

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

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ABSTRACT: 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. 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, time-consuming, and difficult.¹ 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.² The credit industry aggressively promoted this "strategic behavior" model of bankruptcy, which focuses on consumers' personal responsibility for financial outcomes. In the credit industry's view, many bankruptcy debtors were prodigal spenders who accumulated debts through irresponsible financial activity. The credit industry assailed bankrupt families 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.³ The credit industry convinced Congress that curtailing bankruptcy relief was sound social policy;⁴ such reforms were needed to dampen prodigality and encourage consumers to make prudent financial decisions.

1. See NAT'L ASS'N OF CONSUMER BANKR. ATT'YS, *BANKRUPTCY REFORM'S IMPACT: WHERE ARE ALL THE "DEADBEATS"?* 2 (2006), available at http://www.nacba.com/files/main_page/022206NACBAbankruptcyreformstudy.pdf ("[T]he sweeping federal bankruptcy law changes that went into effect on October 17, 2005 are doing little more than imposing new costs and paperwork burdens . . ."); Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 377 (cataloging changes to the Bankruptcy Code that impose burdens on consumer debtors); 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, 193-230 (2005) (describing changes to the Bankruptcy Code that impose burdens on bankruptcy attorneys).

2. 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, 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).

3. See A. Mechele Dickerson, *Regulating Bankruptcy: Public Choice, Ideology, & Beyond*, 84 WASH. U. L. REV. 1861, 1891-92 (2006) ("Supporters [of bankruptcy reform] focused on the culture of bankruptcy and the importance of 'personal responsibility,' and they suggested that debtors lacked integrity because they no longer felt any personal obligation to pay debts they could afford to repay."); Mann, *supra* note 1, at 377 ("The catch phrase in the legislative history was the 'bankruptcy of convenience.'").

4. 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 1862. 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 the then-pending bankruptcy bill was a "poster child" result of the imbalance of money and power between interest groups).

The competing model of causation focused on the role of adverse financial events such as job loss, illness, or divorce in causing financial distress and bankruptcy filings.⁵ The adverse-events model posits that most families fail to pay their debts because of an external financial shock—*not* because they lack moral fiber or borrowed with no intention of repaying. This view focuses on macroeconomic and social trends, rather than individual consumers' decisions, to understand the rise in bankruptcy filings. Advocates of the adverse-events model note that America offers families a relatively weak, and declining, social safety net to help them cope with adverse financial events.⁶ The expansion of consumer credit in recent decades has left families more highly leveraged and less able to weather financial shocks.⁷ If the adverse-events model is correct, creditors' lending practices and the scope of social programs are necessary loci for reforms aimed at reducing the incidence of bankruptcy.

During the bankruptcy reform process, the strategic-debtor and adverse-events models competed for policymakers' attention. Opponents of reform repeatedly cited empirical data on the causes of bankruptcy and harped that the strategic-debtor model was more a matter of perception and politics than documented empirical reality.⁸ Nonetheless, the strategic-debtor model dominated the public discourse and was the leading justification for reducing the availability and scope of consumer bankruptcy relief. This focus on debtor behavior led to bankruptcy reform that intended to alter the incentives for and practices of consumers.

As a consequence, the credit industry's lending decisions were not subjected to the same scrutiny as debtors' borrowing decisions. Nor were lenders held to the same moral standard as debtors for evaluating the appropriateness of their financial practices. Creditors' strategic behavior, and the consequences of their lending activities, were not an integral part of the debate over bankruptcy reform.⁹ The financial practices of creditors

5. See TERESA A. SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 243 (2000) (identifying job and income loss, sickness and injury, divorce, and homeownership as frequent triggering causes of bankruptcy); ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE* 81 (2003) (citing self-reported data from bankruptcy debtors to establish that job loss, family breakup, and medical problems were the reason for eighty-seven percent of consumer bankruptcy filings).

6. SULLIVAN ET AL., *supra* note 5, at 256–60.

7. RONALD J. MANN, *CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS* 64 (2006).

8. See Dickerson, *supra* note 3, at 1870–73 (describing how opponents of bankruptcy reform used data to refute allegations of strategic debtors); see also WARREN & TYAGI, *supra* note 5, at 71–80 (describing the “Myth of the Immoral Debtor” and evaluating evidence to support this conception of bankruptcy filers).

9. Mann, *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

were never closely examined, perhaps in part due to the difficulty of 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. The amount of consumer credit obviously had mushroomed in the past decade. However, the blame for the increased bankruptcy rate accompanying 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.

This Article analyzes original empirical data from the 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 consumer bankruptcies, exposing the credit industry's bankruptcy rhetoric to empirical challenge. If even a modest proportion of bankruptcy debtors are untrustworthy deadbeats whose immoral or strategic behavior harms creditors, 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 they receive a bankruptcy discharge. Some offers specifically target these families based on their recent financial problems, using bankruptcy as an advertising lure. Other credit offers issue 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

U. ILL. L. REV. 405, 407 ("Instead of, or at least in addition to, targeting debtors, Congress should fix its sights on creditors . . .").

offer families most types of secured and unsecured loans. Creditors' widespread efforts to lure bankrupt families into new borrowing relationships stand in stark contrast to the credit industry's portrayal of itself as the victim of these families' strategic behavior.

In addition to credit card solicitations, most families report receiving offers for car loans, second mortgages, live checks, and other credit lines. Two paradoxes emerge. First, debtors report more difficulty in obtaining secured loans than unsecured loans. This outcome is surprising, as collateral is thought to mitigate credit risk.¹⁰ Despite bemoaning the risks created by immoral and strategic borrowers, many lenders do not bother to secure loans to bankrupt families. Second, debtors who chose chapter 13 (repayment) bankruptcy ("Chapter 13") instead of chapter 7 (liquidation) bankruptcy ("Chapter 7") have fewer opportunities to borrow. Rather than signaling to creditors that a family is a "responsible" borrower, repaying a portion of its past debts actually hinders a family's access to future credit. Creditors' actual behavior contradicts the industry's purported policy goal—articulated in the debate leading up to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005—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 that it is harmed by 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 the public, but itself literally "banks" on a different view of bankruptcy debtors. While the 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 adverse-events model is correct, creditors need not refrain from soliciting bankruptcy debtors as future customers because a discharge of debts in bankruptcy reflects the occurrence of an exogenous event that caused severe financial hardship. Thus, a vast majority of bankruptcy filers are neither immoral individuals who chronically fail to honor their obligations nor strategic actors who are intent on evading repayment of their debts using legal protections or strategies other than bankruptcy. The strong overall pattern

10. 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 the existence of secured credit).

of credit offers to bankruptcy debtors suggests that creditors themselves reject the strategic-debtor model of bankruptcy.

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 by making debtors' names a matter of public record and lengthening the required period between bankruptcy discharges, which assures lenders that bankruptcy likely will not 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, policymakers 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' contributions 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 even 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.¹¹ BAPCPA was the final result of a long struggle to narrow the availability of bankruptcy relief.¹² The rhetoric of the reform debate focused

11. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended primarily in scattered sections of 11 U.S.C.).

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

on accusations that debtors were engaged in “strategic” behavior—borrowing without intention to repay and using bankruptcy as a financial tool to avoid repaying those debts.¹³ 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.¹⁴ The credit industry’s characterization of debtors as strategic actors was challenged with empirical evidence of the problems facing families who seek bankruptcy relief.¹⁵ Researchers documented the low to moderate incomes of most families in bankruptcy¹⁶ and pointed to decades of research confirming that job problems, illnesses, injuries, and family break-ups were pandemic in the bankrupt population.¹⁷ However, efforts on behalf of

13. WARREN & TYAGI, *supra* note 5, at 71–81.

14. See 11 U.S.C. § 707(b)(2) (Supp. V 2005). Numerous critics have attacked the means test. Some have complained that it creates large administrative and expense burdens that are not justified by the few families who are subject to the test. See Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 16 (2001) (concluding that the 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 the potential of means testing to harm the consumer bankruptcy system as a social safety net). Others have offered better systems to accomplish the goal of ensuring that creditors are repaid if a family can repay. See 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*, AM. BANKR. INST. J., Feb. 2003, at 6, 6 (proposing a system of “means measurement” that would “require chapter 7 debtors above a threshold income level to pay, according to a graduated scale, a percentage of income for a period of three years after discharge, with collections distributed to creditors”); 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) (describing “[s]ome who believe the new means test is not mean enough” and hope to “supplement[] the means test with additional, more stringent can-pay tests”).

15. See *Bankruptcy Reform: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2005) (statement of Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School), http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3996. 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.”).

16. See SULLIVAN ET AL., *supra* note 5, at 61–62 (finding that the median income for those who file bankruptcy is about 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 twenty-four percent of those in bankruptcy “had incomes at or above the national medians”). 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 WIS. L. REV. 969, 972–73 (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).

17. See SULLIVAN ET AL., *supra* note 5, at 186 (finding that “[d]ivorce and bankruptcy seem to be tied to each other”); WARREN & TYAGI, *supra* note 5, at 81 (“Nearly nine out of ten families with children cite just three reasons for their bankruptcies: job loss, family breakup, and

debtors 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.

That rising bankruptcy rates were the result of debtors' strategic behavior was a persistent theme 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 "growing perception that bankruptcy has become a first resort rather than a last measure for people who cannot keep up with their bills."¹⁸ The credit industry formed organizations to advocate for bankruptcy reform and hired powerful lobbyists to assert this perception of why consumers file bankruptcy.¹⁹ 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.²⁰ Congressional representatives echoed these fears about strategic or immoral debtors. Bankruptcy was just another "financial planning tool" for too many families looking to "skip out" on their debts.²¹ Prodigality and strategic rationality were wedded together in the strongest characterizations of debtors as immoral actors. Representative George Gekas from Pennsylvania lamented that "bankruptcy has become a way for reckless spenders to escape their debts."²² Advocates of bankruptcy reform deployed

medical problems."); Elizabeth Warren, *Financial Collapse and Class Status: Who Goes Bankrupt?*, 41 OSGOODE HALL L.J. 115, 144–45 (2003) ("[B]ankruptcy is a system that serves families on the way down. These individuals evidence substantial participation in activities that usually signal economic success—college, good jobs, home ownership—but something has gone badly wrong that results in their financial collapse . . . [such as] layoffs . . . [or] divorce . . .").

