

2002

## Comment: The End Justifies the Means: The Legal, Social, and Economic Justifications for Means Testing Under the Bankruptcy Reform Act of 2001

James T. Hubler

*American University Washington College of Law*

Follow this and additional works at: <http://digitalcommons.wcl.american.edu/aulr>



Part of the [Law Commons](#)

---

### Recommended Citation

Hubler, James T. "Comment: The End Justifies the Means: The Legal, Social, and Economic Justifications for Means Testing Under the Bankruptcy Reform Act of 2001." *American University Law Review* 52, no.1 (2002):309-338.

This Comment is brought to you for free and open access by the Washington College of Law Journals & Law Reviews at Digital Commons @ American University Washington College of Law. It has been accepted for inclusion in American University Law Review by an authorized administrator of Digital Commons @ American University Washington College of Law. For more information, please contact [fbrown@wcl.american.edu](mailto:fbrown@wcl.american.edu).

---

Comment: The End Justifies the Means: The Legal, Social, and Economic  
Justifications for Means Testing Under the Bankruptcy Reform Act of  
2001

## COMMENTS

# THE END JUSTIFIES THE MEANS: THE LEGAL, SOCIAL, AND ECONOMIC JUSTIFICATIONS FOR MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT OF 2001\*

JAMES T. HUBLER\*\*

### TABLE OF CONTENTS

Introduction.....	310
I. The Historical Evolution of Eligibility Under the Consumer Bankruptcy System .....	313
A. The Creation and Early Development of Bankruptcy Law in the United States .....	313
B. The Advent of Repayment Plans .....	315
C. The Next Phase of U.S. Bankruptcy Law: The Push for a Mandatory Chapter 13 and the Advent of Substantial Abuse .....	316
D. Interpretations of “Substantial Abuse” .....	320

---

\* This Comment will refer to the bankruptcy legislation under analysis as the Bankruptcy Reform Act of 2001. At the time of the publication of this Comment, however, the Act has been renamed the Bankruptcy Abuse and Prevention Act of 2002. H.R. 333, 107th Cong. (2002).

\*\* Articles Editor, *American University Law Review*, Volume 52; J.D. Candidate, May 2003, *American University, Washington College of Law*, B.S., *magna cum laude*, 2000, *Truman State University*. I wish to thank Professor John B. Corr for his insights and guidance on earlier drafts. I am also appreciative of the editorial assistance provided by Andrea Mack and Danielle Schonback. I am eternally grateful to my parents, Craig and Lisa Hubler, whose love and tireless support made all of this possible. Finally, a very special thanks to my fiancé, Liz Maloney, for her enduring love, patience and inspiration.

II. The Bankruptcy Reform Act of 2001: Formulation and Articulation .....	323
A. Legislative Formulation of the Reform Act.....	323
B. The Legislative Details for Eligibility Under the Reform Act.....	324
1. Test 1: The means test and defeating the presumption of abuse .....	325
2. Test 2: the median income test .....	327
3. Exception: special circumstances and bad faith.....	328
III. Analysis: Bankruptcy Reform at the Right Time and in the Right Place .....	329
A. The Legal Justifications: A Universally Applicable Test ..	329
B. The Moral and Social Justifications: A Fresh Start to Only Those Who Need It .....	331
C. The Economic Justification: Promoting the Availability of Affordable Consumer Credit.....	334
Conclusions and Recommendations: Pass the Legislation and Let the Healing Begin! .....	337

#### INTRODUCTION

The U.S. economy endured a lurid plunge in 2001. By March, the U.S. economy had descended into its first recession in almost a decade.<sup>1</sup> In 2001, the Dow Jones Industrial Average fell seven percent, the largest percentage drop since 1981,<sup>2</sup> while the Nasdaq composite fell over twenty-one percent.<sup>3</sup> Unemployment rates rose each month in the latter half of 2001, culminating at a 5.8% unemployment rate, the highest level of unemployment since April of 1995.<sup>4</sup> Compounding these troubling economic realities, the average household owed more than \$8,000 in credit-card debt at the end of 2001.<sup>5</sup> Such large amounts of debt can be an unmanageable burden

1. See *Economists Call It Recession*, CNNMONEY, at <http://money.cnn.com/2001/11/26/economy/recession/index.htm> (Nov. 26, 2001) (citing a report published by the National Bureau of Economic Research that based its findings on monthly employment, industrial production, incomes, and sales data) (on file with the American University Law Review).

2. See E.S. Browning, *After Two Years of Suffering, Investors Hope for a Rebound*, WALL ST. J., Jan. 2, 2002, at A1 (noting that the Dow Jones industrial average fell 7.1% during 2001, the largest percentage decline for the Dow since 1981, when the index fell 9.23%), available at <http://interactive.wsj.com/articles/SB1009575912654276400.htm>.

3. See *id.* (stating that the 21.05% drop in the Nasdaq Composite Index in 2001 was less than the 39.29% drop in 2000), available at <http://interactive.wsj.com/articles/SB1009575912654276400.htm>.

4. See U.S. *Unemployment Rises*, CNNMONEY, at <http://money.cnn.com/2002/01/04/economy/economy> (Jan. 4, 2002) (noting that the Labor Department's statistics indicate that the economy has lost 1.4 million jobs since March 2001) (on file with the American University Law Review).

5. See Jeanie Sahadi, *Debt Overload: 5 Red Flags*, CNNMONEY, at [http://money.cnn.com/2001/10/07/debt/q\\_debt/](http://money.cnn.com/2001/10/07/debt/q_debt/) (Oct. 8, 2001) (quoting a CardWeb.com

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 311

for individuals facing layoffs incident to the economic slowdown.

The bankruptcy system provides debtors with relief from debt's harsh realities,<sup>6</sup> but changes to the bankruptcy laws are coming. The 107th Congress is in the final stages of enacting the Bankruptcy Reform Act of 2001 ("Reform Act"),<sup>7</sup> an ambitious overhaul of the U.S. bankruptcy system.<sup>8</sup> Final passage of the Reform Act merely requires reconciliation of the House and Senate versions of the bill,<sup>9</sup> which are substantially "similar"<sup>10</sup> and President Bush's "promised" signature.<sup>11</sup>

Because of the economic downturn of 2001, bankruptcy reforms will affect the average consumer. The Reform Act presents a marked change in the bankruptcy field for consumer debtors. For example, the Reform Act creates the "means test,"<sup>12</sup> and an eligibility requirement under Chapter 7 bankruptcy,<sup>13</sup> which will prevent

---

household study that found the average credit card balance per U.S. household equaled \$8,523) (on file with the American University Law Review). According to a Myvesta.org study, the average credit card balance per person was \$2,814. *Id.*

6. See discussion *infra* Part I.C (noting how the U.S. bankruptcy system provides relief to debtors by discharging much of their indebtedness).

7. Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001), currently referred to as the Bankruptcy Abuse and Prevention Act of 2002. H.R. 333, 107th Cong. (2002).

8. See Peter Spero, *Impact of Bankruptcy Reform Legislation on Asset Protection*, 28 EST. PLAN. 291, 291 (2001) (stating that passage of the Bankruptcy Reform Act of 2001 is a "virtual certainty," and noting that both the House and Senate have passed similar versions and that the "President has said that he will sign it.").

9. See *generally* S. 420.

10. See *id.* (noting the similarities between the House and Senate versions of the Reform Act). See *generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001).

11. See W. Clarkson McDow, Jr., *The Bankruptcy Reform Act of 2001 and Its Impact on Consumer Lawyers*, 13 Aug. S.C. LAW. 32, 33 (July/Aug. 2001) (stating that as of August, 2001, the Bankruptcy Reform Act of 2001 has passed both Houses of Congress and the "President has promised to sign it."). The House-Senate conference committee on the bankruptcy legislation was originally scheduled to convene on September 12, 2001, but because of the events of September 11, they did not convene until November 14, 2001. The committee's chairman, House Judiciary Chairman James Sensenbrenner (R-Wis.), noted that the Reform Act probably would not be completed by the Conference Committee until 2002. American Bankruptcy Institute, *Today's Bankruptcy Headlines: Sept. 11 Plays Role in Opinions During Bankruptcy Panel Meeting*, Daily Bankruptcy Review, at <http://www.abiworld.org/headlines/TODAY.html> (Nov. 15, 2001) (on file with the American University Law Review). Currently, an agreed upon conference committee report is tied up in the House of Representatives because of a disagreement regarding an abortion provision entirely unrelated to the analysis of this Comment. See American Bankruptcy Institute, *Today's Bankruptcy Headlines: Bankruptcy "Agreement" Hits New Snag in House*, Daily Bankruptcy Review, at <http://www.abiworld.org/headlines/02july29.html> (July 29, 2002) (on file with the American University Law Review).

12. See discussion *infra* Part II.B.1 (detailing the Reform Act's means test).

13. Chapter 7 bankruptcy is a liquidation proceeding in which a trustee collects the debtor's nonexempt assets, converts them to cash, and pays the claims of the debtor's creditors with this cash. See JOHN H. WILLIAMSON, *THE ATTORNEY'S HANDBOOK ON SMALL BUSINESS REORGANIZATION UNDER CHAPTER 11* 20 (Argyle Pub.

debtors with the financial ability to repay a portion of their debt from receiving an unconditional discharge under Chapter 7.<sup>14</sup>

Although limiting access to bankruptcy relief at a time of economic uncertainty seems counterintuitive, this reform is a response to what some observers have called a “bankruptcy crisis” caused by rampant debtor abuse of the bankruptcy system.<sup>15</sup> The data supporting that contention is compelling. In the 1990s the United States experienced its largest and longest period of economic growth,<sup>16</sup> coupled with record low unemployment rates,<sup>17</sup> yet personal bankruptcy filings rose seventy-two percent between 1994 and 1998.<sup>18</sup> During that same period of increased personal filings, corporate bankruptcy filings steadily declined.<sup>19</sup>

Therein lies the paradox: a booming economy and increasing personal bankruptcy filings. The Reform Act is premised on the belief that this paradox exists because current consumer bankruptcy laws are too lenient, allowing individuals with future earnings potential to seek a full discharge of large unsecured debts without any future recourse or consequences.<sup>20</sup> To limit abuse of the

---

5th ed. 1998) (noting that if debtors do not wish to liquidate their assets, they should file for a reorganization of their debts under Chapter 13).

14. See discussion *infra* Part II.B.1; see also McDow, *supra* note 11, at 33 (noting the change from the current subjective substantial abuse test under 11 U.S.C. § 707(b) to a proposed objective means test). Those debtors who fail to meet the proposed eligibility requirements will either have their filing dismissed or converted to a Chapter 13 filing, thereby requiring them to repay a portion of their debt pursuant to a Chapter 13 plan. See Spero, *supra* note 8, at 291 (discussing reports that, as a general rule, families of four with income of \$52,000 would be required to file under Chapter 13).

