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**Bankrupt Profits:  
The Credit Industry's Business Model For  
Postbankruptcy Lending**

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**BANKRUPT PROFITS:  
THE CREDIT INDUSTRY’S BUSINESS MODEL FOR POSTBANKRUPTCY LENDING**

*Katherine Porter\**

*Consumer credit and consumer bankruptcy filings have grown rapidly over the last two decades, and several researchers have attempted to understand the relationship between these two intertwined features of the modern American economy. Teasing out causation is almost impossible, as consumer advocates lay blame on the industry and the industry responds by citing the same data to show consumer misbehavior. Using a novel vantage point, this analysis examines what the credit industry's behavior toward recently bankrupt families reveals about its internal profit models and the likely causes of consumer bankruptcy. The empirical evidence on postbankruptcy credit solicitation belies the industry’s characterizations of bankrupt families as opportunistic or strategic actors. Original data from longitudinal interviews with consumer debtors show that lenders target recent bankrupts, sending these families repeated offers for unsecured and secured loans. The modern credit industry sees bankrupt families as lucrative targets for high-yield lending, a reality that has important implications for developing optimal consumer credit policy and bankruptcy law.*

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## INTRODUCTION

The recent reform of America's bankruptcy law favored the interests of creditors. In the two years since the reform, obtaining consumer bankruptcy relief has become more expensive, more time-consuming, and more difficult.<sup>1</sup> These legal changes were motivated by a perceived need to reduce the incentives and ability of consumer debtors to "overborrow" and then seek relief from the bankruptcy system.<sup>2</sup> This strategic behavior model was arguably more a matter of perception and politics than documented empirical reality.<sup>3</sup> Nonetheless, this vision of financial distress dominated the public discourse as the justification for reducing the availability and scope of consumer bankruptcy relief.

The credit industry aggressively promoted an understanding of bankruptcy that focused on personal responsibility for financial outcomes. In its view, many bankruptcy debtors were prodigal spenders who engaged in irresponsible financial activity when they accumulated debts. Bankrupt families were assailed for lacking the moral conviction to repay their debts. Bankruptcy was proffered as an easy way out that attracted consumers who were intent on gaming the credit system.<sup>4</sup> The credit industry convinced Congress that curtailing bankruptcy

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<sup>1</sup> See Ronald J. Mann, *Bankruptcy Reform and the "Sweatbox" of Credit Card Debt*, 2007 ILL. L. REV. 375, 377 (cataloging changes to Bankruptcy Code that impose burdens on consumer debtors); NAT'L ASS'N OF CONSUMER BANKR. ATTY'S, *BANKRUPTCY REFORM'S IMPACT: WHERE ARE ALL THE "DEADBEATS?"* (2006), available at [http://www.nacba.com/files/main\\_page/022206NACBAbankruptcyreformstudy.pdf](http://www.nacba.com/files/main_page/022206NACBAbankruptcyreformstudy.pdf); Henry J. Sommer, *Trying to Make Sense Out of Nonsense: Representing Consumers Under the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005"*, 79 AM. BANKR. L.J. 191, 191 (2005).

<sup>2</sup> See Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481 (2006) ("Congress recently enacted legislation motivated by the perception that rational consumers act strategically when they borrow money and file for bankruptcy."); Richard L. Wiener et al., *Unwrapping Assumptions: Applying Social Analytic Jurisprudence to Consumer Bankruptcy Education Requirements and Policy*, 79 AM. BANKR. L.J. 453, 459 (2005)

<sup>3</sup> See Mechele Dickerson, *Regulating Bankruptcy: Public Choice, Ideology & Beyond*, 85 WASH. U. L. REV. \_\_\_\_ (forthcoming 2007) (describing how opponents of bankruptcy reforms used data to refute allegations of strategic debtors); ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE* 71-80 (2003) (describing the "myth of immoral debtor" and evaluating evidence to support this conception of bankruptcy filers).

<sup>4</sup> See Dickerson, *supra* note 3, at nn. 168-169 ("Supporters [of BAPCPA and its predecessors] focused on the culture of bankruptcy and the importance of 'personal responsibility,' and suggested that debtors lacked integrity

relief was sound social policy.<sup>5</sup> Such reforms were supposed to dampen prodigality and encourage consumers to make prudent financial decisions. This focus on debtor behavior led to bankruptcy reform that intended to alter the incentives and practices of consumers.

The credit industry's lending decisions were not subjected to similar scrutiny to that imposed on debtors' borrowing or bankruptcy decisions. Nor were lenders held to the same moral standard for evaluating the appropriateness of their financial practices as debtors were. Creditors' strategic behaviors, and the consequences of their lending activity, were not an integral part of the debate over bankruptcy reform.<sup>6</sup> The financial practices of creditors were never closely examined, perhaps in part due to difficulty in obtaining proprietary lending data. The fragmented regulatory framework for consumer lending also hindered efforts to identify problems in the consumer credit market. Further, theoretical scholarship has emphasized the law's role in shaping debtors' incentives, rather than evaluating how creditors react to bankruptcy laws. These factors combined to shroud the realities of consumer credit marketing and lending. While the amount of consumer credit had obviously mushroomed in the past decade, the blame for the increased bankruptcy rate that accompanied this credit expansion was put squarely on the shoulders of consumers rather than creditors. This focus on debtors has distracted scholars and lawmakers from examining how lenders contribute to financial distress and from considering how bankruptcy law influences creditor behavior.

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because they no longer felt any personal obligation to pay debts they could afford to repay.”); Mann, *Sweatbox*, *supra* note 1, at 377 (“The catch phrase in the legislative history was the ‘bankruptcy of convenience.’”).

<sup>5</sup> As Mechele Dickerson has explained, bankruptcy reform raised ideological issues that may have persuaded individual members of Congress to favor the legislation. *See* Dickerson, *supra* note 3, at 1. However, the standard characterization of the legislation is a public choice story that strongly emphasizes the consumer credit industry's capture of Congress through lobbying and financial contributions. *See* Victoria F. Nourse & Jane S. Schacter, *The Politics of Legislative Drafting: A Congressional Case Study*, 77 N.Y.U. L. REV. 575, 613 (2002) (opining that then-pending bankruptcy bill was “poster child” of result of imbalance of money and power between interest groups).

<sup>6</sup> Mann, *Sweatbox*, *supra* note 1, at 376 (“Proponents spent much less time discussing the economics of the consumer credit industry or the business models of those most affected by consumer bankruptcy.”); John A.E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 ILL. L. REV. 405, 407 (“Instead of, or at least in addition to, targeting debtors, Congress should fix its sights on creditors . . .”).