18. Edith H. Jones & James I. Shepard, *Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners*, in NAT'L BANKR. REVIEW COMM'N, *BANKRUPTCY: THE NEXT TWENTY YEARS*, ch. 5, at 2 (1997).

19. See Dickerson, *supra* note 3, at nn.78–84 (collecting accounts of bankruptcy reform that rely on public-choice theory to show the influence of the credit industry in enactment of legislation); Jensen, *supra* note 12, 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).

20. See Edith H. Jones & James I. Shepard, *Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law*, in NAT'L BANKR. REVIEW COMM'N, *supra* note 18, at ch. 5, 6, 11, 26.

21. 144 CONG. REC. 21,643 (1998) (statement of Sen. Grassley) ("The fact is that some people use bankruptcy as a convenient financial planning tool to skip out on debts they could repay.").

22. *National Bankruptcy Review Commission Report: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 105th Cong. 3 (1997) (statement of Rep. Gekas, Chairman, Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary).

an alternate argument that the bankruptcy system effectively amounted to a \$400 tax on every American family each year.²³ 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 characterizations of debtors as strategic actors who reacted in immoral ways to the undesirable incentives that bankruptcy law created for borrowers.²⁴

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 of Illinois 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.”²⁵ Mechele Dickerson has suggested that this public-choice focus on lobbying and campaign contributions shortchanged the policy debate.²⁶ She identifies the ideological underpinnings of the bill as an attempt to expand the scope of “personal responsibility” that bankrupt families should bear for their financial distress.²⁷ However, this description of bankruptcy reform’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 the apparent hypocrisy of creditors who complained about overindebted debtors while continuing to lend to such customers.²⁸ Such efforts were diluted by the panoply of alternate arguments raised against the proposed legislation.²⁹ Although the final bill included “Consumer Protection” in its title, the

23. See generally Elizabeth Warren, *The Phantom \$400*, 13 J. BANKR. L. & PRAC. 77 (2004) (chronicling the history of the \$400 bankruptcy-tax figure and its role in lobbying efforts for bankruptcy reform).

24. Mann, *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.”).

25. 145 CONG. REC. 8579 (1999) (statement of Rep. Hyde).

26. Dickerson, *supra* note 3, at 1876.

27. *Id.*; see also Mann, *supra* note 1, at 376 (“For the most part, the proponents relied on moral arguments—how shameful it is that Americans walk away so easily from their debts.”).

28. Jensen, *supra* note 12, at 520 (“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.’” (alteration in original) (quoting *Bankruptcy Reform Act of 1999 (Part I): Hearing on H.R. 833 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 106th Cong. 8 (1999) (statement of Rep. Jackson Lee) (opposing a 1999 bankruptcy-reform bill))).

29. 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 generally Jensen, *supra* note 12.

legislation made only modest reforms to creditor practices by requiring additional disclosures in credit contracts.³⁰ 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.”³¹ The purpose of the study was to examine the “effects of such practices on consumer debt and insolvency.”³² This provision reflects the frustrations of bankruptcy-reform opponents about the paucity of quantitative data about creditor practices.

The Federal Reserve issued the required report in June 2006, and it bore the promising title, “Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency.”³³ Yet, it contained no new data and yielded few insights into actual credit practices.³⁴ Notwithstanding the lack of empirical evidence, the report issued 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.”³⁵ The report concluded that “[c]onsideration of an existing or potential customer’s ability to repay is a major aspect” of credit solicitation and credit extension.³⁶ This statement fails to evaluate how lenders weigh repayment ability. In fact, lenders may consider ability to repay as a negative factor

30. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, §§ 1301–1306, 119 Stat. 23, 204–13 (codified as amended in scattered sections of 15 U.S.C.).

31. *Id.* § 1229, 119 Stat. at 200–01.

32. *Id.*

33. BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON PRACTICES OF THE CONSUMER CREDIT INDUSTRY IN SOLICITING AND EXTENDING CREDIT AND THEIR EFFECTS ON CONSUMER DEBT AND INSOLVENCY (2006) [hereinafter FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT], available at <http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybillstudy200606.pdf>.

34. See Pottow, *supra* note 9, at 415 n.47 (describing the Federal Reserve report required by section 1229 of BAPCPA as an “anticlimax”); Posting of Elizabeth Warren to TPM Café, Warren Report, Problems? What Problems? Fed Paints Happy Face on Credit Card Debt, http://tpmcafe.talkingpointsmemo.com/2006/08/08/problems_what_problems_fed_pai/ (Aug. 8, 2006, 11:59) (excerpting a long statement from Ronald Mann on weaknesses with the Federal Reserve study pursuant to section 1229 of BAPCPA). 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 MO. L. REV. 963, 972–76 (2006) (identifying reasons for skepticism about mandatory reports incorporated into BAPCPA).

35. FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 3–4.

36. *Id.* at 26.

rather than a positive factor in their profit models.³⁷ The mere fact that risk-scoring models include measurements of propensity or willingness to repay does not mean that lenders restrict their 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' strategies in marketing and extending credit were 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 the law "will ensure that more Americans can get access to affordable credit."³⁸ The President expressed concern that debtor abuse of the bankruptcy system had "made credit less affordable and less accessible, especially for low-income workers who already face financial obstacles."³⁹ 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."⁴⁰ This Article's original data on credit marketing to former bankruptcy debtors provide crucial evidence for evaluating the effects of bankruptcy reform on optimal credit use.

B. MODELS OF CONSUMER LENDING

Since 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

37. See Mann, *supra* note 1, at 384 (noting that for debt-based credit card issuers, the "most profitable customers are sometimes the least likely to ever repay their debts in full")

38. Remarks on Signing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 41 WEEKLY COMP. PRES. DOC. 641, 642 (Apr. 20, 2005); see also Jensen, *supra* note 12, at 566–67 (excerpting the statement of President Bush on the new bankruptcy law).

39. Remarks on Signing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 41 WEEKLY COMP. PRES. DOC. 641, 642 (Apr. 20, 2005).

40. *Id.*

financial problems.⁴¹ While literature on postbankruptcy credit is sparse, prior studies illustrate a need for effective policymaking to be cognizant of the role of creditors in the financial-distress dynamic.

Scholars have disagreed on whether consumer debt correlates with bankruptcy, the most common measure of financial distress in consumer-debt research.⁴² Debates about causation have been even more heated. Most research uses aggregate national data, due to weaknesses in household data,⁴³ and looks broadly at how the expansion of consumer credit tracks bankruptcy filings.⁴⁴ Some studies have focused particularly on credit cards because card use and card debt greatly expanded during the same period as consumer bankruptcy filings.⁴⁵ This line of research generally concludes that climbing consumer-debt burdens have some substantial relationship to higher bankruptcy filings.⁴⁶ These findings are limited by the fact that aggregate data reflect “only a typical household and may not be indicative of financial distress.”⁴⁷

Prior Consumer Bankruptcy Project research has yielded useful household-level data on the economic characteristics of families in bankruptcy.⁴⁸ These findings offer a “snapshot” view of the debt obligations

41. See WARREN & TYAGI, *supra* note 5, at 81 (showing that a large fraction of families with children who filed bankruptcy reported job problems, illness or injury, or a family break-up as reasons for their bankruptcy).

42. See, e.g., Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 348, 367–68 (analyzing the relationship between consumer debt and bankruptcy); 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 STAN. L. REV. 213, 248–50 figs.10 & 11 (2006) (charting changes in household debt using Federal Reserve data).

43. MANN, *supra* note 7, at 61–62.

44. See FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 15 tbl.6; Robert M. Lawless, *The Relationship Between Nonbusiness Bankruptcy Filings and Various Basic Measures of Consumer Debt* 5 (July 18, 2001) (unpublished manuscript, University of Illinois Law & Economics Research Paper Series), available at <http://ssrn.com/abstract=934798>.

45. See MANN, *supra* note 7 (examining the relation between credit card debt and consumer bankruptcy using nation-level aggregate data from five countries); Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits and Bankruptcy*, 71 AM. BANKR. L.J. 249 (1997) (analyzing the effect of limiting the dischargeability of credit card debt on overextended consumers); Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79 (2000) (developing a model of the underlying economics of credit cards and credit card use); Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate*, BANK TRENDS (Fed. Deposit Ins. Corp., Wash., D.C.), Mar. 1998, available at http://www.fdic.gov/bank/analytical/bank/bt_9805.pdf (describing the expanding access to consumer credit and higher level of personal bankruptcies after the deregulation of consumer interest rates in the late 1970s).

46. MANN, *supra* note 7, at 69; see also FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 15 (“The rate at which consumers file for bankruptcy has broadly trended up with the real value of revolving consumer credit per household.”).

47. FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 13.

48. SULLIVAN ET AL., *supra* note 5, at 63–71; WARREN & TYAGI, *supra* note 5, at 64 & tbl.4.1.

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,⁴⁹ choosing to evidence the strategic-debtor model with anecdotes, not data.

Despite public lamentations about being taken advantage of, the credit industry may in fact seek out families in financial distress. Two recent articles explain this phenomenon and illuminate how current law permits creditors to 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.⁵⁰ They describe how this construct drives fears that the “Bankruptcy Code encourages inefficient and opportunistic ex ante decisionmaking.”⁵¹ 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 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.”⁵² In their view, consumer-credit policy evinces a misplaced focus on borrower rationality.⁵³ 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.⁵⁴ 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.⁵⁵ Focusing on credit card issuers,⁵⁶ Mann

49. See Jones & Shepard, *supra* note 20, at 6, 13.

50. Block-Lieb & Janger, *supra* note 2.

51. *Id.* at 1486.

52. *Id.* at 1488.

53. *Id.* at 1565 (“To the 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.”).

