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As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America

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BOOK REVIEW

AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA. By Teresa A. Sullivan, Elizabeth Warren and Jay Lawrence Westbrook. New York: Oxford University Press, 1989. pp. xii, 370. $29.95.

*Reviewed by Michael J. Herbert**

Bankruptcy may soon join death and taxes as an inevitable consequence of human life. During the year ending June 30, 1988, (the most recent year for which there are conveniently available figures) 594,567 American individuals and companies filed for bankruptcy.[1] There is more than a sporting chance that, come the next recession, bankruptcies will top one million per year. Good news for lawyers, if not the economy.

It already appears that bankruptcy is by far the most common form of litigation. Why? Explanations range from the muted and mundane to the apoplectic and apocalyptic; they run the full gamut of contemporary political and economic belief. Maybe it's all just lawyer advertising. Or it might be the inevitable effects of economic decay in an overstretched imperial power. Or it could be all due to a swarm of lazy, deadly deadbeats who epitomize the loss of moral fibre in a permissive society.

The proliferation of bankruptcy proceedings has brought with it a welcome explosion in bankruptcy scholarship. For decades, the legal profession produced relatively little bankruptcy theory beyond Charles Warren's admirable but somewhat limited 1935 study.[2] A trickle of serious work in the 1960's has led to a torrent of diverse and challenging studies of the function and purpose of

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1. STATISTICAL ABSTRACT OF THE UNITED STATES No. 879 (1990).
2. C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935).

bankruptcy. And, unlike so much academic legal work, these studies have had, and are having, a significant impact on the day-to-day practice of lawyers. Much of the bankruptcy theory churned out in a search for tenure or ivory-tower status has been seriously considered by Congress and the courts in the development of bankruptcy law. In part, this is because much of the work done during the last twenty years or so has moved from the laboratory of the law school library to the laboratory of the bankruptcy court. A number of "empirical" studies have concentrated not on the reported cases and the Bankruptcy Code, but on the wealth of information about real bankrupts contained in the files of real bankruptcy cases. An unconnected group of scholars has devised a fairly uniform and highly useful methodology, one which has released them from the limitations of studying only the traditional legal data contained in cases and statutes. They have more-or-less systematically compiled raw data from bankruptcy files and converted that data into analyses of bankruptcy law.[3] Who *are* the people who wind up in bankruptcy court? What happens to them? This is a new model of legal research which holds out the promise of narrowing the gap between academic and practical lawyering.

The most extensive and most sophisticated study of bankruptcy files has now been completed. It was begun about a decade ago by two law professors (Elizabeth Warren, then of the University of Texas, now of the University of Pennsylvania, and Jay Lawrence Westbrook, Andrews & Kurth Professor of Law at the University of Texas) and one sociologist (Teresa A. Sullivan, Professor of Sociology and Law at the University of Texas). It has culminated in a book which is destined to become a true classic of legal scholarship, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America*.[4] As is true with any classic, it will be both (deservedly) admired and (somewhat less deservedly) excoriated.

Sullivan, Warren and Westbrook began with a mission. They sought to discredit a theory of bankruptcy law which had become popular among creditors at least. This theory held that individual debtors are extremely sensitive toward changes in debtor/creditor

3. For a couple of examples, see Herbert & Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-87*, 22 U. RICH. L. REV. 303 (1988); Schuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288 (1983).

4. T. SULLIVAN, E. WARREN & J. WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA (1989) [hereinafter DEBTORS].

law, and are thus very quick to change their own behavior in response to changes that are favorable or unfavorable to their interests. For example, suppose that a state changes its exemption law to increase the amount of property which a debtor can protect from creditors in bankruptcy from $5,000 to $10,000. If debtors carefully weigh the advantages of bankruptcy—if they view it as an investment, not an embarrassment—the number of bankruptcies should increase as debtors seek to take advantage of the increased exemptions.