This Article analyzes original empirical data from first-ever detailed longitudinal study of bankrupt families. This novel postbankruptcy vantage point offers a fresh perspective on the credit industry's beliefs about the causes and consequences of consumer bankruptcy. The findings document how the credit industry responds to consumers' bankruptcies, exposing the credit industry's bankruptcy rhetoric to empirical challenge. If even a modest proportion of bankruptcy debtors are untrustworthy deadbeats who behave in immoral or strategic ways, the credit industry should be reluctant to lend to these families. These families have self-identified themselves as "profligates" by filing bankruptcy, thereby giving lenders hard, public evidence that they borrowed and did not repay. Even after bankruptcy, these families will have ample opportunity to avoid repaying new postbankruptcy loans. Indeed, the credit industry's portrayal of bankruptcy debtors suggests that these families are skilled at evading collectors, hiding assets, shielding income from garnishment, and relying on state laws such as exemptions to prevent legal action. Faced with this knowledge, lenders should eschew bankruptcy debtors. Creditors should purge these families from their solicitation lists, and when approached by these families, demand security for any loan.

In fact, the data show the opposite. This Article's key finding is that creditors repeatedly solicit debtors to borrow after bankruptcy. Families receive dozens of offers for new credit in each month immediately after their bankruptcy discharge. Some offers specifically target these families based on their recent financial problems, using bankruptcy as an advertising lure. Other credit offers emanate from the very same lenders that the families could not repay before bankruptcy. While not every lender will accept a "profligate" bankrupt as a customer, debtors report being overwhelmed after bankruptcy with a variety of credit solicitations from many sources. Lenders offer families most types of secured and unsecured loans. The widespread

efforts of creditors to lure bankrupt families into new borrowing relationships stand in stark contrast to the credit industry's portrayal of these families' propensity for honoring their obligations.

While credit card solicitations are ubiquitous, most families report receiving offers for car loans, second mortgages, live checks and other credit lines. Two paradoxes emerge. Debtors report more difficulty in obtaining secured loans than unsecured loans. This outcome is surprising, as collateral is thought to mitigate credit risk.<sup>7</sup> Despite bemoaning the risks created by immoral and strategic borrowers, many lenders do not bother to secure loans to bankrupt families. Also, debtors who chose Chapter 13 (repayment) bankruptcy instead of Chapter 7 (liquidation) bankruptcy have fewer opportunities to borrow. Rather than identifying them to creditors as a "responsible" borrower, repaying a portion of their past debts actually hinders a family's access to future credit. Creditors' actual behavior undermines the industry's purported policy goal of channeling more families into Chapter 13 instead of Chapter 7. On the whole, the credit industry treats former Chapter 7 bankruptcy debtors as valuable customers, seeking to profit by loading these families with new debt immediately after bankruptcy.

The vast opportunities to borrow after bankruptcy belie the credit industry's assertions about the immoral or strategic behavior of bankruptcy debtors. When the empirical data are juxtaposed against creditors' rhetoric in support of restricting bankruptcy relief, the gulf between creditors' actions and words is enormous. Despite their disparagement of the character of bankrupt families, lenders actively solicit them as future customers. This empirical evidence suggests that the credit industry takes one view of bankruptcy debtors to Congress, the media, and public, but it itself literally "banks" on a different view of bankruptcy debtors. While the

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<sup>7</sup> See Richard Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 171 (2002) (citing research on reasons for existence of secured credit).

data are not conclusive on bankruptcy causation, creditors' interest in lending to bankrupt families is consistent with acceptance of an adverse events model of bankruptcy. If the vast majority of families are unable to pay because of an external financial shock such as illness or injury, creditors need not refrain from soliciting bankruptcy debtors as customers out of serious concern that these families will borrow intending to evade future obligations using strategies other than bankruptcy. The strong overall pattern of credit offers to bankruptcy debtors suggests that creditors themselves reject a view of bankruptcy filers as either immoral individuals who chronically fail to honor their obligations or as strategic actors who are apt to abuse legal protections to avoid debts.

Creditors' targeted marketing to recently bankrupt families exposes a consequence of the deregulated credit market—distressed borrowers are highly lucrative. The findings on creditors' postbankruptcy behavior show that substantial segments of modern credit markets rely on financial distress for their profitability. Bankruptcy law itself facilitates this business model, making debtors' names a matter of public record and lengthening the required period between bankruptcy discharges to assure lenders that bankruptcy will not likely bar their future collection efforts. Understanding the realities of how creditors contribute to the financial distress dynamic has crucial policy implications. Bankruptcy law could be a powerful tool to shape creditors' financial practices, not just debtors' financial practices. Current law gives insufficient attention to the collective harms imposed by the credit industry's distressed-based profit model. Armed with knowledge of creditors' strategic lending behavior, policy makers can consider and implement reforms that will reduce the credit industry's incentives to engage in lending that thrives when families suffer from financial distress.

Part I of this Article documents the debtor-focused rhetoric that drove the bankruptcy reform debate and shows how recent scholars have responded by emphasizing the need to understand creditors' contribution to the bankruptcy dynamic. Part II presents original empirical data on creditors' behavior toward families who have filed bankruptcy. The findings emphasize the need for policy attention to the economics of consumer lending and its effect on financial distress. Part III develops the implications of these findings for bankruptcy and consumer law. An exclusive emphasis on "strategic" debtors is myopic. Law powerfully shapes the behavior of creditors, and these incentives may be suboptimal or harmful to society. Effective consumer credit policy requires a rich understanding of how lenders stimulate and profit from financial distress.

## I. THE MODERN CONSUMER CREDIT ECONOMY

### A. The Debtor Debate

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) made sweeping changes to the consumer bankruptcy system.<sup>8</sup> BAPCPA was the final result of a long struggle to narrow the availability of bankruptcy relief.<sup>9</sup> The rhetoric of the reform debate focused on accusations that debtors were engaged in "strategic" behavior—borrowing without intention to repay and using bankruptcy as financial tool to avoid repaying those debts. The principal policy response was to incorporate a means test into the Bankruptcy Code that would screen families for the ability to repay as a condition for bankruptcy relief.<sup>10</sup> The credit

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<sup>8</sup> Pub. L. No. 109-8, 119 Stat. 23 (codified as amended throughout 11 U.S.C.).

<sup>9</sup> See Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005) (chronicling history of efforts to restrict bankruptcy relief).