54. *Id.* at 1500.

55. See Mann, *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.

56. 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

sketches a “dynamic of profitability,” showing how financially distressed borrowers generate hyper-profits.⁵⁷ He contrasts this new lending model with conventional loans to illustrate how financial distress—at least to a point—fuels, rather than depresses, revenue.⁵⁸ Indeed, credit card companies enjoyed record profits as the bankruptcy rate escalated.⁵⁹ Mann identifies ways that BAPCPA may enhance profits from families in financial distress by delaying or deterring bankruptcy.⁶⁰ Growing recognition of such lending models has spawned reform proposals that aim to limit such lending or to force lenders to internalize the harms of financial distress.⁶¹

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.⁶² Just one year after bankruptcy, the substantial minority of families reports that their financial position has worsened or failed to improve.⁶³ Many struggle to meet ordinary expenses.⁶⁴ Examining the availability of postbankruptcy credit complements efforts to understand lenders’ roles in their customers’ 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 does 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 data that reflect the current consumer-lending market.

Accounts of the availability of postbankruptcy credit differ greatly. The general public, and indeed many people who file bankruptcy, apparently believe that bankruptcy will devastate a consumer’s ability to borrow.⁶⁵ These

subprime borrowers are developed. Whether relying on fee revenue in these broader markets will prove successful is unclear at this time.

57. *Id.* at 386.

58. *Id.*

59. Adam Goldstein, Note, *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.

60. Mann, *supra* note 1, at 392–97.

61. See, e.g., Pottow, *supra* note 9, at 420–63.

62. 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).

63. *Id.* at 87 fig.3, 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.”).

64. *Id.* at 84 fig.1 (reporting that twenty-five percent of the Chapter 7 debtors studied reported difficulty in paying bills one year after bankruptcy).

65. The conventional wisdom that credit is hard to get after bankruptcy typically is spread by nonspecialists. See, e.g., Michael Moody, *Obtaining Credit After Bankruptcy: Mission Impossible*, EZINE ARTICLES, Oct. 16, 2006, <http://ezinearticles.com/?Obtaining-Credit-After-Bankruptcy:->

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.”⁶⁶ 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 highlighted the rampant solicitation of families after bankruptcy.⁶⁷ 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.⁶⁸ The story noted that firms specialize in marketing to bankrupt consumers; the firms’ advertising materials to investors trumpet a “unique and lucrative market.”⁶⁹ The *New York Times* used the experience of another bankruptcy filer to shape its story, reporting 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.”⁷⁰ While quotes from banking industry representatives in the *New York Times* story reflected some variation in credit marketing to recent debtors,⁷¹ neither news story turned up any industry or government data to support the extent and nature of credit availability after bankruptcy.⁷²

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

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). *But see, e.g.*, Total Bankruptcy, What the Credit Industry Doesn’t Want You to Know About Bankruptcy, http://www.totalbankruptcy.com/credit_industry_secrets.htm (last visited Apr. 1, 2008) (debunking the myth that one cannot get credit after bankruptcy).

66. Selwyn Enzer, Raul de Brigard & Frederick D. Lazar, *Some Considerations Concerning Bankruptcy Reform*, in REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, pt. III, at 1, 90 (1973).

67. *See, e.g.*, Robert J. Hawkins, *Truth Is Scariest 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 the highlight of a bankruptcy documentary).

68. Caroline Mayer, *Bankrupt and Swamped with Credit Offers*, WASH. POST, Apr. 15, 2005, at A1.

69. *Id.*

70. Timothy Egan, *Newly Bankrupt Raking in Piles of Credit Offers*, N.Y. TIMES, Dec. 11, 2005, § 1, at 1.

71. *Id.* (describing different approaches reported by Bank of America and Citibank).

72. The *Washington Post* article reported preliminary data from the Consumer Bankruptcy Project sample that is the basis for this Article’s analysis. *See Mayer, supra* note 68.

and practices of consumer bankruptcy attorneys.⁷³ Although her study had a much broader focus,⁷⁴ Braucher assessed the perceptions of debtors' attorneys about postbankruptcy access to credit. She found that lawyers are frequently asked about the impact of bankruptcy on future credit.⁷⁵ Her interviews led her to conclude that "[m]ost debtors who consult bankruptcy lawyers are concerned about future access to credit."⁷⁶ She noted that while "nearly all" lawyers give advice to clients on this matter, most do so without the benefit of accurate information.⁷⁷ 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).⁷⁸ Many attorneys expressed concern about the easy access to postbankruptcy credit.⁷⁹ This concern caused some attorneys to understate the availability of credit to potential Chapter 7 debtors.⁸⁰ Braucher also identified attorneys' desire to have clients file Chapter 13 as a factor that dampens lawyers' disclosure about credit availability after Chapter 7 bankruptcy.⁸¹ Attorneys apparently use their impressions about the *type* of credit, not just the availability of credit, to bolster their preference for Chapter 13 cases.⁸² Several lawyers believed that after a Chapter 7 bankruptcy, the available credit was "often at the highest rates and from the

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

74. *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.")

75. *Id.* at 537.

76. *Id.*

77. *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.")

78. Braucher, *supra* note 73, at 538.

79. See *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.")

80. *Id.* ("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.")

81. *Id.* at 538-39.

82. *Id.* The motivation to have clients choose Chapter 13 is driven largely by the ability to recover fees in installments through a debtor's plan. See *id.* at 548-50. Attorneys may also prefer Chapter 13 because most districts approve higher attorneys' fees for Chapter 13 cases than Chapter 7 cases. See *id.* at 546. Finally, some attorneys believe that Chapter 13's repayment scheme has moral or educational benefits for their clients. See *id.* at 567-69.

sleaziest purveyors.”⁸³ These attorneys believed credit would be cheaper or offered on more favorable terms after a Chapter 13 bankruptcy. Braucher did 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.⁸⁴ However, Braucher’s research does not have sufficient data on postbankruptcy credit to provide 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 two thousand people who filed bankruptcy between 1978 and 1988.⁸⁵ In the twenty to thirty years since that study’s families filed bankruptcy, the variety and quantity of subprime credit has exploded,⁸⁶ and Americans have loaded up on debt.⁸⁷ These changes may undercut the applicability of Staten’s 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.⁸⁸ 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% of new credit lines accepted by debtors were issued by prior creditors.⁸⁹ Staten hypothesizes that an indeterminate amount of this new credit could result from prescreened offers that were processed before the debtors filed bankruptcy, but he offers

83. Braucher, *supra* note 73, at 540.

84. *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.”).

85. Michael E. Staten, *The Impact of Post-Bankruptcy Credit on the Number of Personal Bankruptcies* 12 (Credit Research Ctr., Purdue Univ., Working Paper No. 58, 1993), available at <http://www.gwu.edu/~business/research/centers/fsrp/pdf/WP58.pdf>.

86. See Block-Lieb & 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.”); see also JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., STATE OF THE NATION’S HOUSING 2005 REPORT, EXECUTIVE SUMMARY 17 & fig.20 (2005), available at <http://www.jchs.harvard.edu/publications/markets/son2005/son2005.pdf> (showing the recent increase in subprime lending).

87. See MANN, *supra* note 7, at 53 (noting a “major increase in total consumer debt”); Lawless, *supra* note 42, at 364 figs.1.A & 1.B (showing an increasing rate of nonmortgage short-term and long-term consumer credit).

88. These findings are very important for testing how families respond to bankruptcy discharge and are useful for testing the fresh-start theory against the realities of postbankruptcy life. Staten’s principal findings are reported in several useful figures. See Staten, *supra* note 85, at 26 exhibit 8, 28 exhibit 11.

89. *Id.* at 15 tbl.4. Note, however, that only 16.2% of all debtors had accepted any new credit at the one-year postbankruptcy mark. *Id.* at 13.

no evidence of this effect.⁹⁰ His conjecture may reflect surprise at the substantial fraction of creditors who chose to lend quickly 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.⁹¹ David Musto found that consumers' FICO credit scores jumped significantly after a bankruptcy was expunged from their reports⁹² and that this boost in apparent creditworthiness corresponded with debtors' acquisition of new bank credit cards.⁹³ Musto's research nicely illustrates how the law can and does shape creditors' responses to families who file bankruptcy. However, because Musto studied 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 credit availability after bankruptcy. This gap in the existing literature has contributed to the dominance of the strategic-debtor model and has 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 III"),

90. *Id.* at 16.

91. David K. Musto, *What Happens When Information Leaves a Market? Evidence from Postbankruptcy Consumers*, 77 J. BUS. 725, 726 (2004). The relevant federal law is the Fair Credit Reporting Act. See 15 U.S.C. § 1681c(a)(1) (2000).

92. Musto, *supra* note 91, at 735.

93. *Id.* at 737 (estimating one extra card is obtained per four consumers in the tenth year following bankruptcy).

which began in 2001 and ended in 2004.⁹⁴ CBP III was a large, interdisciplinary study of consumer bankruptcy that involved a dozen researchers.⁹⁵ The sample consists of consumer bankruptcy cases filed in the first months of 2001 in five judicial districts across the nation.⁹⁶ 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 1250 consumer bankruptcy cases, consisting of 780 Chapter 7 bankruptcies and 470 Chapter 13 bankruptcies. 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.⁹⁷ The questionnaire requested demographic information, such as age, occupation, and marital status, and inquired about the family’s reasons for seeking bankruptcy relief.⁹⁸ For each debtor who completed a questionnaire, researchers coded data from the debtor’s corresponding public court records, the 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.

The questionnaire invited debtors to participate in follow-up telephone interviews in return for compensation of fifty dollars per interview. Approximately one year after bankruptcy, a small team of trained researchers conducted telephone interviews with 601 families in the core sample.⁹⁹ Approximately three years after the debtors filed bankruptcy, researchers attempted to contact each respondent who had completed the first telephone interview to conduct a second telephone interview. These

94. I served as Project Director of CBP III 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. Phase IV of the Consumer Bankruptcy Project (“CBP IV”) began in January 2007 to study post-BAPCPA debtors. I am an investigator in CBP IV, but no data in this Article come from that study.