Of course, no one seriously questions that gross changes in debtors' rights will change debtor behavior. If exemptions were increased from $5,000 to $10,000,000, there would no doubt be an increase in bankruptcies. Sullivan, Warren and Westbrook, however, challenge the assertion that debtors react predictably to relatively minor changes in the law; they reject the notion that the law can be fine-tuned to produce an optimal number of bankruptcies. They particularly had in their sights a study produced (at the behest of creditors) at Purdue University;[5] that study purported to prove that over one billion dollars per year was uselessly discharged in bankruptcy proceedings.[6]

The Purdue study represented part of a backlash against the 1978 Bankruptcy Reform Act. That act "liberalized" bankruptcy law and, in the view of many, virtually invited debtors into deadbeat heaven.[7] Indeed, the Act stopped calling bankrupts "bankrupts" and started calling them "debtors," because Congress was concerned that the word "bankrupt" hurt people's feelings.[8] To many, this solicitude for the emotional well-being of the non-paying customer symbolized everything that was wrong with the Act.

The Purdue study certainly influenced Congress which, in 1984, reined in the perceived excesses of the 1978 law. The 1984 law, which was in large measure the residue of an attempted countercoup by the credit industry, limited the availability of discharge in consumer bankruptcy proceedings. Certain consumer debtors were forced either to forgo bankruptcy discharge entirely, or to take the relatively hard road of paying to their creditors all their disposable

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5. More properly known as Credit Research Center, Krannert School of Management, Purdue University, Monograph Nos. 23 and 24, Consumer Bankruptcy Study (1982).

6. DEBTORS, *supra* note 4, at 5-7.

7. *See* Black & Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. RICH. L. REV. 845, 845-46 (1985).

8. *Id.* at 851 n. 27.

income for a three-year period.[9] Although these changes affected very few actual bankruptcies, they appeared to many to be the creditors' opening wedge. There was great concern that bankruptcy discharge might soon be broadly denied to consumer debtors on very dubious grounds. The belief of some, that many consumer bankrupts had more than enough income to pay their debts and were thus improperly manipulating bankruptcy, seemed to have become a truism.

The Sullivan, Warren and Westbrook team began with a brilliant attack on the Purdue study, which they viewed, and view, as a hopelessly flawed bit of bought research.[10] They were by no means alone in their contempt for that work. Many other empirical studies suggested that bankruptcy abuse was not particularly widespread.[11] The General Accounting Office weighed in with a fine study of "pre-1978" and "post-1978" bankruptcies which indicated that the allegedly pro-debtor bias of the 1978 law had made little, if any, difference.[12] Congress resisted the most extreme demands for limitation of bankruptcy discharge and, in fact, in 1986 enacted a very generous set of bankruptcy rules for family farmers.[13]

To this extent, at least, *As We Forgive Our Debtors* is rather a day late (though not by any means a dollar short). The argument its authors set out to make has, in the short term at least, largely been resolved in their favor. This only diminishes the immediate political value of the book, however. The struggle over the proper scope of bankruptcy discharge—which dates back to the very inception of the bankruptcy laws—will surely recur.

The book's theses are simple. First, bankrupts are not a distinctive class of Americans; they are, by and large, a random cross-section of our society, distinctive only in that they make less money and have more debt than the rest of us. Second, bankruptcy "abuse," although not unknown, is rare—too rare to justify major reformulation of bankruptcy law. Third, bankruptcy law is not an efficient means of shaping human behavior; people do not respond

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9. *Id.* at 852-61.

10. Sullivan, Warren & Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WIS. L. REV. 1091.

11. *See* Black & Herbert, *supra* note 7, at 849 n. 18; Herbert and Pacitti, *supra* note 3, at 303 n. 1.

12. GEN. ACCOUNTING OFFICE, REPORT TO THE HOUSE COMM. ON THE JUDICIARY, *Bankruptcy Reform Act of 1978—A Before and After Look* GAO/GGD-83-54 (July 20, 1983).