<sup>10</sup> See 11 U.S.C. § 707(a)(2). Numerous critics have attacked the means test. Some have complained that it creates a large administrative and expense burden that is not justified by the few families who are subject to the test. See Charles Tabb, *The Death of Consumer Bankruptcy in the United States*, 18 BANKR. DEV. J. 1, 16 (2001) (concluding that then-pending "means testing would create a huge new bureaucratic burden for courts, trustees, debtors, and debtors' attorneys—for everybody in the bankruptcy game, that is, except creditors."); Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 506 (1997) (describing potential of

industry's characterization of debtors as strategic actors was challenged with empirical evidence on the problems facing families who seek bankruptcy relief.<sup>11</sup> Researchers documented the low to moderate incomes of most families in bankruptcy,<sup>12</sup> and pointed to decades of research confirming that job problems, illness/injury or family break-up were pandemic in the bankrupt population.<sup>13</sup> However, efforts had an unintended effect. They reinforced debtors as the focus of bankruptcy reform, subtly helping to ensure that policy proposals avoided creditors' activities. This section briefly describes the credit industry's strategic-debtor model of bankruptcy and its influence on amending the Bankruptcy Code.

Attempts to show that the rising bankruptcy rates was the result of debtors' strategic behavior was persistent tool in the decade-long effort to enact bankruptcy reform. Commissioners who dissented from the National Bankruptcy Review Commission's recommendations for the consumer bankruptcy system expressed concern about debtors' incentives under bankruptcy law. They claimed the existence of a "[g]rowing perception that

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means testing to harm consumer bankruptcy system as social safety net). Others have offered better systems to accomplish the goal of ensuring that creditors are repaid if a family can repay. *See* Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 666 (2005); Jean Braucher & Charles W. Mooney, Jr., *Means Measurement Rather than Means Testing: Using the Tax System to Collect from Can-Pay Consumer Debtors After Bankruptcy*, 22 AM. BANKR. INST. J. 6 (Feb. 2003).

<sup>11</sup> Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Hearing on S. 256 Before the Subcomm. on Administrative Oversight and the Courts of the S. Comm. on the Judiciary, 109th Cong. (statement by Elizabeth Warren) (2005). Some representatives cited the findings of these studies in the debates about bankruptcy reform. *See, e.g.*, 151 CONG. REC. H1979 (daily ed. Apr. 14, 2005) (statement of Rep. Scott) ("[W]hile some who file bankruptcy have been financially irresponsible, the overwhelming majority of those who file do so as a result of divorce, major illness, or job loss. Half of those who go into bankruptcy do so because of illness, and most of them had health insurance but still could not pay their bills.")

<sup>12</sup> *See* TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 61-62 (2000) (finding that the median income for those who file bankruptcy is almost half the national median); Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 37 (1999) (reporting that only 24% of those in bankruptcy had incomes above the national median). My own pre-BAPCPA scholarship focused on debtors' circumstances as well. *See* Katherine Porter, *Going Broke the Hard Way: The Economics of Rural Failure*, 2005 WISC. L. REV. 971, 973 (documenting that rural bankruptcy debtors have more severe economic circumstances than urban bankruptcy debtors and using this finding to argue that bankruptcy reform could particularly harm rural families).

<sup>13</sup> *See* SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 12 at 186; WARREN & TYAGI, *supra* note 3, at 81 tbl. 4.1; Elizabeth Warren, *Financial Collapse and Class Status: Who Goes Bankrupt*, 41 OSGOODE HALL L.J. 116, 142 (2002).

bankruptcy has become a first resort rather than a last measure for people who cannot keep up with their bills.”<sup>14</sup> The credit industry formed organizations to advocate for bankruptcy reform and hired powerful lobbyists to assert this perception of why consumers file bankruptcy.<sup>15</sup> Reform proponents focused on the incentives created by a Chapter 7 discharge, asserting that some bankruptcy filers received new credit shortly before bankruptcy or filed bankruptcy even though they were not in default.<sup>16</sup> Congressional representatives echoed these fears about strategic or immoral debtors. Bankruptcy was “just another tool of financial management” for too many families looking to “skip out” of their debts.<sup>17</sup> Prodigality and strategic rationality were wedded together in the strongest characterizations of debtors as immoral actors. Representative Gekas lamented that “bankruptcy has become a way for reckless spenders to escape their debts.”<sup>18</sup> Advocates of bankruptcy reform deployed an alternate argument that the bankruptcy system effectively amounted to a \$400 tax on each American family each year.<sup>19</sup> This “economic” approach incorporated moral concerns too, however, since the persuasive power of this argument was ostensibly that such a tax was unfair to “moral” and “responsible” families who repaid their debts and did not file bankruptcy. Overall, the debate centered on

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<sup>14</sup> REPORT OF THE NAT’L BANKRUPTCY REVIEW COMMISSION, ch. 5 (1997) (Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, at 2).

<sup>15</sup> Dickerson, *supra* note 3, at nn. 78-84 and associated text (forthcoming 2007) (collecting accounts of bankruptcy reform that rely on public choice theory to show influence of credit industry in enactment of legislation); Jensen, *supra* note 9, at 498-99 (describing efforts of the Bankruptcy Issues Council, the Consumer Bankruptcy Reform Coalition, and the American Financial Services Association in lobbying for restricting bankruptcy relief.)

<sup>16</sup> NAT’L BANKRUPTCY COMMISSION REVIEW, ch. 5, *supra* note 14, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law at 11.

<sup>17</sup>144 CONG. REC. 21594, 21643 (1998) (statement of Sen. Grassley) (“The fact is that some people use bankruptcy as a convenient financial planning tool to skip out on debts that they could repay.”)

<sup>18</sup> National Bankruptcy Review Commission Report: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 105th Cong. 2-3 (1997) (statement of Rep. Gekas).

<sup>19</sup> See Elizabeth Warren, *The Phantom \$400*, 13 J. BANKR. L. & PRAC. 77 (2004) (chronicling history of bankruptcy tax figure and its role in lobbying efforts for bankruptcy reform).

characterizations of debtors as strategic actors who reacted in immoral ways to undesirable incentives that bankruptcy law created for borrowers.<sup>20</sup>

When policymakers did focus on the lending industry, the principal complaint was the intensity of creditors' lobbying efforts to enact bankruptcy reform. Representative Henry Hyde critiqued the substance of the proposed legislation, but added the following postscript: "Lastly, let me pay my respects to the creditor lobby. They are awesome."<sup>21</sup> Mechele Dickerson has suggested that this public choice focus on lobbying and campaign contributions shortchanged the policy debate.<sup>22</sup> She identifies the ideological underpinnings of the bill as a struggle about the scope of "personal responsibility" that bankrupt families should bear for their financial distress.<sup>23</sup> However, this description bankruptcy's ideology largely ignores the possibility of such a debate as a forum for discussing the appropriate responsibilities of creditors.