15. See generally Gordon Bermant & Ed Flynn, *Consumer Filings in a Complex Economy*, 18 Jan. AM. BANKR. INST. J. 22 (Dec./Jan. 2000) (arguing that the substantial increase in personal bankruptcy filings is due to debtor abuse as opposed to traditional causal explanations like recession, depression, inflation, or high unemployment).

16. See *supra* note 1 (noting the recession that started in March ended a ten-year period of economic expansion, the longest in U.S. history, topping a growth period of eight years and ten months that took place in the 1960s).

17. According to the Bureau of Labor’s Statistics, between 1998-99, the “civilian labor force grew 1.3 million and unemployment fell to 4.2 percent.” Bermant & Flynn, *supra* note 15, at 22.

18. See H.R. REP. NO. 107-3, pt. 1, at 5 (2001) (citing data provided by the Administrative Office for United States Courts).

19. See *U.S. Bankruptcy Filings 1980-2001 (Business, Non-Business, Total)*, ABI WORLD, at <http://www.abiworld.org/stats/1980annual.html> (last visited Apr. 14, 2002) (providing data that shows a fifty percent decline in business filings between 1990-2000 from 71,549 filings in 1991 to 35,472 filings in 2000 as opposed to non-business filings which have almost doubled from 718,107 in 1990 to 1,217,972 in 2000) (on file with the American University Law Review); see also Bermant & Flynn, *supra* note 15, at 22 (noting that the recent fall in Chapter 11 filings led to suspicion of serious flaws in the consumer bankruptcy system that present inappropriate temptations to prospective filers).

20. See discussion *infra* Part II (discussing the paradox of the current bankruptcy

bankruptcy system, Congress has proposed that a means test be utilized to determine eligibility for Chapter 7 relief.<sup>21</sup>

This Comment addresses the bankruptcy eligibility aspects of the Reform Act and analyzes them in practical, legal, equitable, and economic contexts. Part I outlines the historical evolution of the eligibility standard under the consumer bankruptcy system in the United States. Part II details how the Reform Act will affect consumers' current eligibility for bankruptcy protection. Part III analyzes these details and presents legal, equitable, and economic reasons for passing the Reform Act. Finally, Part IV concludes by recommending passage of the Reform Act because it will unify current consumer bankruptcy law, prevent morally repugnant and socially undesirable discharges of consumer debt, and provide a long-term economic stimulus to the ailing U.S. economy by ensuring the availability of affordable consumer credit.

#### I. THE HISTORICAL EVOLUTION OF ELIGIBILITY UNDER THE CONSUMER BANKRUPTCY SYSTEM

A typical personal bankruptcy action involves a debtor voluntarily or involuntarily liquidating all pre-determined non-exempt assets in favor of creditors in return for a discharge of debts owed to these creditors.<sup>22</sup> Evolving U.S. bankruptcy laws have addressed each aspect of the typical personal bankruptcy filing in different ways.<sup>23</sup>

##### *A. The Creation and Early Development of Bankruptcy Law in the United States*

Congress' ability to formulate a bankruptcy system was first enunciated in 1787, in the U.S. Constitution.<sup>24</sup> In 1800, the first American bankruptcy law<sup>25</sup> enacted under this charge copied the

---

crisis); *see also* S. REP. NO. 106-49, at 3 (1999) ("It is the strong view of the [Senate Judiciary] Committee that the Bankruptcy Code's generous, no-questions-asked policy of providing complete debt forgiveness under chapter [sic] 7 without serious consideration of a bankrupt's ability to repay is deeply flawed and encourages a lack of personal responsibility.").

21. *See* discussion *infra* Part II (noting that the means test, by requiring financially able debtors to repay a portion of their debt, will prevent debtors from abusing the bankruptcy system).

22. *See* Richard E. Coulson, *Consumer Abuse of Bankruptcy: An Evolving Philosophy of Debtor Qualifications for Bankruptcy Discharge*, 62 ALB. L. REV. 467, 470-71 (1998) (describing a "traditional Chapter 7 scenario").

23. *See id.* (indicating that the roles of the in a traditional Chapter 7 scenario vary according to the applicable law at the time of the filing); *see also* discussion *infra* Parts I.A, I.B, I.C.

24. *See* U.S. CONST. art. I, § 8, cl. 4 (stating that Congress has the right to establish "uniform laws of bankruptcy").

25. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

English bankruptcy law of that time.<sup>26</sup> The American law was “limited to creditor-initiated petitions against merchants,” thereby having little applicability to the average consumer debtor.<sup>27</sup>

Congress quickly repealed the first law in 1803, but passed another in 1841.<sup>28</sup> The second law made bankruptcy available to voluntary debtors for the first time.<sup>29</sup> The debtor entering bankruptcy was required to surrender all non-exempt property for liquidation to pay off as much of his debts as the liquidated assets would allow.<sup>30</sup> In exchange, all of the debtor’s debts would be “discharged.”<sup>31</sup> However, if a majority of the creditors—in number or in value—holding proven debts objected, they could deny the discharge.<sup>32</sup>

The Bankruptcy Act of 1867 (“1867 Act”)<sup>33</sup> slightly modified these requirements.<sup>34</sup> Pursuant to the 1867 Act, creditor consent was not required for filings before June 1, 1868.<sup>35</sup> If the debtor’s non-exempt assets did not satisfy a fifty percent or larger portion of the total debt, a discharge would still require the consent of a majority—in either number or value—of the creditors.<sup>36</sup>

---

26. See DAVID G. EPSTEIN ET AL., *BANKRUPTCY* 1-2 (1993) (describing the similarities between the first codified American bankruptcy law and the English version as essentially being procedural in nature).

27. *Id.* at 1.

28. See Coulson, *supra* note 22, at 473 (stating that the second attempt at a codified bankruptcy law in the United States was a direct response to the economic panic of 1837).

29. See Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 349 (1991) (maintaining that the Bankruptcy Act of 1841 was the “first time in Anglo-American jurisprudence” in which voluntary bankruptcy was allowed).

30. See Coulson, *supra* note 22, at 473-74 (explaining that the exempt property included household and kitchen furniture and other articles judged necessary, such as clothing, but these items were not to exceed \$300).

31. See *id.* at 474 (“The 1841 discharge included all the debts, if, as before, the debtor surrendered his property, complied with all court orders, and conformed with the Act.”).

32. See *id.* (recognizing that a debtor could demand a jury trial to determine whether his filing should be approved despite creditors’ objections if it appeared that the debtor made a full disclosure of his assets and surrendered all of his estate).

33. The Bankruptcy Act of 1867, ch. 176, §§ 4972-5132, 14 Stat. 517 (repealed 1878).

34. See Coulson, *supra* note 22, at 474-76 (noting that like the 1841 Bankruptcy Act, the 1867 Act was a response to an economic panic in 1857).

35. See *id.* at 476 (arguing the 1867 Act, while short lived, was a rather sophisticated form of legislation and foreshadowed future developments in bankruptcy law in 1898).

36. See Tabb, *supra* note 29, at 357 (explaining that amendments made in 1874 provided that a voluntary debtor whose non-exempt assets paid less than thirty percent of the proven claims would not be discharged unless one-fourth of the creditors in number and one-third in value consented as opposed to the majority of creditors required to consent under the original 1867 language).

In 1898, a “fully modern bankruptcy act” was enacted.<sup>37</sup> The law recognized for the first time the public interest in granting a discharge to “honest but unfortunate” debtors.<sup>38</sup> Congress promoted the public interest by eliminating the long-standing requirements of either creditor consent or a minimum dividend as a prerequisite for obtaining a discharge.<sup>39</sup> The 1898 Act codified the conditions under which a discharge would not be granted.<sup>40</sup> It also defined particular types of debts that were “non-dischargeable”<sup>41</sup> as essentially exempt from a discharge.<sup>42</sup>

### B. *The Advent of Repayment Plans*

In the aforementioned consumer bankruptcy laws, the emphasis was on the debtor receiving a fresh start after liquidation of his assets.<sup>43</sup> Changes made by the Chandler Act of 1938,<sup>44</sup> however, made a debtor’s future potential income an issue.<sup>45</sup> It created a Chapter 13 bankruptcy option entitled “Wage Earners’ Plans”<sup>46</sup> that allowed consumer debtors to adjust their debts by using future income.<sup>47</sup> The Wage Earners’ Plans detailed and prioritized a debtor’s debt by

---

37. Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978). See Coulson, *supra* note 22, at 477 (describing the 1898 Bankruptcy Act).

38. See Tabb, *supra* note 29, at 364-65 (stating that the underlying theory behind recognizing the public interest in discharging “honest but unfortunate” debtors is that “society as a whole benefits when an overburdened debtor is freed from the oppressive weight of accumulated debt,” thereby allowing a debtor to “resume his or her place as a productive member of society.”).

39. See *id.* (suggesting that “[t]his innovation marked as much as anything else the arrival of the ‘modern’ American pro-debtor discharge policy”).

40. See Coulson, *supra* note 22, at 481 (stating that “[o]n a debtor’s application, the court was to discharge the debtor unless she committed a bankruptcy crime, or, with fraudulent intent, destroyed, concealed or failed to keep books from which the debtor’s true financial condition could be determined.”).

41. See *id.* at 482 (defining non-dischargeable debt as debts for which the debtor remains obligated despite bankruptcy).

42. See *id.* (observing that such non-dischargeable debts included “debts: (1) for taxes; (2) based on judgments for fraud, false pretense, or willful and malicious injuries; (3) not properly scheduled so the creditor could timely file a claim; or (4) created by ‘fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity.’”).

43. See *id.* at 493 (stating that “[i]n non-commercial bankruptcies, emphasis in the past [had] been on discharge, rather than on distribution to creditors”).

44. See Chandler Act of 1938, ch. 575, 52 Stat. 840, 930-41 (repealed 1978) (creating the Wage Earners’ Plans).

45. See Coulson, *supra* note 22, at 493 (discussing the advent of a new policy in which future assets, specifically future earnings, should be procured and used to pay creditors in a bankruptcy proceeding if available).