13. *See* Herbert, *Once More Unto the Breach, Dear Friends: The 1986 Reforms of the Reformed Bankruptcy Reform Act*, 16 CAP. U.L. REV. 325 (1987).

to incremental changes in their insolvency rights. But perhaps even more significantly, the book undermines a great many treasured bankruptcy cliches. Much of the folklore that is commonly believed about those who seek bankruptcy relief is called seriously into question.

The empirical data for the book was drawn from 1,529 case files. All of the cases were filed in 1981. The files were selected from ten districts—three each in Illinois and Pennsylvania, four in Texas.[14] Because bankruptcy filing required detailed financial statements concerning assets, debts, occupations and income, these files gave at least something of a portrait of the average bankrupt and the average bankruptcy.

The core of the book is chapters 4 and 5, in which the authors' dissect their data on the financial profile and occupations of their bankrupts. Many of the findings are, to say the least, surprising. The number of bankrupts who were unemployed was not terribly high. Somewhere between 7% and 17% of the bankrupts had no employment at the time they filed; this was at a time when the unemployment rates in the three states ranged from 5.3% in Texas to 8.4% in Pennsylvania.[15] The jobs of the employed bankrupts covered the whole range of occupations in roughly the same proportions as the whole population. Bankrupts were only slightly more likely than other people to hold low-status occupations.[16] In short, bankrupt America is essentially middle America—it is not the underclass.

About one-fourth of the bankrupts in the sample had suffered a sharp drop in income during the two years before their filings. This hardly surprising statistic, however, is more than balanced by the fact that over half the bankrupts had gains—usually sharp gains—in income during the two years before their filings. This is not to say that those bankrupts got rich; indeed, the incomes of the income-gaining bankrupts remained far below the national average.[17] The study also revealed that bankrupts generally have substantially lower-than-average incomes when compared to the general population and to people in the same occupations.[18] The most striking difference between bankrupts and non-bankrupts is

14. DEBTORS, *supra* note 4, at 17-18.
15. *Id.* at 85-86.
16. *Id.* at 86-95.
17. *Id.* at 98-99.
18. *Id.* at 64-66, 91-95.

that their debt to income ratios are markedly higher than normal.[19]

Bankrupts are almost as likely as the rest of the population to own their own homes.[20] Bankrupts are not particularly likely to have had recent major medical expenses.[21] Relatively few bankrupts have been the target of foreclosures or other formal collection processes.[22] Bankrupts, however, do tend to have very large amounts of credit card debt.[23]

To summarize: the findings are that the community of bankrupts is in most respects a microcosm of the entire community. Only two clear differences are noted. First, reported income is only about two-thirds that of the general population. Second, debt/income ratios are very high.[24]

From these somewhat discordant facts, the authors crafted their central thesis about the cause of bankruptcy. In their view the most likely explanation is that bankrupts are much more likely than the rest of the population to have suffered recent substantial interruption in income. Although they admit that they cannot prove this, they argue that the key determinant of bankruptcy is a sharp, if temporary, loss of earnings. That, they say, is what most frequently tips a marginal household economy into a failed one.[25]

It is certainly not an implausible theory. Take, for example, a family of four with an income of $30,000 per year. They own two old cars, a modest home, and at least one Nintendo. Like most Americans they save very little; the monthly income is just more than enough to pay all the bills. Because of a layoff, the family income drops to $6,000 for 10 months. What might happen?

In Sullivan, Warren and Westbrook's reconstruction, many things may happen. The family may begin to live off their credit cards, especially because credit card credit is so easy to obtain.[26] This would explain the high amount of such debt in the balance sheet. Creditors would not be over-eager to sue them, because the cost of litigation might overwhelm the meager assets that creditors could hope to recover. Although there would certainly be a period

19. *Id.* at 73-76.
20. *Id.* at 129.
21. *Id.* at 168-69.
22. *Id.* at 305.
23. *Id.* at 183-84.
24. *Id.* at 64-66, 73-76, 91-95, 328-33.
25. *Id.* at 95-102.
26. *Id.* at 187-88, 316-17.