95. Additional descriptions of the methodology used in CBP III have appeared in numerous articles presenting data from the study. See WARREN & TYAGI, *supra* note 5, at 181–88; David U. Himmelstein et al., *Market Watch: Illness and Injury as Contributors to Bankruptcy*, HEALTH AFF., Feb. 2, 2005, at W5-64 to -66, <http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1.pdf>; Porter & Thorne, *supra* note 62, at 125–28.

96. The CBP III sample was collected in the following five judicial districts: Eastern District of Pennsylvania; Northern District of Illinois; Middle District of Tennessee; Northern District of Texas; and Central District of California.

97. See 11 U.S.C. § 341 (2000 & Supp. V 2005).

98. A copy of the questionnaire is publicly available. See Elizabeth Warren, *Bankrupt Children*, 86 MINN. L. REV. 1003, 1028–32 (2002).

99. See *infra* notes 108–09 and accompanying text for an analysis of the issue of respondent bias.

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 thirty-eight percent of the original sample of 1250 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 questionnaires 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, I analyze data from respondents who filed Chapter 13 cases to compare how credit opportunities differ between Chapter 7 debtors and Chapter 13 debtors. At that point, I explain that the legal differences between Chapter 7 and Chapter 13 justify considering the two types of bankruptcy separately.¹⁰⁰ Analysis of the demographic and economic characteristics of Chapter 13 respondents shows that these filers have higher incomes and more assets and are more likely than Chapter 7 filers to be married, employed, or homeowners when they file bankruptcy.¹⁰¹ These significant differences are a further reason for considering separately the experiences of Chapter 7 and Chapter 13 debtors.

The Chapter 7 sample used for this Article was narrowed from the 780 Chapter 7 cases in the core sample to include only those cases in which a first-round telephone interview was completed. The longitudinal perspective of my analysis requires data on the postbankruptcy experiences of debtors, and the telephone interview was the instrument used to gather such data. Thus, the relevant sample (unless otherwise specified)¹⁰² contains 359 Chapter 7 bankruptcy cases and captures forty-six percent of the 780 Chapter 7 cases in the core sample.¹⁰³

100. See *infra* notes 180–85 and accompanying text.

101. These differences were significant at the .05 level. The differences between the sex of the primary petitioners and the families' total liabilities at the time of filing were not significant. Details on the demographics of Chapter 7 debtors are presented in the main text.

102. See *infra* Part II.E (analyzing a sample consisting of Chapter 13 debtors in the core sample who completed the first telephone interview).

103. Some debtors could not be contacted at the contact information that they provided because the debtors had apparently moved or provided incorrect information. In anticipation

I compared the Chapter 7 telephone-interview sample to the demographic findings of previous bankruptcy studies.¹⁰⁴ These studies measured common demographic and economic characteristics of debtors, such as age, marital status, occupational prestige score, homeownership, median annual income, and median unsecured debt. The respondents in this sample appear consistent with the profiles of Chapter 7 debtors in prior studies.¹⁰⁵ Primary petitioners in the Chapter 7 telephone-interview sample averaged forty-three years old. Approximately one-third were married and living with a spouse, while another seven percent were married but living separately. The median occupational prestige score was thirty-six; occupations such as office clerk, bricklayer, teacher's assistant, and steel worker are represented by this score. Approximately thirty-one percent of the respondents reported that they owned their homes at the time of filing. Families earned a wide range of incomes. Eight households, or just over two percent of the sample, said that they received no income whatsoever. At the other end of the spectrum, one debtor reported annual earnings of just over \$101,000. Overall, median annual income for households in the sample was \$21,870—about half of the national average.¹⁰⁶ Median unsecured debt was \$27,528. Like other researchers, I conclude that most bankruptcy debtors are demographically similar to middle-class Americans but earn much lower incomes at the time of their bankruptcies.¹⁰⁷

Debtors who completed the telephone interviews were self-selected, introducing the possibility of respondent bias.¹⁰⁸ To test for this, Dr. Deborah Thorne, the Project Director of the Consumer Bankruptcy Project when the interviews were conducted, compared interview participants and nonparticipants on several important demographic and economic variables. Demographically, the two groups were comparable on the variables of age, employment status, and homeownership. Interview participants were, however, significantly more likely to be single and white than those who did

of this problem, we asked debtors to provide us with two alternative contacts, which increased the response rate. Nevertheless, some debtors gave only their own information, and sometimes the alternative contacts could not be located. We were unable to complete interviews with these debtors. This nonparticipation may have skewed the data to overrepresent the economic stability of the postbankruptcy population. That is, those who could not be located for interviews may be those facing the most severe financial distress, considering that they either moved and/or changed telephone numbers in the immediate aftermath of their bankruptcy.

104. See SULLIVAN ET AL., *supra* note 5, at 27–74; WARREN & TYAGI, *supra* note 5, at 7; Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1, 26–29 (2004).

105. Warren, *supra* note 17, at 121 (2003) (concluding that 2001 bankruptcy debtors were middle class and similar to debtors who filed in 1991).

106. *Id.* at 125 (citing U.S. Census Bureau data for median household income in 2001 at \$42,228 and comparing that figure with the median bankrupt debtor's income of \$24,108 in 2001).

107. See SULLIVAN ET AL., *supra* note 5, at 64–65; Warren, *supra* note 17, at 155.

108. See EARL BABBIE, *THE PRACTICE OF SOCIAL RESEARCH* 187–90 (10th ed. 2004).

not complete interviews. Analysis of the economic variables did not reveal any statistically significant differences between the two groups. Debtors' court records revealed similar incomes, assets, and liabilities. Based on this analysis, the narrowed sample of telephone interview respondents appears to be generally representative of the 780 Chapter 7 cases that comprised the CBP III core sample.¹⁰⁹

To increase the longitudinal perspective on postbankruptcy experiences, I also present data from the second round of telephone interviews completed in 2004. Of the 359 households in the sample used in this Article (Chapter 7 debtors who completed the first-round telephone interview), 302 households completed a second interview approximately three years after each family's bankruptcy. This modest atrophy in the sample reflects the increased difficulty in locating debtors as years elapsed after their bankruptcies and their completion of the written questionnaire. I report the number of respondents with the relevant data and indicate whether the data come from the first or second interviews. A comparative analysis of demographic and economic differences between the first-round interview respondents and the second-round interview respondents showed no significant differences between the groups.¹¹⁰

B. SOLICITING CREDIT CUSTOMERS

The availability of postbankruptcy credit was a principal focus of the longitudinal interviews. The detailed data reveal how the credit industry responds to bankruptcy and support assertions that the current economy for consumer credit relies on high-risk borrowing to maximize profits.

Credit solicitation of recent bankruptcy debtors is rampant. Nearly all debtors stated that lenders offered them credit in the first months following their bankruptcy.¹¹¹ Figure 1 illustrates that just one year after bankruptcy, 96.1% of debtors were recipients of credit solicitations. Only 3.9% of families said that they had not received credit offers. To the extent that conventional wisdom says that debtors will not be able to borrow immediately after a bankruptcy filing,¹¹² the adage is neither wise nor reflective of today's credit market.

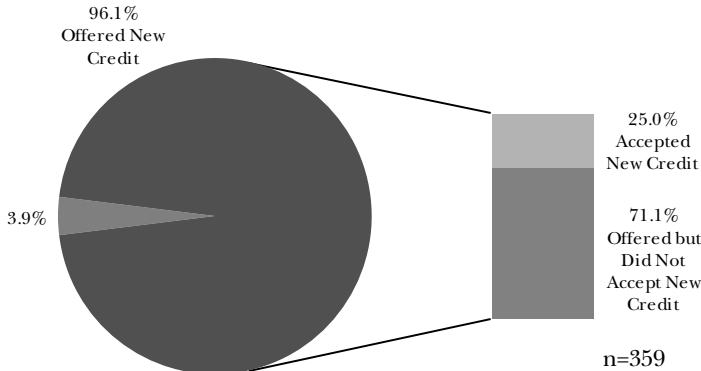
109. Porter & Thorne, *supra* note 62, app. at 127–28 (reporting detailed respondent and nonrespondent data for a subsample of 359 Chapter 7 bankruptcy cases from CBP III).

110. I compared Chapter 7 respondents who completed the first-round interviews with the respondents who completed the second-round interviews along several variables: total assets at bankruptcy, total liabilities at bankruptcy, total unsecured debt at bankruptcy, income at bankruptcy, sex, homeownership, employment status, marital status, and age. Tests of each group showed no significant differences for any of these factors.

111. Again, these data reflect respondents from the Chapter 7 core sample who completed the first round of telephone interviews. Data on Chapter 13 families are presented in Part II.E, *infra*.

112. See *supra* note 65 and accompanying text.

Figure 1. Percent of Debtors Offered Credit and Who Accepted Credit in First Year After Bankruptcy



Most debtors did not accept new credit, reporting that they were avoiding the credit industry entirely after bankruptcy.¹¹³ Debtors' use of credit bears directly on the rehabilitative goal of consumer bankruptcy,¹¹⁴ and further research could consider how debtors use credit during the crucial "fresh start" period after bankruptcy.

Debtors not only had the chance to borrow, they were inundated with solicitations urging them to borrow.¹¹⁵ One year postbankruptcy, these families reported that creditors sent them an average of more than fourteen credit offers per month. In practical terms, this means that more often than not, each new day after bankruptcy presented these former bankrupts with an opportunity to borrow. Table 1 gives summary statistics on the frequency of credit offers. While the reported numbers ranged significantly, the typical (median) family said that it received ten credit offers each month. On an annual basis, this corresponds to more than one hundred invitations to borrow.

113. A modest fraction of families in addition to the twenty-five percent shown in Figure 1 may have had access to credit after bankruptcy despite avoiding new postbankruptcy credit. These families may have had a prebankruptcy credit line that was reaffirmed in their bankruptcy and remained available for their use after bankruptcy.