46. Walter Chandler, *The Wage Earners’ Plan: Its Purpose*, 15 VAND. L. REV. 169 (1961). The 1938 Chandler Act was named after Walter Chandler. *Id.*

47. See Coulson, *supra* note 22, at 493 (“Chapter 13 was the first carefully considered effort to address the need for some consumer debtors to adjust their debts by using future income.”)

applying the debtor's future income to pay off all or a portion of the debt according to set priorities while leaving "a sufficient amount . . . for the support of his family and himself."<sup>48</sup> The plans required the consent of a majority of the creditors with claims, and of each affected, secured creditor.<sup>49</sup> The debtor received his discharge upon execution of the plan subject to his satisfactory compliance with the plan throughout its duration.<sup>50</sup>

The Chapter 13 option was never the "preferred mode"<sup>51</sup> for most consumer debtors when compared to the more conventional option of liquidation of a debtor's assets option.<sup>52</sup> Most debtors chose to free their future earnings from prior credit claims by filing for a voluntary liquidation, regardless of whether their future earnings could pay down some, if not all, of their debt.<sup>53</sup> This phenomenon of consumer debt avoidance would become the justification for the creditors' rallying cry for bankruptcy reform, eventually culminating in the passage of the Bankruptcy Reform Act of 1978.<sup>54</sup>

*C. The Next Phase of U.S. Bankruptcy Law: The Push for a Mandatory Chapter 13 and the Advent of Substantial Abuse*

In the 1960s, the credit industry began a push to overhaul the bankruptcy system by mandating that all consumer debtors use Chapter 13 to discharge debt.<sup>55</sup> In 1964, that overhaul led to the

---

48. Chandler, *supra* note 46, at 169-70.

49. See Coulson, *supra* note 22, at 494 (explaining that "[t]he consent of a majority of the proven claims in amount and number, and of each affected secured creditor was necessary for confirmation.").

50. See *id.* (highlighting that "after three years, if the court found that the plan payments had not been completed 'due to circumstances for which [the debtor] could not be justly held accountable' the discharge would remain in effect) (citing Chandler Act of 1938, § 661, 52 Stat. at 936).

51. *Id.* at 495 (citing annual reports from the Director of the Administrations Office of the United States Courts indicating that in 1961, only fifteen percent of the non-business filings were for wage earner plans).

52. See *id.* (recognizing that in the more conventional liquidation of assets option, a creditor could not touch a debtor's future earnings unless: (1) a debt was determined to be nondischargeable, (2) a discharge was denied, (3) there was an express agreement allowing creditors access thereto).

53. See *id.* at 495-96 (noting that an individual with nominal assets and a significant future earnings potential could choose to liquidate his nominal assets, repay his creditors to a nominal extent while receiving a discharge, and prevent access to his large future earning ability).

54. See discussion *infra* Part II (discussing the advent of "substantial abuse" and its application to potentially abusive debtors).

55. See Coulson, *supra* note 22, at 500 (noting that the credit industry's efforts to amend the bankruptcy laws were similar to legislation in the 1930s that was denounced as "un-American"); Vern Countryman, *Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 821 (1983) (stating that the proposed legislation resembled the English practice of conditional or suspended discharge).

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 317

introduction of House Bill 12,784,<sup>56</sup> which would have amended the bankruptcy laws to require a wage earning debtor, seeking relief under a liquidation plan, to show that relief under Chapter 13 would be inadequate.<sup>57</sup> However, House Bill 12,784 never emerged from committee.<sup>58</sup> The credit industry introduced identical legislation in 1965<sup>59</sup> and 1967,<sup>60</sup> but those pieces of legislation also failed to emerge from committee. Similarly, in 1965, legislation was introduced in the Senate,<sup>61</sup> which would have created a new section in the bankruptcy laws mandating that debtors file under Chapter 13.<sup>62</sup> The Senate Bill also failed to gain enough support to pass committee.<sup>63</sup>

Even though none of the mandatory Chapter 13 requirements became law, the credit industry's pressure on Congress led to the creation of the Commission on Bankruptcy Laws ("Commission") to "study, analyze, evaluate, and recommend changes" for establishing a uniform system of bankruptcy throughout the United States.<sup>64</sup> One of the Commission's purposes was to study legislative solutions to handle the increasing number of consumer bankruptcies.<sup>65</sup> In 1973, after a two-year study, the Commission reported its findings on the feasibility of a mandatory Chapter 13 for all consumer debtors.<sup>66</sup> The Commission soundly rejected a mandatory Chapter 13 law,<sup>67</sup> citing among other reasons that such a requirement "would be almost

---

56. See H.R. 12,784, 88th Cong. (1964) (stating that the judge or referee shall determine at the first meeting of creditors whether the wage earning debtor has shown that adequate relief cannot be obtained under Chapter 13).

57. See *id.* (permitting non-wage earning debtors and wage earning debtors who showed that Chapter 13 relief is inadequate to proceed under a liquidation plan).

58. Coulson, *supra* note 22, at 500; Countryman, *supra* note 55, at 821.

59. H.R. 292, 89th Cong. (1965).

60. H.R. 1057, 90th Cong. (1967); H.R. 5771, 90th Cong. (1967).

61. S. 613, 89th Cong. (1965).

62. See *id.* (authorizing the court "upon application of any creditor or upon its own motion, whenever it determines it to be feasible and desirable, and for the best interests of the creditors, [to] order any voluntary bankrupt who is receiving salary or wages to file a petition under . . . [Chapter 13]").

63. Coulson, *supra* note 22, at 500. See Countryman, *supra* note 55, at 821 (noting that further attempts to enact similar legislation failed in the 1970s).

64. See Act of July 24, 1970, Pub. L. No. 91-354, § 1(b), 84 Stat. 468, 468 (stating that during the study the Commission shall consider basic philosophy of bankruptcy, causes of bankruptcy, and alternatives to the bankruptcy system).

65. See H.R. REP. NO. 91-927 (1970), *reprinted in* 1970 U.S.C.C.A.N. 3559, 3560 (stating that the number of bankruptcies over the past twenty years increased by 1000% and consumer bankruptcies accounted for 90% of that increase).

66. See Report of the Commission of the Bankruptcy Laws of the United States, H.R. DOC. NO. 93-137 (1973), *reprinted in* COLLIER ON BANKRUPTCY, at App. Pt. 4-409 (Lawrence P. King ed., 15th ed. Rev. 2001) (Appendix 4(c)) (reporting that the Commission reviewed Chapter 13 usage in areas in which this type of relief was most extensively used, such as Alabama, Ohio, California, Georgia, Tennessee, Kansas, and Maine).

67. See *id.* at App. Pt. 4, 412 (stating that new bankruptcy laws should promote Chapter 13 so that debtors know all available relief).

bound to encourage debtors to change employment and, if necessary, to move to another area to escape the importuning calls and correspondence of his creditors.<sup>68</sup> As a result of the Commission's conclusions, the Bankruptcy Reform Act of 1978 ("1978 Act")<sup>69</sup> did not include any mandatory Chapter 13 provisions.<sup>70</sup>

The credit industry responded to the 1978 Act by pushing to reform what creditors perceived to be "an undue bias toward bankrupts."<sup>71</sup> Similar to the credit industry's push in the 1960s to mandate Chapter 13, legislation was introduced to restrict access to Chapter 7 bankruptcy.<sup>72</sup> The proposed legislation in the House<sup>73</sup> and Senate<sup>74</sup> sought to limit Chapter 7 to debtors who could not afford to pay a reasonable amount of their debts pursuant to a Chapter 13 plan.<sup>75</sup>

Although neither piece of legislation immediately changed the use of Chapter 13,<sup>76</sup> a study by Robert W. Johnson,<sup>77</sup> a professor at Purdue University's Credit Research Center ("Purdue Study"), added fuel to the credit union's building fire.<sup>78</sup> The Purdue Study concluded that \$1.1 billion of the debt discharged annually under Chapter 7 could be repaid by debtors' future income.<sup>79</sup> While critics attacked the

---

68. See *id.* at App. Pt. 4, 411-12 (stating that a mandatory Chapter 13 plan would force a debtor and the debtor's family to live within the constraints of the plan to the end and thus appeared to be debtor peonage).

69. Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended in various sections of 11 U.S.C. and 28 U.S.C.).

70. Coulson, *supra* note 22, at 501.

71. Paul M. Black & Michael J. Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. RICH. L. REV. 845, 845 (1985). The 1978 Act "was branded a debtor's paradise practically beckoning borrowers to shed their debts painlessly and needlessly." *Id.*

72. Coulson, *supra* note 22, at 501. Two years after the enactment of the 1978 Act, legislation was introduced in the House and Senate limiting debtors access to Chapter 7 bankruptcy. *Id.* The 1978 Act named the liquidation of assets form of bankruptcy as Chapter 7. Act of Nov. 6, 1978, § 721, 92 Stat. at 2606.

73. See H.R. 4786, 97th Cong. § 2 (1981) (providing that "an individual may be a debtor under chapter 7 . . . only if such individual cannot pay a reasonable portion of his debts out of anticipated future income").

74. See S. 2000, 97th Cong. § 2(c) (1981) (prohibiting individuals from being a debtor under Chapter 7 if they could pay "a substantial percentage of the outstanding debt" out of anticipated future income).

75. See Coulson, *supra* note 22, at 501-02 (noting that the definitions in the legislation did not provide much guidance on fluid concepts, such as anticipated future income).

76. See *id.* at 502 (indicating that Congress did not pass either bill due to the lack of uniform support for bankruptcy reform at that time).

77. 1 CREDIT RES. CTR., PURDUE UNIV., CONSUMER BANKR. STUDY 88-91 (1982). The study asserted that the 1978 Act had an adverse financial impact on the credit industry. *Id.*

78. See Countryman, *supra* note 55, at 822 (describing the credit industry's influence on the Purdue Study).

79. See *id.* (concluding that 33.1% of bankruptcy debtors could have repaid their debts in full); see also John M. Czarnetzky, *The Individual and Failure: A Theory of the*

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 319

validity of this conclusion,<sup>80</sup> the momentum of the credit industry's campaign continued when the American Bar Association endorsed legislation allowing creditors to seek dismissal of Chapter 7 petitions when the debtor could pay a reasonable portion of his debts out of future income.<sup>81</sup>

The credit industry's momentum resulted in Senate Bill 2000 being "reintroduced"<sup>82</sup> in February of 1983 as Senate Bill 445.<sup>83</sup> Originally, Senate Bill 445, like Senate Bill 2000, contained language limiting Chapter 7 bankruptcy to individuals who could not pay a reasonable portion of their debts.<sup>84</sup> By the time Senate Bill 445 was reported by the Senate Judiciary Committee, however, the Chapter 7 language had been replaced with a new "substantial abuse" test.<sup>85</sup> The new test stated that a court may dismiss a motion for discharge under Chapter 7 if granting relief would be a substantial abuse of Chapter 7.<sup>86</sup> Meanwhile, companion legislation in the House included similar language.<sup>87</sup> The substantial abuse test was eventually codified in 1984 as an amendment to the 1978 Act.<sup>88</sup> The obfuscated origins of the

---

*Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 440-41 (2000) (explaining that the Purdue Study involved a questionnaire study in two judicial districts in ten states with willing respondents answering a series of follow-up questions).