of time during which the family would have to face nasty letters and phone calls from creditors, those letters and calls would gradually fade away as the creditors realized that there would be no repayment.[27]

Then, when the family's income rose back to, say, $22,000, hungry creditors would again pick up the scent. Now there would be something to latch on to. This renewed pressure would finally lead our exhausted debtors to file bankruptcy. This helps explain why so many bankrupts had low overall income and very high debts, yet reported an increase in income shortly before the filing.[28]

The preceding synopsis is of course a considerable simplification of the book's discussion, which is far more nuanced. It does, however, represent the authors' core explanation for the profile of the typical bankrupt. It is not the only explanation. Almost everything reported by Sullivan, Warren and Westbrook is consistent with the thesis that bankrupts are, on average, more careless about financial matters than the rest of the population. They can be viewed as a class of people who stretch their spending to the absolute limit of the most optimistic appraisal of their income prospects. They do not budget for normal fluctuations in income; and when those fluctuations occur, their financial house of credit cards collapses.

Chapters 10 through 13 of the book are a sustained attack upon the belief that a great number of consumer bankrupts have the capacity to pay their bills, and thus should be forced to do so. One of the major proposals for squeezing back the alleged generosity of the 1978 Bankruptcy Act was that Chapter 13—the main consumer reorganization chapter—should be made mandatory for many consumer bankrupts.[29] The theory was that many consumers had enough income to pay all, or a substantial part, of their debts if they were forced to live modestly for the three year period of a Chapter 13 plan. The 1984 amendments to the Bankruptcy Code included only a few fragments of this proposal; by and large, Congress rejected the whole notion of a mandatory Chapter 13.[30]

The book asserts that only about 10% of the studied bankrupts

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27. *Id.* at 100-01.
28. *Id.* at 101.
29. *See* Black & Herbert, *supra* note 7, at 845-52.
30. For a general discussion of these issues, see Corish & Herbert, *The Debtor's Dilemma: Disposable Income as the Cost of Chapter 13 Discharge in Consumer Bankruptcy*, 47 LA. L. REV. 47 (1986).

show *any* prospect of being able to repay debts from future income, and argue that this is too small a group to justify the expense involved in identifying them.[31] Of course, to some degree this argument is self-proving. The key issue underlying the question of bankrupts' ability to pay is what level of economic well-being are we willing to let bankrupts enjoy? If, as a society, we were willing to say that the price of bankruptcy discharge is three years' worth of the barest subsistence, a great deal of money might be sweated out. There are many problems with this, not the least of which is that a bankrupt who is reduced to such a level of poverty no longer has any incentive to go to work and earn the money that the creditors so badly want.

There is also other evidence, in the book and elsewhere, that forced repayment is a doomed hope. Chapter 13, which was designed to entice consumer bankrupts into making voluntary efforts to repay debt, has been far less successful than its drafters hoped. The vast majority of Chapter 13 repayment plans fail.[32] This means that most bankrupts who do in fact attempt repayment will be unable to do so. No doubt the failure rate of involuntary Chapter 13 plans would be even higher.

Another creditor whine is that many debtors overuse credit cards on the eve of bankruptcy. Horror stories are told of last minute binges, courtesy the debtor's bankcard, just before filing—a sort of economic Mardi Gras before the grim Lent imposed by the bankruptcy court. Sullivan, Warren and Westbrook find little evidence of this.[33] In any event, this is a problem for which creditors have already been given some statutory relief; the debts created by those binges are now non-dischargeable in Chapter 7 of the Bankruptcy Code.[34]

The book also studies bankruptcy recidivism. If many of the complaints of creditor groups are true, we should find a substantial number of people who repeatedly use bankruptcy. Chapter 7 (liquidation bankruptcy) discharge is available every seventh year.[35] That should be just about enough time for the average crafty deadbeat to run up another string of debts and thus to make another dash to the bankruptcy court. Yet Sullivan, Warren and West-