Some legislators made periodic efforts to highlight perceptions of hypocrisy by creditors who complained about overindebted debtors while continuing to lend to these customers.<sup>24</sup> Such efforts were diluted by the panoply of alternate arguments raised against the proposed legislation.<sup>25</sup> Although the final bill included "Consumer Protection" in its title, the legislation made only modest reforms to creditor practices, which focused on additional disclosures in credit

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<sup>20</sup> Mann, *Sweatbox*, *supra* note 1, at 376. ("In particular, the debates often focused on . . . the concern that the skyrocketing bankruptcy filing rates indicate that consumers are using the bankruptcy system for financial planning purposes.")

<sup>21</sup> 145 CONG. REC. 2723-2724 (daily ed. May 5, 1999) (statement by Rep. Hyde on H2718).

<sup>22</sup> Dickerson, *supra* note 3, at 20.

<sup>23</sup> *Id.*; Mann, *Sweatbox*, *supra* note 1, at 376 ("For the most part, proponents relied on moral arguments—how shameful it is that Americans walk away so easily from their debts.")

<sup>24</sup> Jensen, *supra* note 9, at 520, n. 199. "Members who opposed the legislation argued that the increase in bankruptcy filings was due to the credit card industry itself, which, they claimed 'actively solicits unsuspecting consumers through the mail with terms of easy credit . . . addicting debtors to this financial crack.'" (quoting statement of Rep. Jackson Lee made in opposition to a 1999 bankruptcy reform bill).

<sup>25</sup> Opponents complained that various versions of the legislation were too complicated, would be too costly to implement, were unfair to women, were drafted without the input of bankruptcy experts, were technically defective and internally inconsistent, and would not halt the worst instances of abuse in the system. For a representative sampling of these critiques during the entire bankruptcy debate, *see* Jensen, *supra* note 9.

contracts.<sup>26</sup> BAPCPA did require the Federal Reserve to conduct a study on “consumer credit industry practices of soliciting and extending credit—(A) indiscriminately; (B) without taking steps to ensure that consumers are capable of repaying the resulting debt; and (C) in a manner that encourages consumers to accumulate additional debt.”<sup>27</sup> The purpose of the study was to examine the “effects of such practices on consumer debt and insolvency.”<sup>28</sup> This provision “sense of Congress” may be a tangible reflection of frustrations about the paucity of quantitative data about creditor practices.

The required report was issued in June 2006 and bore the promising title, “Report to Congress on the Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency.”<sup>29</sup> Yet, it contained no new data and yielded few insights on actual credit practices.<sup>30</sup> Notwithstanding the lack of empirical evidence, the report issues a “key finding” that “as a matter of industry practice, market discipline, and banking agency supervision and enforcement, credit card issuers do not solicit customers or extend credit to them indiscriminately or without assessing their ability to repay.”<sup>31</sup> The report concluded that “[c]onsideration of an existing or potential customer’s ability to repay is a major

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<sup>26</sup> Pub. L. No. 109-8, §§ 1301-1306; 19 Stat. 23, 204-213.

<sup>27</sup> Id. at § 1229; 19 Stat. 23, 200.

<sup>28</sup> Id.

<sup>29</sup> BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO CONGRESS ON THE PRACTICES OF THE CONSUMER CREDIT INDUSTRY IN SOLICITING AND EXTENDING CREDIT AND THEIR EFFECTS ON CONSUMER DEBT AND INSOLVENCY (2006), available at [http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybills\\_tudy200606.pdf](http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybills_tudy200606.pdf).

<sup>30</sup> See Warren Reports on the Middle Class, TPM Café, *Problems? What Problems? Fed Paints Happy Face on Credit Card Debt*, (Aug. 8, 2006) (excerpting long statement from Ronald Mann on weaknesses with Federal Reserve study pursuant to section 1229 of BAPCPA), available at [http://warrenreports.tpmcafe.com/blog/warren-reports/2006/aug/08/problems\\_what\\_problems\\_fed\\_is\\_clueless](http://warrenreports.tpmcafe.com/blog/warren-reports/2006/aug/08/problems_what_problems_fed_is_clueless); Pottow, *supra* note 6, at 418, n. 47 (describing Federal Reserve report required by section 1229 of BAPCPA as “anti-climax.”) To be fair, Congress did not allocate additional funds to the Federal Reserve to conduct this study and gave it only one year to complete the report. See generally Katherine Porter, *The Potential and Peril of BAPCPA for Empirical Research*, 71 MISSOURI L. REV. 963, 972-976 (2006) (identifying reasons for skepticism about mandatory reports incorporated into BAPCPA).

<sup>31</sup> FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 3.

aspect” of credit solicitation and credit extension.<sup>32</sup> This statement fails to evaluate how lenders weigh repayment ability. In fact, lenders may consider ability to pay as a negative factor, rather than a positive factor in their profit models.<sup>33</sup> The mere fact that risk-scoring models include measurements of propensity or willingness to pay does not mean that lenders limit lending to risky customers. Indeed, lenders may profit from financial distress meaning that credit extensions to troubled borrowers are not “indiscriminate” but deliberate.

The realities of such lending models (the subject of the next section of this Article) did not sidetrack the rhetoric of bankruptcy reform from its obsession with strategic debtor behavior. Lenders’ “strategy” in marketing and extending credit was an occasional sideshow, at best, in the circus of Congressional debate. The role of bankruptcy law in incentivizing undesirable credit activity was ignored entirely. To the contrary, the bill was heralded as a critical measure to ensure that current lending practices were sustained in the future. When he signed BAPCPA into law, President Bush explained that law “will ensure that more Americans can get access to affordable credit.”<sup>34</sup> The President expressed concern that debtor abuse of the bankruptcy system has “made credit less affordable and less accessible, especially for low-income workers who already face financial obstacles.” The opposite possibility—that families who are struggling financially may have too much credit opportunity—did not receive serious policy attention. Instead, BAPCPA was praised for its ability to help those who did seek bankruptcy relief “avoid future credit problems.”<sup>35</sup> This Article’s original data on credit marketing to former bankruptcy,

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<sup>32</sup> *Id.* at 26.

<sup>33</sup> Mann, *Sweatbox*, *supra* note 1, at 384 (noting for debt-based credit card issuers the “most profitable customers are sometimes the least likely to ever repay their debts in full.”)