114. See Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1062 (1987) (identifying participation in the open credit economy through borrowing as one of the principal definitions of rehabilitation for bankrupt debtors).

115. Analysis of respondents' answers to the question asking them to report the number of credit offers that they received in a month revealed two responses of 300 offers per month (corresponding to ten per day in a thirty-day month). These two outliers were removed before these data were analyzed, and the findings on credit offers do not include these two individuals.

Table 1. Frequency of Credit Offers Per Month in Year After Bankruptcy

Average	14.56
Median	10
Standard Deviation	19.66
Number of Respondents	339

Most debtors did not seem to expect these solicitations. Debtors' expectations about postbankruptcy credit were not a subject of the written survey that debtors completed shortly after their bankruptcy filing.¹¹⁶ However, comments in the longitudinal interviews suggest that some families were shocked at the response of lenders to their bankruptcy. A married man in his early thirties from Texas expressed this reaction:

I was surprised at how fast they wanted to get you back into the credit game, [at] all of the offers of credit. It was incredible. They sent us lots and lots of offers for credit, right after we filed. And I was told that it would improve my credit history.¹¹⁷

Debtors gave vivid and colorful descriptions of the numerous credit offers that they received after bankruptcy.¹¹⁸ A middle-aged real-estate developer likened himself to “fresh meat” out on the market, noting that it seemed like everyone was willing to help him get credit back.¹¹⁹ Families generally felt inundated with what they described as an “unreal” number of credit solicitations.¹²⁰

Indeed, families who have filed bankruptcy appear to be particularly desirable future borrowers. Bankruptcy debtors seem to receive more credit solicitations than the general American population. Industry researchers

116. Researchers interested in understanding how debtors choose between the two types of bankruptcy relief could fruitfully explore the role of credit expectation in the chapter-choice decision.

117. Telephone Interview by Consumer Bankr. Project III with Respondent TX-07-067 (one year postbankruptcy).

118. A Tennessean claimed that “[p]eople have been running over me to get me to buy a car.” Telephone Interview by Consumer Bankr. Project III with Respondent TN-07-062 (one year postbankruptcy). Another debtor stated that he got frequent offers to refinance his mortgage and was mailed “live” checks. Telephone Interview by Consumer Bankr. Project III with Respondent PA-07-015 (one year postbankruptcy). He told his interviewer, “If I don’t get at least one or two in a week, it is not a good week.” *Id.*

119. Telephone Interview by Consumer Bankr. Project III with Respondent TN-07-133 (three years postbankruptcy).

120. Telephone Interview by Consumer Bankr. Project III with Respondent IL-07-038 (one year postbankruptcy).

report that the average American gets six credit offers each month.¹²¹ The average bankrupt household in the sample reported receiving fifteen offers each month, 2.5 times the number directed to the average nonbankrupt family.¹²² A carpenter in his mid-thirties warned that “[o]nce you file for bankruptcy, lenders come out of the woodwork. . . . They just really try to get you back in debt again. I still get lots of offers [three years after bankruptcy] and just toss them.”¹²³ Many debtors noted a marked uptick in credit marketing after bankruptcy. An insurance claims worker described her perception that bankruptcy improved her credit access:

All these offers that I get for financing—Before I filed I bet I could not get a loan. The ironic thing is I’m sure, say within the six months before I filed, they would have laughed at me if I wanted to get a loan. Now they are saying “let us give you money.”¹²⁴

The frequency and persistence of credit solicitations leaves many American families feeling overwhelmed.¹²⁵ Federal Reserve researchers found that eighty-five percent of consumers in a study believed that credit card solicitations caused other consumers to take on too much debt.¹²⁶ In response to complaints about the deluge of credit-industry mail, Congress passed legislation that allows families to opt out of receiving prescreened

121. See Andrew Becker, *The Battle over “Share of Wallet,”* FRONTLINE: SECRET HISTORY OF THE CREDIT CARD, Nov. 23, 2004, <http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/battle.html> (citing research conducted by Synovate, a private research firm). The overall response rate on credit card solicitations is very low and has dropped significantly in recent years. See FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 20 tbl.11 (showing that in 2004, the industry mailed 5.23 billion credit card solicitations that returned a 0.4% response rate); David Enrich, *Card Firms Curb Mailings—a Bit*, WALL ST. J., July 26, 2006, at D3 (reporting that data from the marketing firm Synovate show that more than six billion credit card offers sent in 2005 generated a response rate of only three per one-thousand offers).

122. In telephone interviews approximately one year after bankruptcy, debtors were asked to report how many credit offers they received each month. Because these data are self-reported, there is potential for reporting bias or cognitive error to skew the data. It is unclear whether the data on the number of solicitations sent to the general population, cited *supra* note 121, comes from self-reporting or from private industry data. Thus, I cannot determine if a similar potential for bias exists for that figure.

123. Telephone Interview by Consumer Bankr. Project III with Respondent TN-07-041 (three years postbankruptcy).

124. Telephone Interview by Consumer Bankr. Project III with Respondent PA-07-132 (one year postbankruptcy).

125. See Robert Berner, *Cap One’s Credit Trap*, BUS. WK., Nov. 6, 2006, at 34, 34 (quoting a consumer with six Capital One credit cards who believed that Capital One was “nuts” for being “willing to give me another credit card” when he “owe[d] these people that much damn money”); Bob Sullivan, *Deluged with Credit Card Mail? Help Is on the Way*, MSNBC.COM, Aug. 8, 2005, <http://www.msnbc.msn.com/id/8827007/> (documenting the number of solicitations some families receive each month and describing the law allowing consumers to opt out of prescreened solicitations).

126. FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 12–13.

credit offers.¹²⁷ This regulatory intervention enables families to eliminate themselves as potential customers for new credit. Opting out also can be a tool for financial discipline, reducing marketing pressure to borrow and helping consumers to take affirmative control of their financial decisions.¹²⁸ Yet few families take advantage of the opt-out law, and the result is that credit solicitations are a reality of modern American life.¹²⁹

Many debtors reported feeling frustrated, and even angered or scared, by the intensity of credit solicitations after bankruptcy. Indeed, these families' frustration with credit offers may be even sharper than that of the typical American. These families' downward spirals into bankruptcy were punctuated with efforts to borrow their way back to financial stability and with increasing reliance on credit to make ends meet. The number of dollars of debt discharged in each family's bankruptcy was a tangible and public signal of the depth of its financial collapse. Because credit was a crucial (albeit unsuccessful) strategy that they used in their efforts to avoid bankruptcy, they now may associate credit with financial failure. Their financial collapse may heighten their consternation about credit marketing and explain why such offers made many consumers feel vulnerable. When asked if she had received credit offers, a Californian proclaimed:

Constantly! I've been pre-approved more times than you can count. I just throw them in the trash. I actually got a \$2000 credit card; it suddenly arrived in the mail, a real, live credit card. I scissored it up into seventeen pieces. You'd think I was Donald Trump, the way they would send me credit cards. When I got that credit card, I sat down and wrote them a blistering letter, but I doubt anyone ever read it.¹³⁰

This woman's disdain for credit solicitations seems to stem from her belief that she cannot afford \$2000 in credit card charges. Many families echoed her perception that lenders' credit offers threatened their financial recovery after bankruptcy.

Generally, debtors disapproved of the aggressive marketing to bankruptcy filers. A Californian said that getting credit cards after

127. Fair Credit Reporting Act § 604, 15 U.S.C. § 1681b(e) (2000 & Supp. V 2005); *see also* BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON FURTHER RESTRICTIONS ON UNSOLICITED WRITTEN OFFERS OF CREDIT AND INSURANCE 11–12 (2004) [hereinafter FED. RESERVE, REPORT ON UNSOLICITED WRITTEN OFFERS], *available at* <http://www.federalreserve.gov/boarddocs/rptcongress/UnsolicitedCreditOffers2004.pdf>.

128. *See* Angela Littwin, *Beyond Usury: A Study of Credit-Card Use and Preference Among Low-Income Consumers*, 86 TEX. L. REV. 451, 481–84 (2008) (developing recommendations to improve the opt-out law to provide users with more control over the type of solicitations received).

129. FED. RESERVE, REPORT ON UNSOLICITED WRITTEN OFFERS, *supra* note 127, at 17 (stating that only six percent of people with credit records choose to opt out).

130. Telephone Interview by Consumer Bankr. Project III with Respondent CA-07-187 (one year postbankruptcy).

bankruptcy was “[n]ot as difficult as it should have been. It just seemed almost too easy. They just sent a piece of paper and said that I’ve been preapproved for \$3000. It’s yours, just return the application”¹³¹ This woman’s comments hint at some anxiety about the consequences of the widespread availability of postbankruptcy credit. A man in his mid-fifties with some college education used the final open-ended question of the interview to share his frustrations: “The bottom-line profit mentality we have in the United States is one of the main issues here. I can’t believe how many credit applications are coming in even now.”¹³²

These respondents’ concerns reveal an important consequence of the “democratization of credit” that is rarely explored. Rather than seeing expansive credit as a benefit, families may desire restraints on credit marketing as an aid for improving their financial practices.¹³³ Optimal policy must balance these desires against the goal of credit rehabilitation that is encompassed by bankruptcy’s fresh-start theory.¹³⁴

C. THE BANKRUPTCY BEACON

The prior data show that lenders repeatedly solicit families who file bankruptcy. This Section explores the identity of these creditors and their knowledge about their potential customers’ bankruptcies. The findings show that the industry’s appetite for “deadbeat debtors” results from neither miscalculation nor marketing mishap. Bankruptcy debtors are specifically targeted to become new consumers of credit products. The public records of bankruptcy cases serve as a beacon that guides lenders to these lucrative customers.