80. See, e.g., Teresa A. Sullivan et al., *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WIS. L. REV. 1091, 1104-08 (1983) (arguing that the Purdue Study's methodology created a selection bias that raised significant concerns about the data used in the conclusions); Elizabeth Warren, *Reducing Bankruptcy Protection for Consumers: A Response*, 72 GEO. L.J. 1333, 1338-39 (1984) (noting that the Purdue Study lacked crucial expertise, was designed incorrectly, gathered its data improperly, misanalyzed the statistical data, and drew erroneous and biased inferences from the data analysis).

81. See *Consumer Bankruptcy Subcommittee of the Committee on Consumer Financial Services of the American Bar Association*, 2 N. ILL. U. L. REV. 239, 259 (1982) (recommending the dismissal of Chapter 7 cases when the debtor is able to allocate future earnings to pay a reasonable portion of his debts). The problem of Chapter 7 bankruptcy is that it is a form of equitable relief and unavailable for the asking. *Id.*

82. See Coulson, *supra* note 22, at 503 (explaining that the reintroduced bill sought to limit Chapter 7 to individuals who could not pay a reasonable portion of their debts out of future income).

83. Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong. (1983).

84. See David L. Balser, Note, *Section 707(b) of the Bankruptcy Code: A Roadmap With a Proposed Standard for Defining Substantial Abuse*, 19 U. MICH. J.L. REFORM 1011, 1018 (1986) (stating that the "language in S. 2000 was incorporated verbatim into S. 445").

85. See S. 445, § 202(b) (stating that the court may dismiss a case under Chapter 7 if granting relief is a substantial abuse of Chapter 7); see also Balser, *supra* note 84, at 1018 (noting that there was no explanation in the legislative history for why a "substantial abuse" test replaced a "future income" test).

86. See S. 445, § 202(b) (creating a presumption in favor of granting the relief requested by the debtor).

87. See H.R. 5174, 98th Cong. (1984) (proposing to amend the Bankruptcy Code without a future income test).

88. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified in various sections of title 11 of the United States Code).

test, however, have resulted in courts interpreting “substantial abuse” in a myriad of ways.<sup>89</sup>

#### D. Interpretations of “Substantial Abuse”

The addition of the “substantial abuse” test, codified at 11 U.S.C. § 707(b), limited debtor access to Chapter 7 bankruptcy and is currently the standard that courts employ.<sup>90</sup> However, the language of Section 707(b) has been the source of great interpretative debate.<sup>91</sup>

The United States Code does not define “substantial abuse.”<sup>92</sup> As a result, the courts must develop a definition from the legislative history of Section 707(b).<sup>93</sup> One of the problems with the interpretation of “substantial abuse” is that the amendment to Section 707 lacked an official committee report.<sup>94</sup> The holding of *In re Kelly*<sup>95</sup> compounded this problem. The court in *In re Kelly* noted that, “[t]o the extent that legislative history may be considered, it is the official committee reports that provide the authoritative

---

89. See Balsler, *supra* note 84, at 1018-19 (discussing the multiple interpretations of substantial abuse under the 1984 Amendment).

90. See 11 U.S.C. § 707(b) (1994 & Supp. 2001) (“After a motion and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor . . . whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of [Chapter 7—Liquidation].”).

91. See *infra* notes 92-117 and accompanying text.

92. See, e.g., *In re Walton*, 866 F.2d 981, 983 (1989) (explaining that because “the term ‘substantial abuse’ is not defined in the Act, the term is subject to judicial interpretation”); Robert M. Thompson, Comment, *Consumer Bankruptcy: Substantial Abuse and Section 707 of the Bankruptcy Code*, 55 Mo. L. REV. 247, 254 (1990) (stating that substantial abuse is not defined in the bankruptcy code and has been left to judicial interpretation).

93. See generally Coulson, *supra* note 22, at 506-07 (noting that courts have encountered interpretive difficulties in attempting to quantify substantial abuse under § 707 with legislative history analysis).

94. See Thompson, *supra* note 92, at 251-52 (explaining that no official committee report exists for the amendments to § 707, and that this lack of a formal legislative history has allowed courts to “rummage through the closet of the Congressional Record” to find anything that might provide some interpretative guidance); see also Tamara O. Mitchell, *Dismissal of Cases Via 11 U.S.C. §707: Bad Faith and Substantial Abuse*, 102 COM. L.J. 355, 359 (1997) (highlighting the fact that in addition to an absence of official committee reports, there are also conflicting floor statements regarding the provision). *But see* Coulson, *supra* note 22, at 503-04 (citing Susan Block-Lieb’s research stating that after the introduction of the substantial abuse language in S. 445, Senator Metzenbaum reported to the Judiciary Committee that he had “successfully worked out with the author of this amendment the total elimination of the future income language . . . the future income matter is no longer in the legislation.”). Representative Rodino, Chairman of the House Judiciary Committee during debates on H.R. 5174, inserted into the Congressional Record a few days after passage of the bill the statement that the substantial abuse language “would not create a future income test.” Coulson, *supra* note 22, at 504.

95. 841 F.2d 908 (9th Cir. 1988).

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 321

expression of legislative intent . . . [not the] stray comments by individual legislators.”<sup>96</sup> Therefore, the interpretation of substantial abuse has been a challenging jurisprudential endeavor.<sup>97</sup>

Commentators have classified the circuit courts’ interpretations of “substantial abuse”<sup>98</sup> into three categories.<sup>99</sup> The Ninth Circuit, in *In re Kelly*, set forth the first mode of interpretation,<sup>100</sup> holding that the debtor’s ability to pay was the principal factor to be considered in the substantial abuse determination.<sup>101</sup> The court noted, however, that an inability to pay debts would not “shield a debtor” from dismissal under section 707(b) when bad faith was otherwise shown.<sup>102</sup> The Eighth Circuit developed a similar rule in *In re Walton*,<sup>103</sup> noting that while Section 707(b) considers a petitioner’s good faith and unique hardships,<sup>104</sup> the debtor’s ability to fund a Chapter 13 plan is the primary factor in determining substantial abuse.<sup>105</sup>

The Sixth Circuit’s holding in *In re Krohn*<sup>106</sup> laid out the second mode of interpretation of substantial abuse<sup>107</sup> The court assessed two factors:<sup>108</sup> (1) whether the debtor is seeking a Chapter 7 bankruptcy

---

96. *Id.* at 912 n.3 (quoting *Garcia v. United States*, 469 U.S. 70, 76 (1984)).

97. *See generally* Coulson, *supra* note 22, at 506-07 (noting the varied interpretations courts have made in defining substantial abuse).

98. *See id.* at 506-08 (highlighting the several general categories of interpretation of substantial abuse under § 707(b)).

99. *See* Thompson, *supra* note 92, at 256-57 (stating that there are three separate modes of judicial interpretation for defining substantial abuse). Only four of the eleven circuit courts have defined substantial abuse under § 707(b), with each having a different position on the matter. *Id.* *See also* Michael D. Bruckman, Note, *The Thickening Fog of “Substantial Abuse”: Can 707(a) Help Clear the Air?*, 2 AM. BANKR. INST. L. REV. 193, 195-98 (1994) (dividing the analysis of substantial abuse into three categories: (1) a Chapter 13 per se approach; (2) a Chapter 13 “plus” approach; and (3) a totality of the circumstances approach).

100. *See* 841 F.2d at 914 (concluding that debtors able to repay approximately ninety-nine percent of their unsecured debt do not require Chapter 7 protection).

101. *See id.* at 914-15 (noting that the “overwhelming majority of the courts considering the issue” have adopted this rule consistent with congressional intent, as the committee report on S. 445 indicates).

102. *Id.* at 915.

103. *See* 866 F.2d 981, 982 (8th Cir. 1989) (dismissing a debtor’s Chapter 7 case on grounds of substantial abuse because the debtor’s monthly income was \$1,818, and monthly expenses were \$1,321, leaving a surplus of \$497 with which the debtor could pay off debts under a Chapter 13 plan).

104. *Id.* at 983.

105. *See id.* at 984 (“The primary factor that may indicate substantial abuse is the ability of the debtor to repay the debts out of future disposable income.”) (quoting 4 COLLIER ON BANKRUPTCY, ¶ 707.07, at 707-19 (15th ed. 1988)).

106. 886 F.2d 123 (6th Cir. 1989).

107. *See id.* at 127 (holding that a debtor who had ample future income, a financial situation that was not the product of an unforeseen or catastrophic event, and had lived on a “catalog of excesses” should have a Chapter 7 filing dismissed for substantial abuse).

108. *See id.* at 126-27 (noting that need and honesty are two primary factors in ascertaining substantial abuse).

for “honest” reasons;<sup>109</sup> and (2) whether the debtor is “needy” as determined by a debtor’s ability to pay his debts out of future earnings.<sup>110</sup> The court “cautioned,” however, that a debtor’s ineligibility for Chapter 13 relief alone would not be the decisive factor in dismissal under section 707(b).<sup>111</sup>

The Fourth Circuit, in *In re Green*,<sup>112</sup> established the third mode of interpretation.<sup>113</sup> Rejecting the Ninth Circuit’s position that ability to repay debts is a decisive factor,<sup>114</sup> the court pointed to the 1984 bankruptcy amendments in which Congress rejected a threshold future income or ability to repay test.<sup>115</sup> The Fourth Circuit then adopted a “totality of the circumstances” approach,<sup>116</sup> to be applied on a case-by-case basis.<sup>117</sup> Although an ability to repay debts is a primary factor under this approach, it cannot be the sole basis for finding that a debtor has substantially abused the process.<sup>118</sup>

---

109. *See id.* at 126 (highlighting other factors relevant to honesty, including: (1) the debtor’s good faith and candor in filing schedules and other documents; (2) whether he was engaged in “eve of bankruptcy purchases;” and (3) whether he was forced into Chapter 7 by unforeseen or catastrophic events).

110. *See id.* at 126-27 (stating that other factors relevant to need include: (1) whether a debtor enjoys a stable source of future income; (2) whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code; (3) whether there are state remedies with the potential to ease his financial predicament; (4) the degree of relief obtainable through private negotiations; (5) the degree of relief obtainable through private negotiations; and (6) whether a debtor’s expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities).

111. *See id.* at 127 (noting that a “bright-line” test would encourage debtors to run up unsecured debts in excess of \$100,000, thereby avoiding dedication of future earnings to debt retirement under Chapter 13).

112. 934 F.2d 568 (4th Cir. 1991).

113. *See id.* at 573 (remanding the case to the district court for determination of substantial abuse based on a “totality of the circumstances” analysis).

114. *See id.* at 571-72 (rejecting the rule of *In re Kelly* on the basis that the court in that case made an unsupported logical leap in concluding the ability to repay debt is a decisive factor in evaluating substantial abuse).