31. DEBTORS, *supra* note 4, at 212-13.
32. *Id.* at 213-17.
33. *Id.* at 178-89.
34. 11 U.S.C. § 523(2)(C) (1988).
35. *Id.* § 727(a)(8).

brook find little evidence of this in their files. Only about 8% of their debtors had previously been in bankruptcy.[36] Moreover, the authors contend that only about a third of that 8% are "true repeaters"—which they define as persons who obtain a discharge, run up a new set of debts, and then file for bankruptcy. They contrast this group with a larger group which managed to pay off at least one set of debts between Chapter 7 discharges.[37]

Finally, the authors launch an attack squarely at the assumption which underlies the push for the 1984 amendments—the notion that the market for bankruptcy is efficient. They present a strong case for the proposition that incremental changes in bankruptcy laws do not achieve significant changes in the behavior of bankrupts.[38] Bankrupts are not obsessive wealth maximizers; they do not respond swiftly or in great numbers to the loosening or tightening of the standards for discharge. And the well-off—whose potential bankruptcy gains are the greatest--do not much use it:

> These numbers show a clear economic sorting so obvious it is easy to overlook: People in financial trouble are the people entering bankruptcy. Those not in bankruptcy are, on average, much better off financially. At the grossest level, economic sorting works impressively; it simply does not work according to a simplistic economic model.
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> The proponents of the economic model used in debating bankruptcy policy assumed this basic sorting would *not* work, that rich and poor alike would use bankruptcy, making more powerful economic restrictions necessary. According to a purely economic view, bankruptcy without severe limitations is so attractive that debtors should "enrich" themselves by discharging their debts even if they could pay. . . . In fact, most debtors avoid bankruptcy until they reach an economic crisis, suggesting that bankruptcy seems more attractive to economists than to debtors.[39]

This bit of good sense will win some bitter enemies for the book. There is a lot of very silly economics on the loose these days, especially among the less intellectually adept members of the law-and-economics movement. A depressingly large amount of economic writing is based on an inane model of human behavior that is so

36. DEBTORS, *supra* note 4, at 192.
37. *Id.* at 192-95.
38. *Id.* at 230-63.
39. *Id.* at 243.

absurdly simplistic only academics (and perhaps one or two federal judges) are capable of taking it seriously. Yet for some the model has quasi-religious overtones, which render their devotion to it immune to facts. For them, *As We Forgive Our Debtors* is the moral equivalent of *The Satanic Verses*.

The final substantive chapters of the book deal with the plight of the "other players" in the bankruptcy drama—the creditors. These chapters are, as one would expect given the focus of the study, the weakest in the book. The authors are more than a bit prudish about lax lending practices. They are clearly puzzled by the actions of many creditors in offering so much credit on such easy terms:

> Not only are 60-month car loans on the rise, but so too are three- and four-year unsecured loans solicited on a mass basis. The creditors who are making these loans are as bound for bankruptcy court as if they had asked to be included. The explanation must be as simple as profit and loss, a fact confirmed by an industry analyst who was recently quoted as saying that credit card issuers are so sure that they will suffer high losses from a mass mailing of cards, they charge the resulting unpaid loans to "marketing expense" rather than to bad debt losses.[40]

Sullivan, Warren and Westbrook are particularly bemused by the failure of many consumer lenders to make any significant investigation of a borrower's real credit worthiness,[41] or to obtain collateral.[42] The latter is perhaps especially surprising, since heavily secured creditors have an excellent chance of receiving full or at least substantial payment in bankruptcy.