One bank spokesperson has asserted that any credit card offers that the bank sends to people who have filed bankruptcy are inadvertent.¹³⁵ The data cast doubt on this denial. Major lenders deploy sophisticated analytical tools to identify future customers and their anticipated profitability. This strategy has been fundamental to the price and term differentiation that dominates

131. Telephone Interview by Consumer Bankr. Project III with Respondent CA-07-149 (three years postbankruptcy).

132. Telephone Interview by Consumer Bankr. Project III with Respondent TX-07-057 (one year postbankruptcy).

133. See Littwin, *supra* note 128, at 485 (finding that low-income women would like the law to require credit card companies to give consumers the option of setting their own credit card limits or require consumer approval before increasing credit limits).

134. See Porter & Thorne, *supra* note 62, at 74 (describing how bankruptcy’s rehabilitative purpose includes enabling future borrowing); see also KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 99–103 (1999).

135. Egan, *supra* note 70 (reporting that a Bank of America spokeswoman said that the bank does not give credit cards to people who file bankruptcy but that a delay between the bankruptcy petition and credit reporting could cause the bank to still send an offer to someone who filed bankruptcy).

the current lending environment.¹³⁶ During the same period in which the bankruptcy rate escalated,¹³⁷ technology improved the credit-reporting and -scoring systems. Simultaneously, marketing departments launched powerful incentives, such as “teaser” interest rates and affinity programs, to attract customers.¹³⁸ Given this formidable marketing prowess,¹³⁹ accidental offers are probably rare. The industry’s technology could probably prevent most postbankruptcy credit offers, and the sheer numbers of offers that continue for years after bankruptcy strongly suggest that very few offers were processed before the credit report showed the bankruptcy.

The data suggest that lenders specifically target recent bankruptcy debtors. The evidence to support this assertion comes from debtors’ reports about the credit offers. Figure 2 illustrates two findings that strongly support the existence of a credit market for known bankruptcy debtors. The phenomenon of postbankruptcy credit cannot be dismissed as merely incidental to efforts to solicit the general American population.

136. See FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 19 (noting the existence of “varied product offerings” that allow creditors “to tailor incentives and products to specific segments of the market and to price them in a way that reflects the underlying risk of each segment”).

137. ADMIN. OFFICE OF THE U.S. COURTS, BANKRUPTCY STATISTICS, http://www.uscourts.gov/bnkrpctystats/Bk2002_1990Calendar.pdf (providing the number of filings per calendar year between 1990 and 2002).

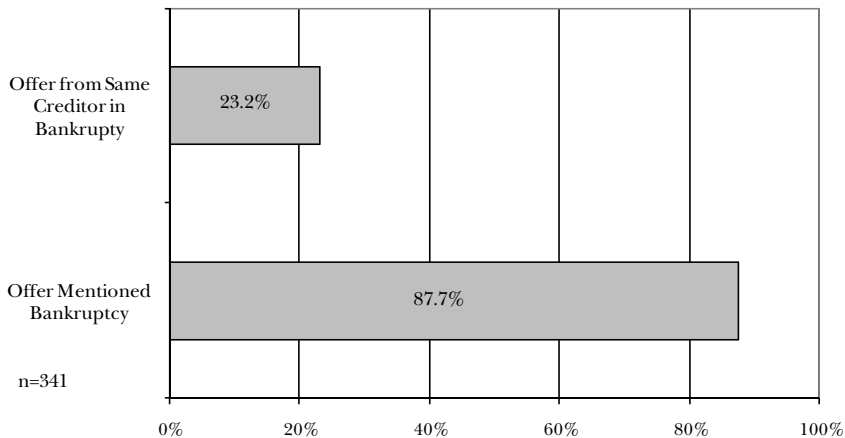
138. See Becker, *supra* note 121.

139. See FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 33, at 19. The report states:

Lender ratings of potential borrowers have become increasingly sophisticated and automated over the past decade. Lenders have extensive information on borrowers available from credit reporting agencies and from proprietary databases. This information is combined with new quantitative modeling techniques—which help lenders rank prospective borrowers on the basis of historical information about borrowers with similar quantifiable characteristics—to guide the determination of which prospective borrowers in each portfolio will be extended credit and the pricing of that credit.

Id.

Figure 2. Bankruptcy as a Factor in Credit Solicitation



A vast majority of debtors had received credit solicitations that specifically mentioned their bankruptcy. Nearly eighty-eight percent of debtors reported that lenders had referenced the debtor's bankruptcy in their credit marketing. The prevalence of these offers reflects that at least some creditors intentionally seek out recent bankruptcy debtors as future customers. When asked if she had received any offers that mentioned her bankruptcy, a woman in her mid-thirties affirmed "almost all of them."¹⁴⁰ She described their content: "We want to help, bankruptcy specialist, blah, blah, blah. It's awful."¹⁴¹ Another woman read an interviewer a loan offer that she had received for a car. The solicitation explained:

Your name was obtained due to your recent bankruptcy filing—don't be alarmed. . . . We know that bad things happen to good people. . . . We know that in the 12 months prior to bankruptcy people may experience considerable anxiety and stress. With our help you could be driving a new car the same day your bankruptcy is discharged.¹⁴²

As an accountant observed, "They seem to be looking for people who filed."¹⁴³

Bankruptcy law facilitates these marketing efforts. Filing bankruptcy is a public act.¹⁴⁴ Individual creditors and the credit-reporting bureaus search

140. Telephone Interview by Consumer Bankr. Project III with Respondent PA-07-062 (one year postbankruptcy).

141. *Id.*

142. Telephone Interview by Consumer Bankr. Project III with Respondent PA-07-108 (one year postbankruptcy).

143. Telephone Interview by Consumer Bankr. Project III with Respondent CA-07-016 (three years postbankruptcy).

the records to obtain the names and contact information of bankruptcy debtors. Some companies specialize in trolling the court records and selling lenders lists of bankruptcy filers.¹⁴⁵ Lenders' access to this information for marketing purposes is probably an unintended consequence of the public nature of bankruptcy. Nevertheless, the effect deserves policy attention.¹⁴⁶ Amidst lamentations that the stigma of bankruptcy is declining,¹⁴⁷ lenders are capitalizing on bankruptcy records to market to debtors. Notwithstanding the public rhetoric, creditors' private message to these families is that, far from being pariahs, they are welcome customers.

Research on Chapter 7 debtors' postbankruptcy experiences suggests that former debtors are lucrative customers. In the first year after filing, many families face financial difficulty and must cope with declining or stagnant incomes.¹⁴⁸ People in financial distress are more likely to have revolving accounts, to exceed their credit limits, and to use cash advances (which carry higher interest rates), creating what some researchers have termed "attractive cash flows."¹⁴⁹ If families face difficulty in making ends meet after bankruptcy, their profitability potential for lenders is greater. Fee and interest income are a major component of credit card lenders' profits.¹⁵⁰ Other subprime lending products may also rely heavily on such revenue. These families exemplify the ideal customers for lenders' "sweatboxes."¹⁵¹ These families may be slow to pay, they may make only small payments, they may incur huge fees, and their balances may negatively amortize. But they cannot seek bankruptcy relief. It is precisely this constellation of features that makes postbankruptcy families particularly profitable for lenders.¹⁵²

144. 11 U.S.C. § 107(a) (Supp. V 2005).

145. Two examples include Information Technologies Inc., which provides a "Financial Hardship" database as an "excellent source for marketing leads," Information Technologies Inc., <http://www.inft.net/> (last visited Apr. 1, 2008), and Discreet Research, which provides names and social security numbers for bankruptcy filers. See Discreet Research, <http://www.discreetresearch.com> (last visited Apr. 1, 2008).

146. See *infra* Part III.A.

147. *Bankruptcy Reform: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2005) (statement of Todd J. Zywicki, Professor of Law, George Mason University), available at http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3997 (stating that increased bankruptcy filings were caused by a loss of "personal shame" and "social stigma" previously associated with filing for bankruptcy).

148. Porter & Thorne, *supra* note 62, at 94–95.

149. A. Charlene Sullivan & Debra Drecnik Worden, *Bankruptcy in a Bank Credit Card Portfolio*, J. RETAIL BANKING, Winter 1991–1992, at 33, 36–37.

150. MANN, *supra* note 7, at 23 tbl.2.2 (showing that interest charges compose sixty-five percent of U.S. card issuers' revenue).

151. Mann, *supra* note 1, at 391. Jay Westbrook apparently first coined the term "sweatbox" to describe the financial situation that maximizes credit card issuers' profits. See Pottow, *supra* note 9, at 416.

152. See Mann, *supra* note 1, at 385 ("The successful card lender profits from the borrowers who become financially distressed.").

These families will generate more profit than cardholders who frequently pay off their balance in full, and the bankruptcy risk is mitigated. In effect, lenders escape anxiety about how long the borrower can sustain his unstable position before bankruptcy. Free from price regulation,¹⁵³ and staving off efforts to curb the substantive terms of their contracts,¹⁵⁴ the consumer-credit industry can market to families who are vulnerable to financial distress at prices and on terms that maximize the industry's profits.

This profit potential explains perhaps the most remarkable fact about postbankruptcy credit offers: the exact same entities that were creditors in these debtors' bankruptcy cases seek to lend to these families again. As shown in Figure 2, more than one in five debtors reported receiving a credit solicitation from a lender that they could identify as a scheduled creditor in their bankruptcy.¹⁵⁵ Given the incredible consolidation in the banking industry during the last decade,¹⁵⁶ this figure may substantially underreport the frequency with which prebankruptcy creditors seek to become postbankruptcy creditors. Debtors may not be able to identify accurately the bank extending credit in a particular offer. For example, a borrower may say that he has a "United Airlines credit card" without remembering that Chase is the actual lender. When Chase later sends him an offer to have a "Chase PerfectCard,"¹⁵⁷ the consumer may not recognize that this offer emanates from the same bank that issued the United Airlines card.¹⁵⁸ Even taking the

153. See *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 318 (1978) (holding that the National Bank Act preempts state laws that regulate interest rates). This decision "effectively released consumer credit providers from usury limits, and thereby encouraged the creation of a national, rather than purely local, market for consumer credit." Block-Lieb & Janger, *supra* note 2, at 1488.