115. *See id.* (noting that the cases supporting the rule established in *In re Kelly* only supported the employment of repayment ability as one of several factors).

116. *See id.* at 572 (noting that employing a totality of the circumstances approach allows the court to determine more accurately whether the particular debtor’s case invokes the real concern behind Section 707(b)—a debtor abusing the bankruptcy process by taking advantage of creditors).

117. *See id.* (stating that the totality of the circumstances approach involves an evaluation of factors such as: “(1) whether the debtor filed the bankruptcy because of sudden illness, calamity, disability, or unemployment; (2) whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay; (3) whether the debtor’s proposed family budget is excessive or unreasonable; (4) whether the debtor’s schedules and statement of current income and expenses reasonably and accurately reflect his financial condition; and (5) whether the debtor filed in good faith”).

118. *See id.* (suggesting that while a debtor’s ability to repay may raise an inference that there is substantial abuse, it does not by itself demonstrate such abuse).

## II. THE BANKRUPTCY REFORM ACT OF 2001: FORMULATION AND ARTICULATION

### A. *Legislative Formulation of the Reform Act*

The Bankruptcy Reform Act of 2001 (“Reform Act”) is a culmination of several years of congressional work,<sup>119</sup> as debate on how to reform the system began in 1997.<sup>120</sup> The 106th Congress passed the Gekas-Grassley Bankruptcy Reform Act of 2000, which was “virtually identical”<sup>121</sup> to the Reform Act of 2001.<sup>122</sup> However, President Clinton pocket-vetoed the conference report on December 19, 2000.<sup>123</sup> Another attempt at reformation in the 107th Congress commenced on January 31, 2001, an effort that came to be known as the Bankruptcy Reform Act of 2001.<sup>124</sup> Currently, a conference committee is reconciling the House and Senate versions of the Reform Act, making it likely that the Act will not face a full vote of Congress until 2002.<sup>125</sup>

These recent attempts to reform the U.S. bankruptcy system were a response to a “bankruptcy crisis”<sup>126</sup> in which a record number of consumers filed for bankruptcy during a time of economic prosperity.<sup>127</sup> The source of the crisis is debated: some suggest it is

---

119. See H.R. REP. NO. 107-3, pt. 1, at 3 (2001) (stating that “H.R. 333 is the product of more than 3 years of Congressional consideration of bankruptcy reform legislation” that included seventeen hearings with testimony from nearly 130 witnesses, representing “nearly every major constituency in the bankruptcy community”).

120. See *id.* (noting that bankruptcy reform legislation began in the 105th Congress with the passage of the Bankruptcy Reform Act of 1998 that had a conference report passed by “veto proof” margins, and was followed by the 106th Congress and House Bill 2415).

121. *Id.*

122. See generally Gekas-Grassley Bankruptcy Reform Act of 2000, H.R. 2415, 106th Cong. (2000) (proposing reform to the U.S. consumer bankruptcy system by limiting access to Chapter 7 relief to debtors capable of paying a portion of their debts).

123. See H.R. REP. NO. 107-3, pt. 1, at 3 (highlighting the demise of the Gekas-Grassley Bankruptcy Reform Act of 2000).

124. See Linda Reid, *Bankruptcy Reform Legislation, The Good, the Bad and the Unknown*, 36 ARK. LAW. 17, 17 (2001) (outlining the in-depth legislative history of the current bankruptcy reform legislation). On July 18, 2001, the Senate voted 82-to-16 to adopt the Senate’s language to the reform measure under the same bill number of the House-passed House Bill 333. See *id.* (noting that this action made the Senate and House versions virtually indistinguishable).

125. See *supra* note 11 and accompanying text (noting that the Reform Act is currently tied up in the House of Representatives on an unrelated amendment dealing with bankruptcy treatment of abortion protestors).

126. Bermant & Flynn, *supra* note 15, at 22.

127. See *supra* note 15 and accompanying text (highlighting the irony of having a record number of consumers filing for bankruptcy during a time of economic prosperity).

due to consumer abuse of the system,<sup>128</sup> while others contend that credit card providers' aggressive marketing to low-income households spawned the crisis.<sup>129</sup> Despite this debate, the legislative history of the Reform Act indicates that Congress believed that consumer abuse caused the crisis.<sup>130</sup> Therefore, the Reform Act can be properly regarded as an attempt to address and eliminate perceived consumer abuse.

*B. The Legislative Details for Eligibility Under the Reform Act*

The Reform Act<sup>131</sup> proposes substantial changes to the current U.S. bankruptcy system, as codified at 11 U.S.C. § 707(b).<sup>132</sup> Structurally, the Reform Act changes the "Dismissal" heading of section 707 to "Dismissal of a case or conversion to a case under Chapter 11 or 13."<sup>133</sup> The Act also replaces the debated "substantial abuse" language in section 707(b) with only "abuse."<sup>134</sup>

The most important substantive change for consumer debtors, however, is that, with the imposition of a means test, the proposed reform actually defines "abuse."<sup>135</sup> The means test is significant because a debtor now faces a presumption of abuse in every Chapter 7 filing that fails the means test.<sup>136</sup> However, a debtor may still avoid dismissal or conversion of a Chapter 7 filing even when he fails the means test if his household income is less than the household median income for his state of residency.<sup>137</sup> The Reform Act of 2001

---

128. See *supra* notes 15-19 and accompanying text (discussing the current paradoxical bankruptcy crisis).

129. See Stephen Brobeck, *Consumer Federation of America: Recent Trends in Bank Credit Card Marketing and Indebtedness*, AMERICAN BANKRUPTCY INSTITUTE, at [http://www.abiworld.org/research/cfa\\_credit\\_study\\_7-98.html](http://www.abiworld.org/research/cfa_credit_study_7-98.html) (July 1998) (reporting on studies conducted in 1998 that attempted to ascertain the tendencies of the consumer credit industry) (on file with the American University Law Review).

130. See H.R. REP. NO. 107-3, pt. 1, at 5 (2001) (stating that House Bill 333 was formulated to respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system).

131. This Comment will refer to both Senate Bill 420 and House Bill 333 as the Bankruptcy Reform Act. The sections addressing a consumer's ability to file under Chapter 7 are identical under the two versions. See *supra* note 124 and accompanying text.

132. See *infra* notes 133-158 and accompanying text (elaborating on the changes to the United States bankruptcy system).

133. Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. § 102 (2001).

134. *Id.*

135. *Id.*

136. See discussion *infra* Part II.B.1 (noting the details of the means test for a debtor's eligibility to receive a Chapter 7 discharge under the Reform Act).

137. See discussion *infra* Part II.B.2 (discussing the median income test).

essentially provides debtors with two independent tests for eligibility under Chapter 7: (1) a means test and (2) a median income test.

1. *Test 1: The means test and defeating the presumption of abuse*

Under the means test, the focus of the judicial inquiry is the debtor's ratio of income to unsecured debt.<sup>138</sup> As was mentioned above, there is a presumption of abuse applied to all debtors who fail the means test.<sup>139</sup> The debtor passes the means test only when the debtor's "excess income"—calculated by reducing current monthly income<sup>140</sup> by specific categories of expenses<sup>141</sup> and multiplied by sixty—is greater than or equal to the lesser of either: (1) twenty-five percent of the debtor's non-priority unsecured claims in the case, or \$6,000, whichever is greater; or (2) \$10,000.<sup>142</sup>

This complicated test implies that a consumer debtor, regardless of debt total, is ineligible for a full Chapter 7 discharge under the means test if the amount of their excess income exceeds \$10,000.<sup>143</sup> However, if a debtor owes between \$24,000 and \$48,000 in unsecured debt, the excess income figure cannot exceed twenty-five percent of the amount owed.<sup>144</sup> For those who owe less than \$24,000 in unsecured debt, their excess income figure must be less than \$6,000 to be eligible for Chapter 7 discharge.<sup>145</sup>

Definitions of monthly income and expenses are critical to the evaluation of a filing under the means test. Income is defined as the average monthly income the debtor earns during the six-month period preceding the date of the determination of eligibility.<sup>146</sup> Expenses are defined in three categories, all of which are deductible

---

138. See H.R. Rep. No. 107-3, pt. 1, at 8 (2001) (explaining that Section 102 implements "need based" bankruptcy reform and permits the court to dismiss a Chapter 7 case for abuse if the debt for which the debtor seeks relief is primarily consumer debt).

139. See *id.* (discussing the replacement of the current presumption in favor of the debtor with a mandatory presumption of abuse triggered by certain criteria).

140. See H.R. 333 § 102(b) (defining current monthly income as the average income from all sources during the preceding six month period, including any third party assistance to household expenses, but excluding Social Security benefits and certain other payments); see also *supra* Part II.B.2 and accompanying text (discussing the exception for income below the median level of the debtor's state of residence).

141. See *infra* notes 148-159 and accompanying text (describing the three categories of deductible expenses).

142. H.R. 333 § 102(a)(1).

143. See *id.* (characterizing the means test as the criteria for determining whether a "grant of relief would be an abuse of the provisions of this chapter").

144. See *id.* (describing the eligibility requirements under the means test).

145. See *id.* (describing in further detail the treatment of a particular debtor when then income dips below a certain threshold).

146. *Id.*

against this monthly income determination.<sup>147</sup>

The first category of deductible expenses is the debtor's monthly expenses.<sup>148</sup> Monthly expenses include and exclude a variety of typical living expenses.<sup>149</sup> Specifically, the debtor's monthly expenses may include actual expenses the debtor pays that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled immediate family member<sup>150</sup> who would be unable to pay for such care otherwise.<sup>151</sup> Deductible monthly expenses can also include actual expenses up to \$1,500 a year for a child to attend a private or public elementary or secondary school, provided the child is dependent and under the age of eighteen.<sup>152</sup> The "debtor's payments for unsecured debts" is the main expense that is not deductible from the monthly income determination.<sup>153</sup>

The second category of deductible expenses is monthly payments on secured debts.<sup>154</sup> These payments are the sum of amounts contractually due to secured creditors in each of the sixty months following the date of the petition, and any additional payments to secured creditors necessary to maintain possession of the debtor's primary residence, motor vehicle, or other property that serves as collateral for secured debts but is also required to support the debtor and the debtor's dependents.<sup>155</sup> That figure is divided by sixty in order to get the monthly average, which is deductible from the debtor's total income.<sup>156</sup>

---

147. See *infra* notes 148-59 and accompanying text (detailing the three categories of expenses that are deductible from a debtor's monthly income determination).

148. H.R. 333 § 102(a)(1).

149. See *id.* (explaining that the Internal Revenue Service Financial Analysis Handbook sets out "National Standards and Local Standards" and the list of "Other Necessary Expenses" in order to calculate acceptable monthly expenses).