<sup>34</sup> Press Release, White House Press Office, President Signs Bankruptcy Abuse Prevention, Consumer Protection Act (Apr. 20, 2005) available at <http://www.whitehouse.gov/news/releases/2005/04/20050420-5.html>; see also Jensen, *supra* note 9, at 566-67.

<sup>35</sup> *Id.*

debtors provides crucial evidence for evaluating the effects of bankruptcy reform on optimal credit use.

## B. Models of Consumer Lending

After BAPCPA's enactment, several prominent scholars have tried to identify the stakes of the credit industry in bankruptcy law and in financial distress more generally. This work has documented recent changes in the economics of the consumer credit markets. These efforts highlight the importance of data on the actual practices of lenders with respect to financially distressed borrowers. Bankruptcy debtors are a useful sample for measuring how lenders react to information that families face serious financial problems.<sup>36</sup> While literature on postbankruptcy credit is sparse, prior studies illustrate need for effective policymaking to be cognizant of creditors' role in the financial distress dynamic.

Scholars have disagreed on whether consumer debt correlates with bankruptcy, the most common measure of financial distress in such research.<sup>37</sup> Debates about causation have been even more heated. Most research uses aggregate national data, due to weaknesses in household data,<sup>38</sup> and looks broadly at how the expansion of consumer credit tracks bankruptcy filings.<sup>39</sup> Some studies have focused particularly on credit cards because card use and card debt greatly expanded during the same period as consumer bankruptcy filings.<sup>40</sup> This line of research

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<sup>36</sup> WARREN & TYAGI, TWO-INCOME TRAP, *supra* note 3, at 81 (showing that large fraction of families with children who file bankruptcy reported either job problems, illness or injury, or a family break-up as a reason for their bankruptcy).

<sup>37</sup> See, e.g., Robert Lawless, *The Paradox of Consumer Credit*, 2007 ILL. L. REV. 348, 367-368 (2007); Teresa A. Sullivan, Elizabeth Warren, & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STANFORD L. REV. 213, 248-250 & fig. 10 & 11 (2006) (charting changes in household debt using Federal Reserve data).

<sup>38</sup> RONALD J. MANN, CHARGING AHEAD 61-62 (2006).

<sup>39</sup> See Robert M. Lawless, *Relationship of U.S. Bankruptcy Filings and Consumer Debt* 5 (Oct. 4, 2006), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=934798](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=934798); FEDERAL RESERVE REPORT, *supra* note 30, at 18 tbl. 6.

<sup>40</sup> See Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits and Bankruptcy*, 71 AM. BANKR. L.J. 249 (2007); MANN, CHARGING AHEAD, *supra* note 38; Todd Zywicki, *Credit Card Economics*, 3 CHAP. L. REV. 79 (2000); Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate*, BANK TRENDS, (May 1998).

generally concludes that climbing consumer debt burdens have some substantial relationship with higher bankruptcy filings.<sup>41</sup> These findings are limited by the fact that aggregate data reflect “only a typical household and may not be indicative of financial distress.”<sup>42</sup>

Prior Consumer Bankruptcy Project research has yielded useful household-level data on the economic characteristics of families in bankruptcy.<sup>43</sup> These findings offer a “snapshot” view of the debt obligations of families at the time that they seek bankruptcy relief. They do not illuminate how families accrue debt over time or what proportion of debt corresponds to borrowing shortly before bankruptcy. The credit industry, which surely tracks these trends, did not offer proprietary data on these points during the bankruptcy reform debate,<sup>44</sup> choosing to evidence the strategic debtor model with anecdotes, not empirics.

Despite public lamentations about failure to pay, the credit industry may in fact seek out such families. Two recent articles explain this phenomenon and illuminate how current law permits creditors to a profit by strategically targeting families in financial distress. Drawing on behavioral economic theories, Susan Block-Lieb and Edward Janger have explored how the “myth of the rational borrower” dominates bankruptcy and consumer credit policymaking.<sup>45</sup> They describe how this construct drives fears that the “Bankruptcy Code encourages inefficient and opportunistic ex ante decisionmaking.”<sup>46</sup> Block-Lieb and Janger contrast this theoretical portrayal of borrowers with the reality of creditors’ continued expansion of the market for credit, noting that the success of the business strategy of subprime lending requires that “nonstrategic

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<sup>41</sup> MANN, CHARGING AHEAD, *supra* note 38, at 69.; *see also* FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 15 (“The rate at which consumers file for bankruptcy has broadly trended up with the real value of revolving consumer credit per household.”)

<sup>42</sup> FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 13.

<sup>43</sup> SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 12 at 63-71; WARREN & TYAGI, TWO-INCOME TRAP, *supra* note 3, at 64 & tbl. 4.1.

<sup>44</sup> NAT’L BANKRUPTCY COMMISSION, ch 5, *supra* note 14, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law at 10-11.

<sup>45</sup> *See generally* Block-Lieb & Janger, *supra* note 2.

<sup>46</sup> *Id.* at 1486.

borrowers must outnumber the strategic borrowers and the interest and fees paid by (at least some) nonstrategic borrowers must outweigh the costs of strategic borrowers' defaults."<sup>47</sup> In their view, consumer credit policy evinces a misplaced focus on borrower rationality.<sup>48</sup> They argue that technology facilitates lender opportunism by permitting the credit industry to accurately target highly profitable borrowers who are likely to incur fees, interest, and other charges that feed superior profit margins.<sup>49</sup> Lenders exploit financial distress in this strategic manner, leaving bankruptcy (and other social institutions) to address the harm caused by overborrowing.

This model of consumer lending suggests that the credit industry's motivation for bankruptcy reform was not realigning borrower incentives. Ronald Mann has developed an alternate explanation for how creditors may benefit from bankruptcy reform.<sup>50</sup> Focusing on credit card issuers,<sup>51</sup> Mann sketches a "dynamic of profitability" how financially distressed borrowers generate hyper-profits.<sup>52</sup> He contrasts this new lending model with conventional loans to illustrate how financial distress—at least to a point—fuels, rather than depresses revenue.<sup>53</sup> Indeed, credit card companies enjoyed record profits as the bankruptcy rate escalated.<sup>54</sup> Mann identifies ways that BAPCPA may enhance profits from families in financial distress by delaying

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<sup>47</sup> *Id.* at 1488.

<sup>48</sup> *Id.* at 1565. ("To extent that rationality and opportunism exist in consumer credit transactions, they both appear to exist on the lender, not the borrower, side of the equation.")

<sup>49</sup> *Id.* at 1500.