154. A number of bills have been introduced to regulate credit-industry practices, but none of these efforts have passed. See *Stop Unfair Practices in Credit Cards Act*, S. 1395, 110th Cong. (2007); *Universal Default Reform Act*, H.R. 2146, 110th Cong. (2007); *Credit Card Accountability Responsibility and Disclosure Act of 2007*, H.R. 1461, 110th Cong. (2007).

155. The qualitative interviews contain additional evidence of repeat lending activity. See, e.g., Telephone Interview by Consumer Bankr. Project III with Respondent IL-07-053 (three years postbankruptcy) ("The same company I had at bankruptcy sent me an application without asking.").

156. See Kenneth D. Jones & Tim Critchfield, *Consolidation in the U.S. Banking Industry: Is the "Long, Strange Trip" About to End?*, FDIC BANKING REV., Jan. 2006, at 31, 32-36, available at <http://www.fdic.gov/bank/analytical/banking/2006jan/article2/article2.pdf>.

157. This is actually the name of a real general-purpose credit card issued by Chase. See Chase PerfectCard Credit Card Offer, http://www.firstusa.com/cgi-bin/webcgi/webserve.cgi?partner_dir_name=cac_chase_perfectcard&page=index (last visited Apr. 1, 2008).

158. Of course, it is possible that some people think of VISA as their lender, instead of recognizing that VISA is the provider of the card processing. This could lead to an overestimation of the number of same lenders if debtors thought that a postbankruptcy offer from VISA was one from the "same creditor listed" in their bankruptcy. Several facts substantially reduce this risk. The bankruptcy schedules frequently list only the bank's name because it is the actual lender, omitting whether the card is processed by VISA. Also, VISA would not have been involved in trying to collect the debt before bankruptcy, and the lender's

finding as is, however, the data show that some lenders are undeterred by a bankruptcy discharge.

Some debtors are shocked to discover that the very creditors who told them that filing bankruptcy would ruin their credit are now soliciting them as customers.¹⁵⁹ “I am continually getting offers for credit cards. Even the cards that I listed on my bankruptcy still offer me more cards, but the interest rates are higher,” explained a California woman.¹⁶⁰ These families’ disbelief at receiving credit solicitations is probably tempered by some terms of the new credit offers. In some cases, an offer for postbankruptcy credit disguises an attempt to collect discharged debt. Ten percent of families whose prebankruptcy creditors solicited them after bankruptcy reported that some of those offers had asked them to make payments on prebankruptcy debts.¹⁶¹ These future offers of credit were presumably conditioned on the debtor making a “voluntary” payment on debt discharged in bankruptcy. While these situations were relatively infrequent and were documented in only two percent of all Chapter 7 cases in the sample, they are nonetheless disturbing.¹⁶² The law prohibits a request to pay debt that was discharged in bankruptcy.¹⁶³ In some instances, postbankruptcy credit was a vehicle for

name or an affinity tie would probably be displayed more prominently on a credit offer than the name or logo of the card processor.

159. See *Frontline: Secret History of the Credit Card* (PBS television broadcast Nov. 23, 2004), available at <http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html>. A married man who had filed bankruptcy told the Frontline reporter of his experience:

We got one yesterday from a credit card company that told me I'd never have credit with them again. One of the last times I talked with them, told them what our situation was, they said, “Well, we’re canceling your card. And you are, in essence, blackballed with us for life. You’ll never have a credit card from us ever again.” Yesterday, [we] received a solicitation from them, zero percent for life, with up to a \$50,000 line of credit.

Id.

160. Telephone Interview by Consumer Bankr. Project III with Respondent CA-07-011 (three years postbankruptcy).

161. This question was posed only to the seventy-nine debtors who said that they received credit offers from the same creditors that were listed on their bankruptcy schedules. Eight of the seventy-nine debtors said these lenders asked them to repay their old debts in the new credit offers.

162. The data in the text reflect the affirmative responses to the query on repaying old debts of eight debtors among the group of seventy-nine who had received credit offers from their prebankruptcy creditors. However, at another point in the interview, all debtors were asked if a prebankruptcy creditor had contacted them after bankruptcy. Nearly four in ten debtors (thirty-nine percent) in the sample reported such contact. Apparently, creditors frequently violate the discharge injunction. However, the wording of this question did not make it clear whether “old debt” referred only to debts that were discharged or included prebankruptcy debts that were reaffirmed or debts that were nondischargeable. Thus, the data do not permit a conclusive determination of what proportion of this postbankruptcy contact by creditors violated the discharge injunction.

163. 11 U.S.C. § 524(a)(2) (2000).

enticing families to repay discharged debts. While a substantial minority of Chapter 7 debtors does, in fact, choose to repay a portion of their discharged debts,¹⁶⁴ the numerous credit offers that debtors received each month would seem to make such repayments truly “voluntary” and not motivated by a need to obtain future credit.¹⁶⁵ Nonetheless, any debtors who accept these offers reinforce creditors’ incentives to violate the discharge injunction. Such fortunate creditors will get a double benefit: they will accrue the superior profits from postbankruptcy borrowing and also reduce their loss from the debt discharged in bankruptcy.

This complicated dynamic reveals the extent to which the credit industry is a repeat-player market. A substantial fraction of creditors will try to engage the very same debtors in new borrowing. Less than one year after receiving notice that these families were no longer obligated to pay their debts to them, the very same creditors actively sought to lend to them again. Because a vast majority of Chapter 7 cases are no-asset cases in which unsecured creditors receive no distribution of payment,¹⁶⁶ these lenders are apparently quick to forget that their desired customers are the same “strategic” and “immoral” borrowers who purportedly game the credit system. This dichotomy between words and actions is stark. Profit opportunities appear to motivate lenders to abandon any effort to stigmatize bankruptcy filers by denying them credit.

D. PARADOX OF SECURED CREDIT

Rather than eliminate credit, bankruptcy may, in fact, increase credit opportunity. Lenders specifically target postbankruptcy debtors. These findings offer a twist on the adage that bankruptcy ruins one’s credit. This Section discusses the types and terms of credit that are marketed to families after bankruptcy. These data expose differences between lenders that suggest which segments of the credit industry rely significantly on financial distress to generate profits.

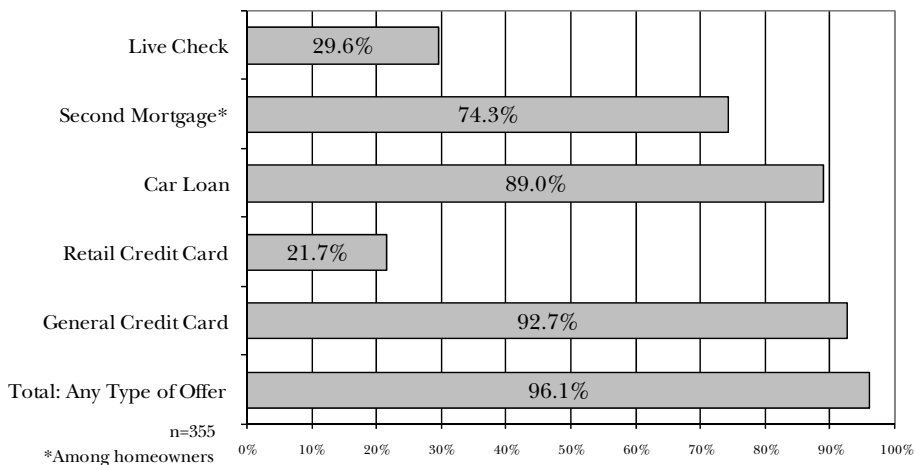
164. Three years after bankruptcy, 20.8% of households reported that they or someone else had made a payment on a debt that they had at the time of their bankruptcy. This included reaffirmed debts.

165. Among the sixty-two families who made payments on at least one prebankruptcy debt, only three families cited “creditor required payment before agreeing to new credit” as one of the reasons for their voluntary repayment. This finding highlights the fact that debtors may repay discharged debts for reasons other than their own financial benefit. Understanding why one in five debtors makes a payment after bankruptcy would provide useful insights into debtors’ attitudes about their prebankruptcy creditors.

166. See Ed Flynn, Gordon Bermant & Suzanne Hazard, *Bankruptcy by the Numbers: Chapter 7 Asset Cases*, AM. BANKR. INST. J., Dec. 2002–Jan. 2003, at 22, 22 (reporting that ninety-six percent of all Chapter 7 cases (combined business and consumer) were closed without any assets distributed); see also Susan D. Kovac, *Judgment-Proof Debtors in Bankruptcy*, 65 AM. BANKR. L.J. 675, 677–78 (1991) (concluding that a significant segment of the bankruptcy population is composed of judgment-proof debtors who have no nonexempt assets and earn wages below garnishment limitations).

After bankruptcy, families receive offers for most types of common credit. Figure 3 illustrates the percentage of debtors who received different types of postbankruptcy offers. Most debtors had access to both secured and unsecured credit.

Figure 3. Percent of Debtors Receiving Different Types of Postbankruptcy Credit Offers



General-purpose credit card offers were ubiquitous. Nearly ninety-three percent of postbankruptcy debtors reported receiving a credit card solicitation. Filing bankruptcy is plainly an ineffective technique for eliminating the phalanx of credit card offers that arrives in one’s mail. Whether you pay your balance in full every month or declare yourself broke, the banking industry appears to have a credit card product that is suitable (and profitable) for your financial profile. This finding on credit card marketing reinforces intuitions that the credit card industry has developed specialized products for different market segments, including high-fee cards for potential customers who are vulnerable to financial problems.¹⁶⁷

Offers for retail charge cards were less common. Only about one in five debtors were solicited to open these accounts. Debtors’ experiences may not be unique. Prescreened retail card offers may be less commonly sent to all consumers. The query about credit offers was not limited to mailed offers, but respondents may not have counted point-of-sale offers made in retail stores. Another possibility is that retail cards are less segmented than general cards. These products could be one-size-fits-all, marketed with rates and fees

167. MANN, *supra* note 7, at 190.

that reflect the creditworthiness and risk of the entire borrower base. Recent bankruptcy filers may not meet retailers' lending criteria.

