharged. Such debtors had nothing to begin with,[105] and the bankruptcy proceeding merely forced their creditors to acknowledge that fact.[106]

The great unknown is the income of the debtors. Debtors with significant disposable income *can* pay debts and *do* benefit from the discharge of those debts to the extent of that disposable income. Put simply, to the extent that the debtors could have made

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101. $106,652 of administrative costs; $4,773,553 of debt discharged.

102. $59,079 of administrative costs; $1,007,681 of debt discharged.

103. $33,689 of administrative expenses; $3,592,421 of debt discharged. These figures would of course become more dramatic if the no-asset cases were included, since the debtor paid nothing but attorney's and filing fees to obtain discharge in those cases. Moreover, the relative costs of the consumer Chapter 7 proceedings would probably rise if attorney's fees, which were not included in the case files, and filing fees were added to the cost of discharge, because the amount of money discharged per dollar spent is so small. For example, if one assumes that the average attorney's fees plus filing fees for a consumer Chapter 7 proceeding were $200, the aggregate cost of discharge rises to $79,879—7.9 cents per dollar discharged. At any rate, among non-corporate Chapter 7 debtors who have any assets at all, the cost of discharge is highest for consumers and lowest for businesspersons.

104. Caveat: to the extent that a duplication of exemptions occurred because of the bankruptcy, the debtor "gained" from the proceeding something it did not already have. *See supra* notes 63-64 and accompanying text. As noted, *supra* note 65, the small size of the exemptions makes it unlikely that exemption duplication was a significant factor.

105. More precisely, nothing that state law would permit creditors to reach.

106. Moreover, as noted, *supra* note 55, these "costs" to the debtor are entirely artificial. The money "spent" on administration of the estate is in fact the creditors' money, except where the debtor is able to pay all debts in full. If all debts can be paid in full, the debtor did not "buy" any discharge.

substantial payments to creditors from future income, it would be possible to extract greater returns for creditors, and to the extent bankruptcy does not extract those payments, it indeed becomes an ideal investment vehicle. Unfortunately, because almost all of the cases studied were filed prior to the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA),[107] there were no consumer Chapter 7 schedules of income and expenses available.[108] In that respect, this analysis is of the classical assumption that bankruptcy is a system of distributing assets, not one that parcels out future income.

Barring that, however, it is clear that Chapter 7 cannot provide much relief to the holders of general unsecured claims. Liquidation bankruptcy operates out of necessity as a system of debt forgiveness—because there is so little to distribute. It thus appears that any attempt to "reform" bankruptcy law to increase emphasis on its distributive function must inevitably focus on future income rather than current assets.

107. Pub. L. No. 98-353, 98 Stat. 333 (1984).
108. *See supra* text accompanying notes 17-19.