<sup>50</sup> See Mann, *Sweatbox*, *supra* note 1, at 378-79. He prophesizes that "it is unlikely that the principal features of [BAPCPA] will have any substantial effect on the borrowing decisions of consumers." *Id.* at 379.

<sup>51</sup> Mann focuses on debt-based credit card issuers, contrasting their lending products with conventional loans. *Id.* at 384. The share of revenue from default-driven provisions like penalty fees, late charges, and loan transaction fees for refinancing may be growing in other lending markets, such as mortgage loans and car loans, as specialized secured loan products for subprime borrowers are developed. The success of relying on fee revenue in these broader markets is unclear at this time.

<sup>52</sup> *Id.* at 385.

<sup>53</sup> *Id.* at 386.

<sup>54</sup> Adam Goldstein, *Why "It Pays" to "Leave Home Without It": Examining the Legal Culpability of Credit Card Issuers Under Tort Principles of Products Liability*, 2006 U. ILL. L. REV. 827, 856.

or deterring bankruptcy.<sup>55</sup> Growing recognition of such lending models has spawned law reform proposals that aim to limit such lending or to force lenders to internalize the harms of financial distress.<sup>56</sup>

This Article applies this prior research to a particular example of lenders' interest in financially distressed customers. Families who file bankruptcy face challenges in achieving financial well-being, even after a bankruptcy discharge.<sup>57</sup> Just one year after bankruptcy, a substantial minority of families report that their financial position has worsened or failed to improve.<sup>58</sup> Many struggle to meet ordinary expenses.<sup>59</sup> Examining the availability of postbankruptcy credit complements efforts to understand lenders' role in financial distress. As an example of a population in financial trouble, postbankruptcy families illustrate the breadth and depth of credit markets for distressed customers generally.

Existing longitudinal research on bankruptcy debtors is sparse. Most evidence is anecdotal and did not focus squarely on creditors' behavior toward bankrupt families. This literature does usefully reveal the range of perceptions about postbankruptcy credit and illustrates the need for recent data that reflect the modern consumer lending market.

Accounts of the availability of postbankruptcy credit differ greatly. Many people considering bankruptcy, and indeed many who file bankruptcy, apparently believe that bankruptcy will devastate their ability to borrow.<sup>60</sup> The general public may have a similar

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<sup>55</sup> *Id.* at 392-97.

<sup>56</sup> *See, e.g.*, Pottow, *supra* note 6.

<sup>57</sup> Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67, 91-92 (2006) (describing financial issues facing families whose self-reported financial condition worsened after bankruptcy).

<sup>58</sup> *Id.* at 87, Fig. 3 and 88 ("More than one in three families stated that their financial situations had either stayed the same or worsened since the time of their bankruptcies.")

<sup>59</sup> *Id.* at 84, Fig. 1 (reporting that 25% of Chapter 7 debtors in study reported difficulty in paying bills one year after bankruptcy.)

<sup>60</sup> The conventional wisdom that credit is hard to get after bankruptcy is typically spread by non-specialists. *See, e.g.*, Michael Moody, *Obtaining Credit After Bankruptcy: Mission Impossible* (Oct. 16, 2006),

perception, which could effect how they view families who chose bankruptcy.<sup>61</sup> These perceptions are curious because concern about widespread marketing to postbankruptcy families dates back over thirty years. An empirical survey of bankruptcy practitioners, judges, and academics in 1973 reported that participants saw the “problem of ‘aggressive solicitation of recently discharged bankrupts’ as very important.”<sup>62</sup> These respondents were experts in bankruptcy, however, and they possessed insider knowledge of the bankruptcy system that the general public lacks. In recent years, newspapers have featured the rampant solicitation of families after bankruptcy.<sup>63</sup> In an April 2005 story, the Washington Post profiled a woman who tried to avoid credit cards after bankruptcy but accepted one of many “preapproved” offers that she received because she found it hard to rent a car without a credit card. The story noted that firms specialize in marketing to bankrupt consumers and quoted their advertising materials trumpeting “unique and lucrative market.”<sup>64</sup> The New York Times used the experience of one bankruptcy filer to shape its story, sharing her reports that every day she got “at least two or three new credit card offers—Citibank, MasterCard, you name it—they want to give me a credit card.”<sup>65</sup> Quotes from banking industry representatives reflected some variation in credit

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<http://ezinearticles.com/?Obtaining-Credit-After-Bankruptcy:-Mission-Impossible&id=330141> (advising potential bankruptcy filers that they likely will not be able to get credit for at least a year or two after bankruptcy); Total Bankruptcy website, *What the Credit Industry Doesn't Want You to Know About Bankruptcy*, [http://www.totalbankruptcy.com/credit\\_industry\\_secrets.htm](http://www.totalbankruptcy.com/credit_industry_secrets.htm) (debunking the myth that you cannot get credit after bankruptcy).

<sup>61</sup> Citibank, Personal Bankruptcy: *The Negatives Far Outweigh the Positives*, <http://www.citibank.com/us/cards/cm/cntrol07.htm>.

<sup>62</sup> Selwyn Enzer, Raul de Brigard, & Frederick D. Lazar, *Some Considerations Concerning Bankruptcy Reform* at 90 (March 1973) in REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, Part III (July 1973).

<sup>63</sup> See, e.g., Robert J. Hawkins, *Truth is Scary Than Fiction in 'Maxed Out,'* PARAMUS POST, June 4, 2007, available at <http://www.paramuspost.com/article.php/20070531201324776> (reporting on credit solicitations to bankruptcy debtors as highlight of film).

<sup>64</sup> Caroline Mayer, *Bankrupt and Swamped with Credit Offers*, WASH. POST., April 15, 2005, at A1.