All of this merely reinforces the book's conclusions. In the closing chapter, the authors' basic assertions are that the current system works quite well, that no system could do a fundamentally better job, and that many of the problems of creditors occur because of choices they have made and business risks they have voluntarily accepted.[43] They also argue that bankruptcy in America takes the place of a European-style safety net of comprehensive benefits.[44] Finally, they make a last spirited attack on the law-and-

40. *Id.* at 323.
41. *Id.* at 312-19.
42. *Id.* at 311-12.
43. *Id.* at 328-33.
44. *Id.* at 333-35.

economics crowd, whom they chide for promulgating vacuous "armchair theories" based on little real data.[45]

Many criticisms of this book are obvious, and no doubt will be forcefully made. The authors are arguing from a thesis; they went into the project with a mission, and they accomplished that mission. They are honest enough to admit this, and seem at times to have tried to counteract their own biases. This, if nothing else, distinguishes them from many theorists who assume their biases have the imprimatur of divine truth and thus would never consider attempting to neutralize them. But the biases are there, and they color the whole work.

As noted above, one of the authors' central arguments—that bankrupts are ordinary people who have suffered a sudden loss of income—is unproven. It is, however, convenient to their biases, and thus must be held suspect by the critical reader. It may well be (as the authors have the disarming grace to admit) that their sample consisted largely of people who were incompetent or lazy—whose loss of income was simply the result of the fecklessness that led to their bankruptcy. The fact that illness—one of the assumed root causes of economic failure by consumers—appeared to be a *minor* factor in triggering bankruptcy at least suggests that many debtors may have had no "good" (read: socially acceptable) reason for the sudden financial collapse. And nothing in their study fully explains the fact that a slight majority of debtors experienced a significant increase in income in the period just before bankruptcy.

The book is filled with reconstructions of the lives of individual debtors.[46] These anecdotal bits make good reading but perhaps less effective scholarship. No doubt the abstractions of the law are a barrier to understanding; and bankruptcy analysis which does not take into account the fact that there is pain in failure is incomplete.[47] Of bankrupts, of all persons, it is true that "[p]erhaps their lives have no cosmic significance, but they have feelings. They can hurt."[48] But the book's reconstructions are rather arbitrary novel-

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45. *Id.* at 335-38.

46. *See, e.g., id.* at 50-60.

47. Interestingly, one critique of DEBTORS seems to take the authors to task for putting too little anecdotal information in the book. *See* Gross, Book Review, 88 MICH. L. REV. 1506 (1990) reviewing T. SULLIVAN, E. WARREN & J. WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA (1989).

48. R. HEINLEIN, DOUBLE STAR 243 (1986).

izations of the known facts. We do not *know* these debtors, we know only what the authors imagine; and what they imagine may be entirely misleading.

The authors are also, of necessity, forced to rely on self-reported information. The bankruptcy courts do not verify the information contained in the schedules filed by the bankrupts. In consequence, those schedules are no more accurate than the debtor's memory and honesty will permit. No doubt at least some are largely fictitious. This does not mean that there is systematic misreporting; there is every reason to believe that most of the schedules are remarkably accurate. However, the very people who are improperly manipulating the bankruptcy system are at the same time the people who are most likely to lie when they fill out their schedules. Thus, the number of cases in which the files reveal misconduct or abuse is almost certainly understated.

One of the painful aspects of any research is that some preconceptions will inevitably be destroyed. Clearly, this happened to Sullivan, Warren and Westbrook. They are honest enough to admit it. They are committed enough to attempt plausible but unprovable explanations for much of their unexpected data. This perhaps demonstrates nothing but what every seasoned lawyer knows: the easy questions are obvious. The hard questions—which are really the heart of law—can never be fully resolved. Persons of intelligence and good will can look at exactly the same data; and where one sees deadbeats, the other sees despair.

Keep these caveats in mind—but read the book. It provides a better understanding of real bankruptcy than does anything else published by any other academic. The data is presented for the most part in a manner which is honest enough to permit the reader to reach his or her own conclusions. The book is astonishingly well written in a crisp prose style, and the flow of text is for the most part enhanced, rather than burdened, with the numbers and the formulae.[49] It sets an example for legal scholarship which has rarely been, and will rarely be, met.

49. Those who are not mathematically inclined can in fact skip all the numbers without losing the thread of the argument.