150. See *id.* (stating that immediate family members include "parents, grandparents, and siblings of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent").

151. An additional monthly allowance is allowed for food and clothing. See *id.* (limiting this allowance to five percent of the food and clothing categories specified by the National Standards issued by the Internal Revenue Service).

152. See *id.* (noting that the debtor must provide documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary). If the debtor is eligible for Chapter 13, the monthly expenses can include administrative expenses of overseeing a Chapter 13 plan for the district in which the debtor resides. See *id.* (limiting this deductible expense to ten percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees).

153. *Id.*

154. See *id.* (noting that expenses due to secured creditors are deductible from the debtor's monthly income determination).

155. *Id.*

156. *Id.*

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 327

The third category of deductible expenses includes payments of priority debt claims.<sup>157</sup> Priority claims typically include payment of federal, state, and local taxes, and “administrative expenses incurred in administration of the bankruptcy filing.”<sup>158</sup> Again, the total amount is divided by sixty in order to arrive at the monthly expense figure for priority claims, which is deducted from the debtor’s total monthly income.<sup>159</sup>

Although the Reform Act would allow these three categories of expenses to be deducted from income, the court may deduct other expenses if they are itemized, documented, and accompanied with a detailed explanation of the special circumstances necessitating the expenses.<sup>160</sup> If a debtor fails to satisfy the means test even with these deductions, his fate in Chapter 7 bankruptcy remains dependent upon the median income test.

## 2. Test 2: The median income test

The means test is not a debtor’s only opportunity to obtain a Chapter 7 discharge. Under the Reform Act, if a debtor satisfies the median income test, a debtor is allowed to receive a discharge under Chapter 7 despite failing the means test.<sup>161</sup> The median income test compares a debtor’s monthly income with the median monthly income in the debtor’s state of residency.<sup>162</sup>

If a debtor’s current monthly income, assuming the debtor lives in a household of one, when “multiplied by twelve is equal to or less than . . . the median family income of the applicable State for one earner last reported by the Bureau of the Census,”<sup>163</sup> then the debtor can still procure a Chapter 7 discharge despite failing of the means test.<sup>164</sup> In the cases of households with more than one person, the filing cannot be dismissed when the household income is less than the State’s median family income with the corresponding number of

---

157. *See id.* (stating that payments made on priority claims, such as child support and alimony, are deductible from the debtor’s total monthly income).

158. *See* 11 U.S.C. § 507(a)(1)-(9) (2000) (listing expenses and claims in order of priority for a bankruptcy proceeding).

159. H.R. 333 § 102(a).

160. *See id.* (creating another exception from the monthly income total for a demonstration of special circumstances necessitating additional monthly expenses or an adjustment to the monthly income determination). House Bill 333 clearly specifies that there can be no reasonable alternative to the additional expenses in order to demonstrate a special circumstance. *Id.*

161. *See id.* (explaining that a court can deny a motion to dismiss or convert if the debtor’s monthly income multiplied by twelve is between 100 and 150% of the median income in the debtor’s state of residency).

162. *Id.*

163. H.R. 333 § 102.

164. *Id.*

people in the household.<sup>165</sup>

For example, a debtor living in the State of Massachusetts with a spouse, two children, and a yearly household income of \$70,000 will be eligible to seek a Chapter 7 discharge regardless of a failure of the means test because the median income of a four person household in 1999 in Massachusetts was \$71,689.<sup>166</sup> If that same family lived in the State of Missouri, however, the debtor would not be eligible for relief under the median family income test because the median income for a four person household in Missouri in 1999 was \$56,673.<sup>167</sup> In Missouri, the debtor would be ineligible for a discharge under Chapter 7, and would be required to withdraw the bankruptcy petition or seek relief under a Chapter 13 repayment plan.

### 3. *Exceptions: Special circumstances and bad faith*

As discussed in Part II.B.1-2, an exception for special circumstances exists to allow additions to formulations of income and expenses that may make a difference in a debtor's successful passage of either the means test or the median income test.<sup>168</sup> The court determines special exceptions and a debtor must present extensive documentation to persuade the court to make special additions or subtractions.<sup>169</sup>

On the other hand, there is an exception to eligibility for a Chapter 7 discharge if there is evidence of bad faith.<sup>170</sup> Even if a particular debtor meets the requirements of either the means test or the median income test, a court can dismiss a Chapter 7 filing or convert a filing to Chapter 13 if the court finds that the debtor filed the petition in "bad faith" or if the "totality of the circumstances" of

---

165. *See id.* (stating that in the case of a debtor from a household exceeding four individuals, the median income will be compared to the highest median family income of the applicable State for a family of four or fewer individuals last reported by the Bureau of the Census plus \$525 per month for each individual in excess of four).

166. *See* U.S. Census Bureau, *Median Income for 4-Person Families, by State* (Mar. 2, 2002) (providing information regarding four-person family median income by state), available at <http://www.census.gov/hhes/income/4person.html> (last revised Aug. 22, 2002).

167. *See id.* (revealing that Missouri's four-person family median income is approximately average for the incomes of all fifty states).

168. *See* discussion *supra* Part II.B.3 (discussing the special circumstances exception to the Reform Act).

169. *See* H.R. 333 § 102 (noting that while a determination of special circumstances is left to the discretion of the court, extensive documentation providing background and supplemental information regarding the special circumstances is required before the court begins to employ its discretion).

170. *See infra* note 171 and accompanying text (discussing the bad faith exception to the Reform Act).

the debtor's financial situation demonstrates abuse.<sup>171</sup>

### III. ANALYSIS: BANKRUPTCY REFORM AT THE RIGHT TIME AND IN THE RIGHT PLACE

Critics and supporters of bankruptcy reform have long debated measures similar to the Reform Act. This Part addresses these contentions and analyzes the Reform Act in the context of these arguments.

#### A. *The Legal Justifications: A Universally Applicable Test*

As noted in Part I.D, the circuit courts have used three different tests to determine how to apply the substantial abuse requirement under the current system.<sup>172</sup> These circuit court cases represent the range of the significance that courts place on the ability to repay when making a substantial abuse determination.<sup>173</sup> Although the significance of the ability to repay varies, it is a constant factor relevant to any Chapter 7 judicial inquiry.<sup>174</sup>

When courts determine a debtor's ability to pay, they construct a "hypothetical Chapter 13 plan for the debtor."<sup>175</sup> Under Chapter 13, if the trustee or holder of an allowed unsecured claim objects to the confirmation of a proposed plan, the court cannot confirm the plan unless the debtor either pays the claim in full or dedicates all of his disposable income<sup>176</sup> to the plan for a period of three years.<sup>177</sup> Once the court determines the monthly disposable income, the amount is multiplied by the number of planned payments, which is usually over a thirty-six month period.<sup>178</sup> The projected amount is a percentage of

---

171. See H.R. 333 § 102 (including in the totality of the circumstances analysis whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor).

172. See discussion *supra* Part I.D (highlighting the three modes of interpretation of "substantial abuse").

173. See Mitchell, *supra* note 94, at 365 (arguing that the four circuit court opinions are best viewed on a "continuum with the Ninth Circuit's *Kelly* and the Eighth Circuit's *Walton* at one end, the Fourth Circuit's *Green* at the other, and the Sixth Circuit's *Krohn* somewhere in the middle.").

174. See *id.* at 368 (stating that "regardless of which test is used, a debtor's ability to pay his debts is relevant to the outcome.").

175. *Id.* at 368.

176. See 11 U.S.C. § 1325(b)(2) (1998) (defining disposable income as "income which is received by the debtor and which is not reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor. . .").

177. See *id.* (explaining that Chapter 13 plans cannot be extended over a longer period than three years unless the court extends that period for "cause").

178. See Mitchell, *supra* note 94, at 369 (describing the process by which disposable income is determined over a three-year Chapter 13 plan period).

the debt owed and is the focal point for determining ability to repay.<sup>179</sup>

There is no bright line test for determining what percentage of disposable income triggers a presumption of an ability to repay.<sup>180</sup> However, the courts that have set a minimum standard have generally held that if a debtor can pay “more than 50% of his/her debts through a Chapter 13 plan, [the case is likely to be dismissed] for substantial abuse of Chapter 7.”<sup>181</sup>

Although a great deal of uncertainty exists as to what clearly constitutes an ability to repay under the current structure, the Reform Act clarifies this question and imposes a universal legal standard.<sup>182</sup> Despite the fact that the means test and median income test are lengthy and laced with definitional details and exceptions,<sup>183</sup> they provide a common standard by which every individual seeking relief under Chapter 7 will be evaluated.

Critics of the Reform Act argue that the clarity of law is not as ideal as one might think,<sup>184</sup> positing that an unambiguous provision can prevent the judicial system from responding to cases that involve abuse yet meet the statutory requirements for a discharge.<sup>185</sup> The typical example illustrating this proposition is an individual with sizable unsecured debts who seeks a full discharge and stops working for the six month period prior to determination to reduce his monthly income to the point at which he could pass either test for eligibility under Chapter 7.<sup>186</sup>

This scheme is likely to fail in procuring a discharge under the Reform Act for one key reason: it would trigger the bad faith exception, noted in Part II.B.3, and be summarily dismissed.<sup>187</sup>

---

179. *See id.* at 369-70 (stating that the percentage of disposable income that a debtor can pay toward his debts is the decisive factor in ascertaining an ability to pay for current substantive abuse determinations).

180. *See id.* (noting that there is always uncertainty as to which court will require what percentage in an ability to repay analysis).

181. *In re Vianese*, 192 B.R. 61, 70-71 (Bankr. N.D.N.Y. 1996); *see also In re Smith*, No. 94-01953, 1995 WL 20345, at \*2 (Bankr. D. Idaho Jan. 11, 1995).

182. *See* discussion *supra* Parts II.B.1-2 (describing the uniformity of the law incident to the means and median income tests).

183. *See id.* (presenting the details of the means and median income tests).

184. *See* Jack F. Williams, *Ruminating on the Proposed Bankruptcy Bill*, 20-AUG AM. BANKR. INST. J. 6, 45 (2001) (noting that most key provisions throttle discretion of bankruptcy judges, relegating them to administrators).

185. *See* Reid, *supra* note 124, at 19 (explaining that “experts anticipate many individuals will manipulate their financial status by reducing their present income or by artificially inflating their debts in order to qualify for relief under the proposed Chapter 7.”).

186. *See id.* (presenting theories on how the debtors can abuse the proposed Reform Act).

187. *See* discussion *supra* Part II.B.3 (describing the bad faith exception to

Courts can use the bad faith exception as a safety net to allow the judicial system to freely maneuver and intercept suspicious activity within the confines of the means test and the median income test.<sup>188</sup> Therefore, the reform provides the best of both worlds: legal clarity and enforceable maneuverability.