<sup>65</sup> Timothy Egan, *Newly Bankrupt Raking in Piles of Credit Offers*, N.Y. TIMES, Dec. 11, 2005.

marketing to recent debtors,<sup>66</sup> but neither news story turned up any industry or government data to support the extent and nature of postbankruptcy credit availability.<sup>67</sup>

More systematic research about postbankruptcy credit is quite dated. Given rapid changes in the lending environment, these data may not be reliable for policymaking. However, these studies illustrate how prior researchers have approached the topic of postbankruptcy credit. Fifteen years ago, Jean Braucher conducted qualitative research about the attitudes and practices of consumer bankruptcy attorneys.<sup>68</sup> Although her study had a much broader focus,<sup>69</sup> Braucher assessed the perceptions of debtors' attorneys about postbankruptcy access to credit. Braucher found that lawyers are frequently asked about the impact of bankruptcy on future credit,<sup>70</sup> with her interviews causing her to conclude that "[m]ost debtors who consult bankruptcy lawyers are concerned about future access to credit," She noted that while "nearly all" lawyers give advice to clients on this matter, that most do so without the benefit of accurate information.<sup>71</sup> Most lawyers believed that Chapter 7 debtors had fast access to credit after bankruptcy and had experiences with clients being offered new credit immediately after filing bankruptcy (even before discharge.)<sup>72</sup> Many attorneys expressed concern about the easy access to postbankruptcy credit.<sup>73</sup> This concern caused some attorneys to understate the availability of credit to potential Chapter 7

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<sup>66</sup> *Id.* (describing different approaches reported by Bank of America and Citibank)

<sup>67</sup> The Washington Post article reported preliminary data from the Consumer Bankruptcy Project sample that is the basis for this Article's analysis. Mayer, *supra* note 64, at A9.

<sup>68</sup> See Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 516 (1993).

<sup>69</sup> *Id.* at 503. ("The 'simple' thesis of this article is that debtors' lawyers pursue different mixes of four goals in consumer bankruptcy practice. They seek to serve their clients' and their own financial interests, and they also attempt to fulfill some version of appropriate social role playing on the part of their clients and themselves.").

<sup>70</sup> *Id.* at 537.

<sup>71</sup> *Id.* ("Most lawyers have not systematically researched these questions. It is not clear that they can obtain valid information from creditors or credit reporting agencies. All the lawyers have rough impressions about credit availability after chapter 7 and chapter 13 based on feedback from former clients, and nearly all give advice on this basis.").

<sup>72</sup> *Id.* at 538.

<sup>73</sup> *Id.* ("Many lawyers said that it is common for debtors to obtain credit within a year or two of a chapter 7 filing. "It's too easy to get new credit," said one lawyer. Another said, "the credit industry is recycling people." Car loans and credit cards can often be obtained quickly after filing a chapter 7 case, the lawyers in all four cities said.").

debtors.<sup>74</sup> Braucher also identifies attorneys' desire to have clients file Chapter 13 as a factor that dampens lawyers' disclosure about credit availability after Chapter 7 bankruptcy.<sup>75</sup> Attorneys apparently use their impressions about the *type* of credit, not just the availability of credit, to bolster their preference for Chapter 13 cases.<sup>76</sup> Several lawyers believed that after a Chapter 7 bankruptcy, the available credit was "often at the highest rates and from the sleaziest purveyors."<sup>77</sup> Apparently, these attorneys believed credit would be cheaper or offered on more favorable terms after a Chapter 13 bankruptcy. Braucher does not identify whether the attorneys had any evidence for these beliefs. These attorney impressions have a critical impact on the bankruptcy system because they shape debtors' decisions about whether to file bankruptcy and what type of relief to seek.<sup>78</sup> However, the research does not have sufficient data on postbankruptcy credit to use it as a lens for understanding creditors' assumptions about and behavior toward bankruptcy debtors.

Two empirical studies more precisely document the landscape of postbankruptcy credit. Each researcher used proprietary data drawn from bankruptcy filers' credit reports. Michael Staten of the Credit Research Center examined the credit reports of 2,000 people who filed bankruptcy between 1978 and 1988.<sup>79</sup> In the twenty to thirty years since that study's families

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<sup>74</sup> Braucher, *One Code*, *supra* note 68, at 538 ("Another reason some lawyers do not discuss better credit availability in general after chapter 7 as opposed to chapter 13 is that they do not want to play up the idea of getting new credit. "You can get credit fast after chapter 7," said one lawyer, who added quickly, "but I don't tell them that!" This lawyer has his clients cut up their credit cards in his office. He and other lawyers said that they try to get clients to focus on living within their means in the future and on saving rather than borrowing.").

<sup>75</sup> *Id.* at 538-9.

<sup>76</sup> *Id.* The motivation to have clients chose Chapter 13 is driven largely by the ability to recover fees in installments through a debtor's plan. Attorneys may also prefer Chapter 13 because most districts approve higher attorneys' fees for Chapter 13 cases than Chapter 7 cases. Finally, some attorneys believe that Chapter 13's repayment scheme has moral or educational benefits for their clients.

<sup>77</sup> *Id.* at 540.

<sup>78</sup> *Id.* ("Most lawyers in the study acknowledge that better credit availability after chapter 13 is a myth, but it is one that many clients believe and that can be used to manipulate them into choosing chapter 13.").

<sup>79</sup> Michael E. Staten, *The Impact of Post-Bankruptcy Credit on the Number of Personal Bankruptcies* \*12 (Credit Research Center, Purdue University, Krannert Graduate School of Management, Working Paper 58, January 1993).

filed bankruptcy, the variety and quantity of subprime credit has exploded,<sup>80</sup> and Americans have loaded up on debt.<sup>81</sup> These changes may undercut the applicability of the study to today's credit markets. Nonetheless, it offers a useful methodology for examining the availability of postbankruptcy credit. Staten did not measure credit solicitations but instead focused on actual uptake of credit by families during the postbankruptcy period.<sup>82</sup> Creditors who had lent prebankruptcy to these families accounted for a significant fraction of the credit that debtors accepted. One year after bankruptcy, 25.5 percent of new credit lines accepted by debtors were issued by prior creditors.<sup>83</sup> Staten hypothesizes that an indeterminate amount of this new credit could result from pre-screened offers that were processed before the debtors filed bankruptcy, but offers no evidence of this effect. His conjecture may reflect surprise at the substantial fraction of creditors who chose to quickly lend again to bankrupt families.

The second study of postbankruptcy credit analyzed the effect of the law prohibiting a bankruptcy that was filed more than ten years prior from appearing on a credit report.<sup>84</sup> David Musto found that consumers' FICO credit scores jumped significantly after a bankruptcy was expunged from their reports,<sup>85</sup> and that this boost in apparent creditworthiness corresponded with

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<sup>80</sup> See Block-Lieb and Janger, *supra* note 2 at 1514 (“Credit scoring and risk-based pricing have permitted financial institutions and other consumer lenders to open up entirely new markets for their products, including the market for subprime lending.”); Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing 2005 Report*, Executive Summary, 19 & tbl. 20 at <http://www.jchs.harvard.edu/publications/markets/son2005/son2005.pdf>.

<sup>81</sup> MANN, CHARGING AHEAD, *supra* note 38, at 53. Lawless, *supra* note 37, at 364 figs. 1.A & 1.B. showing increasing rate of non-mortgage short-term and long-term consumer credit.