*B. The Moral and Social Justifications:  
A Fresh Start to Only Those Who Need It*

Although bankruptcy law may appear to be purely economic in nature, in many ways it also serves as social legislation.<sup>189</sup> Lending transactions implicitly include a moral obligation of repayment.<sup>190</sup> This obligation of reciprocity is derived from both social pressures and religious doctrines.<sup>191</sup> However, in some circumstances an individual's debt repayment is simply impossible.<sup>192</sup> Therefore, morally speaking, bankruptcy should be a vehicle for forgiving the needy while preventing abuse and avoidance of obligations.<sup>193</sup>

Avoidance of the moral responsibilities incident to acquisition of debt has tremendous implications for society.<sup>194</sup> For example, the "rejection of economic obligations by filing [for] bankruptcy tears at the web of reciprocal relationships that underlies society" and can have profound and far-reaching consequences on other areas of society.<sup>195</sup> Most notably, rejecting these obligations can have a

---

eligibility under the Reform Act).

188. See discussion *supra* Parts II.B.1-2 (presenting the means and median income tests).

189. See Todd J. Zywicki, *Bankruptcy Law As Social Legislation*, 5 TEX. REV. L. & POL. 393, 394 (2001) (noting that bankruptcy law essentially creates a system of "legalized post-contractual opportunism" that is only justified by the moral principle that an honest but unfortunate debtor is entitled to discharge their debts).

190. See *id.* at 397-98 (explaining the web of reciprocal promises between lender and borrower symbolizes the essence of humanity causing people to feel a natural affinity to satisfy their promises and expect the same from others); see also Rafael Efrat, *The Moral Appeal of Personal Bankruptcy*, 20 WHITTIER L. REV. 141, 162-67 (1998) (discussing how many religions encourage debt repayment and the avoidance of bankruptcy).

191. See Zywicki, *supra* note 189 at 398-99 (noting that Christianity, Islam, Judaism, and Hinduism foster in their believers a moral code emphasizing the importance of debt repayment and the avoidance of bankruptcy). For example, the Golden Rule is "a rule that exemplifies the reciprocity that underlies the social and economic system." *Id.* at 398.

192. See *id.* at 398-99 (implying that despite these religious commands there are always situations when reciprocity is not possible and the debtor's moral obligation of reciprocity is no longer required).

193. See *id.* at 399 (discussing bankruptcy's tension between helping the needy and avoiding abuses of the system's benefits).

194. See *infra* notes 195-206 and accompanying text (describing the social implications of debt avoidance).

195. Zywicki, *supra* note 189, at 400, 405. Zywicki espouses that a healthy, free, and prosperous society can be imagined as a "three-legged" stool in which all three

negative impact on efficient economic activity by undermining trust in transactions.<sup>196</sup> When there is a lack of social trust in an economy, more resources are needed to monitor and enforce promises, thus preventing economic expansion.<sup>197</sup> Additionally, in order for democracy and the rule of law to prosper, social trust and reciprocity must be maintained.<sup>198</sup> This rule of law is “rooted in notions of reciprocity, namely that political leaders and subjects owe reciprocal obligations to one another.”<sup>199</sup> If the foundation of reciprocity is undermined, political obligations, such as in democracies, weaken.<sup>200</sup> Without reciprocity, majorities would create systems of repression, rather than freedom.

Evidence of this symbiotic relationship can also be demonstrated on an individual level; an individual’s ability to break promises, in the form of debt avoidance, may “spill over” and corrupt the individual’s responsibility and reciprocity in other areas of life.<sup>201</sup> Additionally,

---

legs are necessary for society to prosper. *Id.* at 400-01. The three legs are “(1) a market economy, (2) democratic politics under a rule of law, and (3) healthy institutions of civil society that inculcate habits of reciprocity and personal responsibility in one’s citizens.” *Id.* Each leg is dependent upon the strength of the other legs, and each must work together with the other legs to bear the burden of supporting freedom, prosperity, and individual happiness. *Id.* Therefore, when the “leg” of reciprocity and personal responsibility are undermined by an easily accessible bankruptcy system, the other legs of the stool are affected. *Id.*

196. *See id.* at 401-02 (discussing how suspicion and irresponsibility are not found in the most prosperous economies because economic rewards come to citizens who fulfill their duties of morality).

197. *See id.* (stating that societies with higher degrees of social trust tend to grow faster economically and are wealthier than low-trust societies because fewer resources are used to monitor and enforce promises and leaving increased resources for economic expansion).

198. *See id.* at 403 (“[The] concept [of reciprocity] underlies the birth of the concept of the rule of law in Western Europe and its eventual evolution into the concept of constitutions that bind sovereign and subjects alike.”).

199. *Id.*

200. *See id.* at 403-04 (noting that weak relations of morality and civil society provide “shallow soil for planting the seeds of economic and political freedom”). Poland offers evidence that strong moral and civil relations stimulate economic growth because the transition there to a free market economy and democratic politics can be attributed to the flourishing Catholic Church and labor unions, despite previous Communist control. *Id.* In Poland, these institutions “provided a structure of morality and institutional legitimacy that inculcated the social trust on which economic and political freedom could grow.” *Id.*

201. *Id.* at 405. There is a strong correlation between bankruptcy filing rates and divorce rates suggesting that bankruptcy and divorce are caused by an individual’s inability to keep promises when obligations become costly or difficult to maintain. *See id.* (noting this thesis should be distinguished from the argument that divorce causes bankruptcy by creating financial distress; the argument here is that bankruptcy and divorce correlate when measured against the independent variable of an individual’s propensity to break promises); *see also* F.H. Buckley & Margaret F. Brinig, *The Bankruptcy Puzzle*, 27 J. LEGAL STUD. 187, 205 (1998) (analyzing statistical data indicating that social variables, such as divorce coefficients, complete the analysis of bankruptcy filing rates).

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 333

unchecked irresponsible behavior may tacitly encourage similar behavior in persons associated with bankruptcy filers.<sup>202</sup> As a result, there is little incentive for an individual to sacrifice by living within his means while the neighbor next door lives extravagantly and is free of financial burdens with little or no consequence.<sup>203</sup> A bankruptcy system that promulgates the moral obligations of reciprocity and responsibility will ensure that the social consequences discussed above are avoided.

The Reform Act reinforces these moral obligations by implementing the means test, which addresses morally repugnant discharges by limiting Chapter 7 filing to needy debtors.<sup>204</sup> Studies have estimated that anywhere between one<sup>205</sup> and five<sup>206</sup> billion dollars annually can be repaid by debtors, who under current law, receive a total discharge of debts. This range of repayable debt represents numerous broken promises that weigh down society. The institution of the means test will aid in insuring that debts are repaid and the ideals of reciprocity are pursued. The median income test, on the other hand, will help to insure that the needy have an avenue of recourse at their disposal. Therefore, both moral objectives of bankruptcy are fulfilled.

---

202. See Zywicki, *supra* note 189, at 406-07 (noting that the current bankruptcy system rewards irresponsible behavior and penalizes individuals living within their means; consequently, more and more Americans end up walking away from their debts rather than facing the challenge of living within their means and fulfilling their responsibilities).

203. See *id.* (noting that current consumer bankruptcy trends contradict the morality of Aesop's fable of the grasshopper and the ant that highlighted the importance of planning ahead, diligent saving, and a strong work ethic).

204. See discussion *supra* notes 138-42 and accompanying text (detailing the means test).

205. See GORDON BERMANT & ED FLYNN, EXECUTIVE OFFICE FOR U.S. TRUSTEES, INCOMES, DEBTS, AND REPAYMENT CAPACITIES OF RECENTLY DISCHARGED CHAPTER 7 DEBTORS 5 (1999), at <http://www.abiworld.org/legis/reform/eoust-99jan.html> (considering a variety of factors that would reduce the amount over median income debtors could repay; the authors concluded that approximately \$1 billion could be repaid annually through a means test) (on file with the American University Law Review). See also Marianne B. Culhane & Michael M. White, *Taking the New Consumer Bankruptcy for a Test Drive: Means-Testing for Real Chapter 7 Debtors 2*, at <http://www.abiworld.org/research/creightonstudy.html> (1998) (uncovering similar amounts of an additional four billion dollars, to the Bermant/Flynn study that could be repaid by over-median income debtors) (on file with the American University Law Review).

206. See J. Barron & M. Staten, *Personal Bankruptcy: A Report on Petitioners' Ability to Pay*, CREDIT RESEARCH CENTER, GEORGETOWN UNIVERSITY (1997) (basing findings on 2,441 Chapter 7 cases filed during 1996 in thirteen cities); see also Gordon Bermant & Ed Flynn, *Incomes, Debts, and Repayment Capacities of Recently Discharged Chapter 7 Debtors*, American Bankruptcy Institute (July 8, 1999) (basing results on a study including 2,220 cases drawn from all ninety judicial districts that were filed during 1997) (citing T. Neubig & F. Scheuren, *Chapter 7 Bankruptcy Petitioners' Ability to Repay: the National Perspective*, ERNST & YOUNG L.L.P. (1998)), available at <http://www.abiworld.org/legis/reform/eoust-99jan.html>.

In terms of the individual, the Reform Act will provide statutory incentives for debtors to live within their financial means by eliminating the tantalizing allure of frivolous and liability-free spending.<sup>207</sup> By living within one's means, there is a tacit promotion of personal responsibility in other areas of life. Therefore, the Reform Act will not only stop the "bleeding" caused by current law,<sup>208</sup> but also help to promote a systemic sense of an individual's moral obligations to repay his debt.

*C. The Economic Justification:  
Promoting the Availability of Affordable Consumer Credit*

As the U.S. economy lingers in a recession, the economic impact of the bankruptcy reform becomes increasingly important.<sup>209</sup> As critics of the Act have emphasized, at a time of economic retraction, the last thing consumers need is a bankruptcy reform that limits their access to Chapter 7 relief.<sup>210</sup> However, the Reform Act may actually stave off the growth of a potentially harmful economic reality: the unavailability of consumer credit.

A primary concept in lending transactions is the distribution of risk and the maximization of profits.<sup>211</sup> A primary rule in this regard is

---

207. See discussion *supra* Parts II.B.1-2 (describing how the means and median income tests will help reduce the amount of debtors who may be able to repay a portion of their debt).

208. See discussion *supra* Part I.C (describing current consumer bankruptcy eligibility).

209. Greg Ip, *It's Official: Economy Is in a Recession*, WALL ST. J., Nov. 27, 2001, at A2. According to the National Bureau of Economic Research, the United States economy slipped into a recession during March of 2001. *Id.* The Bureau defines a recession as a "widespread decline in economic activity lasting more than a few months," and is determined by assessing a variety of factors including "industrial production, employment, real incomes, minus government benefits, and real wholesale and retail sales." *Id.*

210. See American Bankruptcy Institute, *Today's Bankruptcy Headlines: Sept. 11 Plays Role in Opinions During Bankruptcy Panel Meeting*, Daily Bankruptcy Review (Nov. 15, 2001), at <http://www.abiworld.org/headlines/TODAY.html> (citing Senator Paul Wellstone's statement that "[i]n the best of times, this bill would be terrible for consumers and regular working class families, but its effects will be all the more devastating now that we have a weakening economy.") (on file with the American University Law Review). House Judiciary Committee ranking member John Conyers noted that "[w]hile our nation is engaged in a recession and has a military engagement abroad, I strongly object to what is about to happen in this conference . . . [while] the economy is shrinking. Half a million people lost their jobs last month and more are losing them each day." *Id.*

211. Rocco I. Debitetto, Comment, *Bankruptcy Reform in Light of Increased Consumer Filings: Means-Testing Employed to Prevent Long-Run Economic Impacts on Consumers and to Cure Debtor Abuse Under the Current Bankruptcy Code*, 69 U. CIN. L. REV. 641, 646-47 (2001) (highlighting the "bedrock" economic principle that "individuals and firms engaged in consumer credit transactions always act as profit maximizers") (quoting Phillip Shuchman, *Theory and Reality in Bankruptcy: The Spherical Chicken*, 41 L. & CONTEMP. PROBS. 66, 71 (1977)). These maximized profits are directly and positively

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 335

that the cost of lending is directly proportional to consumer interest rates and inversely proportional to the quantity of funds supplied by creditors.<sup>212</sup> The cost of lending is “alternative lending opportunities foregone in lieu of making a loan to a consumer, many of which may be less risky.”<sup>213</sup> Applying the aforementioned rule, the riskier the consumer loan, the higher the interest rates will be and as a result, creditors will be more hesitant to fund these risky loans.<sup>214</sup>

Applying these two concepts to the current bankruptcy crisis, it becomes evident that the current situation is not favorable for consumers.<sup>215</sup> The primary risk for a consumer lender is that the borrower will enter into bankruptcy.<sup>216</sup> With the current bankruptcy system in which Chapter 7 discharges are on the rise as a result of debtor abuse, the risk for lenders increases proportionally.<sup>217</sup> As the risk grows, the interest rates for consumer loans rises and the quantity of funds available for loans decreases.<sup>218</sup> In the end, the costs will be passed on to the consumer.<sup>219</sup>

The sluggish economy compounds the problem for consumers.<sup>220</sup> Increased lending costs and decreased credit availability are the last thing that an economy desperately seeking an influx of consumer spending needs.<sup>221</sup> If credit is harder and costlier to obtain,

---

correlated to risk. William H. Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 L. & CONTEMP. PROBS. 13, 21 n.20 (1977).

212. See Meckling, *supra* note 211, at 16, 21 (explaining that the funds available to a particular group of borrowers is completely elastic when interest rates are appropriately set within that market). Thus, when a consumer has a higher risk coefficient, interest rates will be higher but the market for funds will remain responsive to shifts in the supply and demand curves. *Id.* at 21. As profit maximizers, lenders have a strong incentive to minimize administrative costs and mitigate any possible losses from insolvent borrowers. *Id.* at 22.

213. Debitetto, *supra* note 211, at 647.

214. See *id.* at 648 (expounding upon the role of lenders as profit maximizers in pursuing a “riskless” rate of return and requiring sufficient compensation for risks beyond a minimum threshold of risk).

215. See *infra* notes 216-24 and accompanying text (indicating how the current situation indicates that the cost of consumer credit will increase and the supply will decrease).

216. See Debitetto, *supra* note 211, at 649 (explaining that this risk will, in turn, be passed on to consumers by raising the interest rates on loans).

217. See *supra* notes 18-19 and accompanying text (describing the recent rise in consumer bankruptcy filings).

218. See Debitetto, *supra* note 211, at 647-48 (presenting the “distribution of risk” equation).

219. See *id.* at 649 (estimating that the loss passed on to consumers in the form of higher interest rates approaches a revolving balance of \$300 per household annually).

220. See *supra* notes 1-5 and accompanying text (highlighting data indicating the current situation of the U.S. economy).

221. See Debitetto, *supra* note 211, at 650 (noting that the long term impact of an increase in credit prices or a reduction in available credit will adversely affect the overall economy).

consumers will be forced to cut back on purchasing “big ticket” items, such as vacations, requiring the use of unsecured credit.<sup>222</sup> The reduction in consumer spending lowers business sales and profits and exacerbates the current economic conditions the United States faces.<sup>223</sup> As a result, businesses trim their payrolls in order to budget for this decrease in sales and more consumers lose their jobs.<sup>224</sup>

Implementation of the Reform Act is a step towards assuring that those circumstances do not materialize. The Reform Act’s means test will restrict Chapter 7 discharges and therefore, decrease creditor risk.<sup>225</sup> The size of this risk reduction is arguable. Reports indicate that the creditors would annually recover anywhere from one to five billion dollars due to implementation of the means and median income tests.<sup>226</sup> Whatever the actual figure turns out to be, it will still be a sizable return of money and a proportionate decrease in creditor risk.<sup>227</sup>

Applying the economic theory of risk mentioned above,<sup>228</sup> the borrowing rates of creditors should decrease in proportion to creditor risk, while the amount of available credit will increase because the quantity of funds is inversely proportional to the creditor risk.<sup>229</sup> Therefore, the Reform Act will help to ensure that, over the long-run, consumers will have the affordable, unsecured credit necessary to buy those “big ticket” items that will help reinvigorate the economy.<sup>230</sup>

Critics have been quick to point out that despite the recent rise in consumer bankruptcy filings, credit card companies have not responded with rate increases.<sup>231</sup> Although the data provided by the

---

222. *See id.* (explaining that state usury laws will not stop lenders from recouping costs through additional surcharges or increased annual fees).

223. *See generally* RICHARD G. LIPSEY ET AL., *ECONOMICS* 483-501 (7th ed. 1984) (discussing macroeconomic theory as it relates to unemployment and the impact unemployment has on an efficiently running economy).

224. *See id.* (discussing the impact that a reduction in consumer spending will have on employment rates).

225. *See* discussion *supra* Part II.A.1 (discussing the means test).

226. *See supra* notes 205-06 and accompanying text (citing studies identifying the amount of debt that creditors could recoup with the implementation of the means test).

227. *See supra* notes 216-19 and accompanying text (explaining the relationship between creditor risk and the cost and availability of credit).

228. *See supra* note 212 and accompanying text.

229. *See* Debitetto, *supra* note 211, at 650 (discussing the impact of the “distribution of risk” analysis on the current economy if the means test is not implemented).

230. *See id.* at 647-50 (connecting rampant bankruptcy with a decrease in affordable or available unsecured credit).

231. *See* Brobeck, *supra* note 129 (presenting data indicating that credit rates remain at a consistent rate of eighteen percent despite the increase risk of default

## 2002] MEANS TESTING UNDER THE BANKRUPTCY REFORM ACT 337

Consumer Federation of America supports this assertion,<sup>232</sup> the data does not prove that this Comment's argument that rates will rise in the future is inapplicable. In the short term, consumer credit suppliers are likely to accept the increased risk incident to the rise in consumer filings because "creditors are slow to change lending patterns to adjust to the increased cost of lending."<sup>233</sup> This result explains the lack of change in the cost of consumer credit over the past few years, and supports the argument that rates may rise in the future.

Once this equation is factored into a long-term analysis, it appears that the worst is yet to come for consumers. Consumer lenders, while slow to react to the increased cost of risk, will eventually respond and adjust rates accordingly to take into consideration the risk factor.<sup>234</sup> Therefore, it appears as though further harm to consumers is imminent.<sup>235</sup> Further, there is evidence indicating that consumers may already be out of time. The Consumer Federation of America study, which concluded that credit rates have remained steady the last few years, conceded that "banks have raised prices for some of their riskiest customers."<sup>236</sup>

## CONCLUSIONS AND RECOMMENDATIONS:

PASS

## THE LEGISLATION AND LET THE HEALING BEGIN!

As the economy lingers in a recession<sup>237</sup> and the number of consumer bankruptcies continues to spiral out of control,<sup>238</sup> it is clear that something needs to be done. This Comment strongly urges Congress to pass, and President Bush to sign, the Bankruptcy Reform Act of 2001 as soon as possible for three reasons. First, through the imposition of the Reform Act's means and median income tests, the current law on eligibility under consumer bankruptcy will become

---

under the current bankruptcy system).

232. See *id.* (presenting data that indicates no short-term rate effect incident to the increased risk in the extension of consumer credit).

233. Debitetto, *supra* note 211, at 648.

234. See *id.* at 648-49 (noting that, in a long-run analysis, lenders will eventually adjust their rates to reflect any increased costs of lending).

235. See Jack F. Williams, *Distrust: The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REV. 105, 107 (1999) (noting arguments that the current American bankruptcy system essentially imposes an annual \$400 "bankruptcy tax" on consumers by passing on increased costs of lending incurred by creditors to consumers).

236. Brobeck, *supra* note 129.

237. See *supra* notes 1-5 and accompanying text (presenting data illustrating the condition of the U.S. economy).

238. See *supra* note 18 and accompanying text (citing the seventy-two percent rise in consumer bankruptcy filings between 1994 and 1998).

clear and unified.<sup>239</sup> Second, the Reform Act's means test and median income test restrict morally and socially repugnant bankruptcy discharges while ensuring that debtors deserving a "fresh start" actually receive one.<sup>240</sup> Third, by restricting access to Chapter 7 bankruptcy through the means test, the costs of lending will decrease, thereby increasing consumer spending that can aid in reinvigorating the economy.<sup>241</sup>

U.S. bankruptcy law has come a long way from its inception at the Constitutional Convention in 1787.<sup>242</sup> Throughout history, it has been tailored to meet the needs and problems of society.<sup>243</sup> It has become increasingly evident that now is the time for another re-adaptation so that our bankruptcy law can be responsive to the economic problems facing our country today. The Bankruptcy Reform Act of 2001 is that needed and appropriate re-adaptation.

---

239. See discussion *supra* Part III.A (presenting a uniform legal standard as a justification for enacting the Reform Act).

240. See discussion *supra* Part III.B (presenting the facilitation of reciprocity as a social justification for enacting the Reform Act).

241. See discussion *supra* Part III.C (presenting the preservation of available and affordable consumer credit as an economic justification for enacting the Reform Act).

242. See U.S. CONST. art. I, § 8 (establishing "uniform laws of bankruptcy").

243. See discussion *supra* Part I (presenting a historical analysis of the U.S. bankruptcy system).