<sup>82</sup> These findings are very important for testing how families respond to a bankruptcy discharge and are useful for testing the fresh start theory against the realities of postbankruptcy life. His principal findings are reported in several useful figures. See Staten at Exhibit 8 and 11.

<sup>83</sup> *Id.* at 15. Note, however, that only 16.2 percent of all debtors had accepted any new credit at the one-year postbankruptcy mark. *Id.* at 13.

<sup>84</sup> David K. Musto, *What Happens When Information Leaves a Market? Evidence from Postbankruptcy Consumers*, 77 J. OF BUS. 725, 726 (2004). The relevant federal law is the Fair Credit Reporting Act. See 15 U.S.C. § 1681c(a)(1).

<sup>85</sup> *Id.* at 735.

debtors' acquisition of new bank credit cards.<sup>86</sup> Musto's research nicely illustrates how law can and does shape creditors' responses to families who file bankruptcy. Because Musto is studying postbankruptcy credit at such a distant moment—ten years after the bankruptcy filing—his research does not reveal the immediate reactions of the lending industry to bankruptcy. The ability to make inferences about postbankruptcy credit and financial distress is greatest when the time between bankruptcy and the measure of new credit offers is short.

The prior research is insufficient to permit a nuanced analysis of postbankruptcy credit availability. This gap in the existing literature contributed to the dominance of the strategic-debtor model and helped shield lenders from scrutiny.

## II. CREDIT OPPORTUNITIES AFTER BANKRUPTCY

This Article analyzes original data from the only large longitudinal study ever conducted of consumer bankruptcy debtors. These empirical data expose the reaction of the credit industry to consumer bankruptcies—to repeatedly solicit bankrupt families to become new credit customers. Debtors' reports of the vast market of postbankruptcy credit offer insights on lenders' assumptions about the causes of bankruptcy and the need for bankruptcy reform. The findings show how the credit industry seeks to profit from financial distress.

### A. Methodology

This section describes the study's methodology and presents general findings about the respondents. The original data in this Article were collected during Phase III of the Consumer Bankruptcy Project (CBP), which began in 2001 and ended in 2004.<sup>87</sup> CBP III was a large,

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<sup>86</sup> *Id.* at 737 (estimating one extra card is obtained per four consumers in the tenth year postbankruptcy).

<sup>87</sup> I served as Project Director of CBP Phase III—2001 during its first six months of data collection. My responsibilities included pretesting the data instruments, overseeing the distribution and collection of the written questionnaires, and helping to design the court record coding protocols.

interdisciplinary study of consumer bankruptcy that involved a dozen researchers.<sup>88</sup> The sample consists of consumer bankruptcy cases filed in the first months of 2001 in five judicial districts across the nation.<sup>89</sup> The study had a “core” sample designed to be representative of all bankruptcy filers and several specialized samples to study particular issues. This Article uses data only from the core sample. The total core sample contains 1,250 consumer bankruptcy cases, consisting of 780 Chapter 7 bankruptcies and 470 Chapter 13 bankruptcies.<sup>90</sup> The ratio of sampled Chapter 7 and Chapter 13 cases reflected the distribution in each judicial district in the sample.

CBP III used four instruments to gather data. First, a questionnaire was distributed to debtors at their meeting of creditors, a required part of the bankruptcy process.<sup>91</sup> The questionnaire requested demographic information such as age, occupation, and marital status, and inquired about the family’s reasons for seeking bankruptcy relief.<sup>92</sup> For each debtor who completed a questionnaire, researchers coded data from the debtor’s corresponding public court records, second data instrument. These bankruptcy petitions and schedules provided detailed information about the debtors’ assets, liabilities, income, and expenses at the time of their bankruptcies.

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<sup>88</sup> Additional descriptions of the methodology used in CPB Phase III—2001 have appeared in numerous articles presenting data from the study. See WARREN & TYAGI, *supra* note 3 at 181-88; Porter & Thorne, *supra* note 57 at 125-128; David U. Himmelstein et al., *Market Watch: Illness and Injury as Contributors to Bankruptcy*, HEALTH AFF. Feb. 2005, available at <http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1.pdf>. A new iteration of CBP began in January 2007 to study post-BAPCPA debtors. I am an investigator in CBP Phase IV—2007 but no data in this Article come from that study.

<sup>89</sup> The CBP Phase III sample was collected in these five judicial districts: Eastern District of Pennsylvania; Northern District of Illinois; Middle District of Tennessee; Northern District of Texas; and Central District of California.

<sup>90</sup> See *infra* at note 96 for a discussion of the separate analysis of Chapter 7 and Chapter 13 cases employed in this Article.

<sup>91</sup> See 11 U.S.C. § 341 (2005).

<sup>92</sup> A copy of the questionnaire is publicly available. See Elizabeth Warren, *Bankrupt Children*, 86 MINN. L. REV. 1003, 1028-32 (2002).

The questionnaire invited debtors to participate in a series of follow-up telephone interviews in return for compensation of \$50 per interview. Approximately one year after bankruptcy, a small team of trained researchers conducted telephone interviews with 601 families in the core sample.<sup>93</sup> Approximately three years after the debtors filed bankruptcy (the spring of 2004), researchers attempted to contact each respondent that completed the first telephone interview to conduct a second telephone interview. These second-round interviews were conducted with 474 families in the core sample. Thus, all four data instruments (questionnaire, court records, one-year interview, and three-year interview) are available for 38 percent of the original sample of 1,250 consumer bankruptcy cases.

Both the one-year and three-year telephone interviews were approximately one hour long and were conducted using computer-assisted interviewing technology. A general set of questions was posed to every participant. Based on corresponding questionnaire or court record data, some participants were asked subsets of questions on topics such as homeownership and medical debt that pertained to their situations. The research team coded all responses into a specially designed database for each round of interviews. Most questions were closed-ended, although several points in the interview invited unstructured or supplementary responses. Because this was the first-ever detailed longitudinal study of consumer bankruptcy debtors, the families' postbankruptcy experiences were the principal focus of each interview.

For most of this Article, I limit the CBP III core sample to include only debtors who filed Chapter 7 bankruptcy. In Part II, E, *infra*, I analyze data from respondents who filed Chapter 13 cases to compare how postbankruptcy credit opportunities differ between Chapter 7 debtors and Chapter 13 debtors. At that point, I explain legal differences between Chapter 7 and Chapter 13 justify considering the two types of bankruptcy separately. Analysis of the demographic and

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<sup>93</sup> See *infra* at notes 99-104 and accompanying text for analysis of issue of respondent bias.

















































