The differential between general and retail credit card offers could suggest that many of the general credit cards offered to postbankruptcy families were subprime products. Some cards may have required collateral for the credit extension;¹⁶⁸ others may have charged unusually high interest rates or required consumers to pay unusually expensive fees.¹⁶⁹ Further evidence to support this hypothesis comes from debtors' experiences in trying to actually get companies to issue them credit cards. Three years after bankruptcy, forty-four percent of debtors said that they were denied at least once when applying for a credit card. The interviews did not ask for details about these credit rejections. Given the large number of credit offers that most debtors received each month, I hypothesize that these rejections perhaps resulted from the debtor applying directly for a credit card (such as when offered to them during a retail purchase), rather than responding to prescreened solicitations mailed to postbankruptcy families. The credit offers that bankruptcy debtors receive may be tailored to distressed borrowers and carry correspondingly high rates or unfavorable terms.

A majority of families received solicitations for secured loans after bankruptcy, although these offers were somewhat less common than credit card solicitations. Car loans are widely marketed to debtors. Many debtors were surprised to receive these offers, expressing concern that the substantial debt required to purchase a car would cause them financial trouble in the future. A young man from Pennsylvania told his interviewer that he had gotten car loans in the form of live checks worth up to \$50,000 but that "[t]hey go right in the trash with the credit card [offers]."¹⁷⁰

Comparable data for the general American population on the marketing of auto loans were not readily findable.¹⁷¹ However, bankruptcy debtors may be particularly likely to respond to unsolicited offers for auto

168. Secured credit cards require consumers to pay a deposit, usually a minimum of a few hundred dollars, as a condition of the card's issuance. The issuer holds this deposit, and the consumer makes monthly payments toward any accrued charges, fees, and interest. *See* Card Dictionary, Definition of Secured Card, <http://www1.cardtrak.com/glossary/s.html> (last visited Apr. 1, 2008) (describing secured cards as credit cards that are used by people with no credit or those who are trying to rebuild their credit). For an example of the marketing and terms of a secured credit card, see Wells Fargo, Wells Fargo Secured Visa Card, https://www.wellsfargo.com/credit_cards/select_card/secured/ (last visited Apr. 1, 2008).

169. *See* CreditCards.com, Credit Cards for People with Bad Credit, <http://www.creditcards.com/bad-credit.php> (last visited Apr. 1, 2008) (providing fee and rate information on cards designed for consumers with bad credit).

170. Telephone Interview by Consumer Bankr. Project III with Respondent PA-07-074 (one year postbankruptcy).

171. Specialized marketing exists for car loans for the general nonbankrupt population, *see* CUNA Mut. Group, Auto Loans: Compete in the Auto Loan Market and Win, <http://www.cuna.mutual.com/cmgi/freeFormDetail/0,1248,4458,00.html> (last visited Apr. 1, 2008), but data on the quantity of loans were not available.

financing. Repossession of a car may have been the last straw that precipitated a decision to file bankruptcy. Other families may have voluntarily surrendered a car in bankruptcy or may have been unable to defend a lender's motion for relief from the automatic stay. The fact that bankrupt families are lucrative targets for car purchases reinforces the hardship that accompanies bankruptcy.¹⁷² The financial rebuilding process that debtors must undergo after bankruptcy creates opportunities for credit marketing.

Families who retain their homes despite filing bankruptcy are targets for second mortgages or home-equity loans. About three-quarters of homeowners reported that they received offers to use their homes as collateral to borrow. These loans carry the potential for relatively large debts. The marketing of home loans to recent bankruptcy debtors is consistent with evidence of the mortgage industry's penetration deep into the subprime credit market.¹⁷³ While a Congressman lamented the morality of a debtor who would buy a house and then file bankruptcy,¹⁷⁴ the lending industry was actively soliciting families to risk their homes after bankruptcy by loading up on new debt.

Another way to measure creditors' willingness to lend to debtors is to study debtors' perceived difficulty of obtaining credit. Three years after bankruptcy, families were asked if they had "been turned down for, or had trouble getting" certain types of loans. Many families responded that one or more of the queries was inapplicable because they had not attempted to obtain that type of loan. Notwithstanding some rejections, most debtors who wanted to borrow after bankruptcy seemed able to do so. These data reinforce the findings illustrated in Figure 3 that debtors are not limited to secured lending but can borrow without collateral too.

Figure 4 shows families' experiences in trying to obtain three types of credit after bankruptcy. Families with financial problems appear to have greater access to unsecured credit than to secured credit. Credit cards were particularly easy to obtain. Three years after discharging prior credit card debts in bankruptcy, sixty percent of families had at least one new

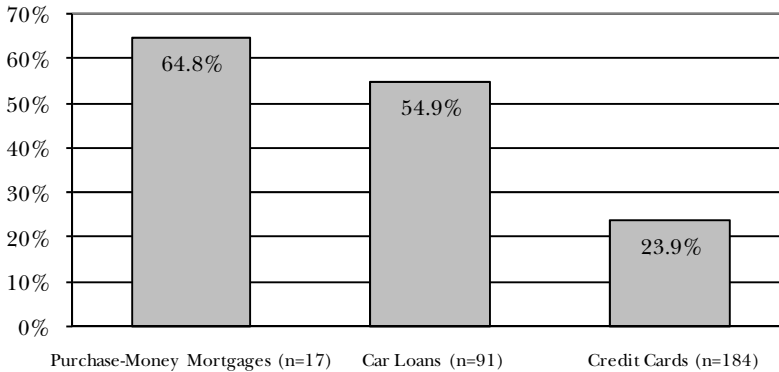
172. See Deborah Thorne & Katherine Porter, *Financial Education of Families in Bankruptcy: Attitudes and Needs*, 24 J. CONSUMER EDUC. 15, 21–22 (2007) (presenting data that sixty-five percent of bankrupt debtors reported that they had difficulty paying household bills three years after bankruptcy).

173. See JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *supra* note 86, at 17 fig.20; Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets Revisited*, 82 TEX. L. REV. 439, 442–43 (2003).

174. See 151 CONG. REC. S1813 (daily ed. Mar. 1, 2005) (statement of Sen. Frist) ("Some folks have even been known to plan their bankruptcy. They buy a house or they buy a car or furniture or whatever else they need and then file a bankruptcy form. They figure they can get the big ticket items upfront, and for everything else they will use cash.").

postbankruptcy credit card.¹⁷⁵ Approximately twenty-four percent of these new cardholders believed that their bankruptcy had made it difficult for them to get these new credit cards. More than three in four families reported that bankruptcy did not cause them to be turned down for credit cards.

Figure 4. Families Who Had Difficulty Accessing Credit
(Three Years Postbankruptcy)



Paradoxically, families found lenders more reluctant to lend to them on a secured basis than to issue them credit cards, which are typically, although not always, unsecured lines of credit. Approximately fifty-five percent of those who financed a car purchase in the first three years after bankruptcy reported having difficulty obtaining a car loan.¹⁷⁶ As Figure 4 illustrates, getting a car loan was twice as difficult as getting a credit card. About two in three families who obtained a home loan after bankruptcy said that their bankruptcy caused them trouble in borrowing or caused their credit application to be refused.

The presence of collateral should reduce a loan's risk, both directly, by increasing the lender's ability to obtain repayment by foreclosing on the collateral, and indirectly, by enhancing the borrower's incentives to pay.¹⁷⁷ Thus, secured credit should facilitate borrowing by less creditworthy consumers. In the commercial context, for instance, only the most

175. A forthcoming paper presents more detailed data on families' use of credit after bankruptcy. See Katherine Porter, *Borrowing After Bankruptcy* (Apr. 1, 2008) (unpublished manuscript, on file with the Iowa Law Review) (providing CBP III data on actual borrowing practices of families in years after bankruptcy).

176. This number reflects only those who tried to take out a car loan. Many debtors paid cash for a car purchased after bankruptcy. These findings are discussed in detail in the next Section on use of credit.

177. Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 626 (1997) ("Granting collateral lowers the aggregate costs of a lending transaction by lowering the pre-loan perception of the risk of default.").

financially sound companies are able to obtain unsecured credit.¹⁷⁸ Strangely, in the consumer context, vulnerable borrowers seem able to obtain unsecured credit *more* easily than secured credit. The reasons for this are unclear. The differential may reflect the greater experience of the credit card industry with lending to subprime borrowers, a trend that only recently has begun in the mortgage and auto-lending industries.¹⁷⁹ Or perhaps, in the consumer context, lenders cannot attract postbankruptcy debtors to secured-lending products that fully reflect the expense of enforcing a security interest or monitoring collateral. Without access to secured credit, families instead may use a credit card cash advance to pay for a car or substitute for a home-equity loan.

E. CHAPTER 13 TWIST

This Section compares how creditors react to Chapter 13 bankruptcy with the Chapter 7 findings presented above. Legal differences in the two main types of consumer bankruptcy relief seem to translate into important differences in creditor behavior. The data suggest that despite the focus of bankruptcy reform on increasing the proportion of debtors who file Chapter 13 bankruptcy, lenders themselves favor Chapter 7 debtors by offering them easier access to credit.

In the vast majority of Chapter 7 cases, individuals receive discharges of eligible debts two or three months after filing their bankruptcy cases.¹⁸⁰ The discharge effectively ends the bankruptcy process for Chapter 7 debtors. No trustee or bankruptcy court supervises the credit activities of debtors after discharge. The prior statement is equally true in Chapter 13, but the discharge in Chapter 13 cases does not enter until the debtor has completed all of the required payments in a repayment plan, an event that occurs between three and five years after the plan confirmation.¹⁸¹ Chapter 13 imposes obstacles to obtaining new credit. While making plan payments, debtors are required to get authorization before obtaining new credit.¹⁸² Many trustees emphasize this requirement to debtors,¹⁸³ although in fact

178. *Id.* at 634.

179. Cherie Berkley, *Interest Rates Shake Up Subprime Lending Market*, CARDS&PAYMENTS, Oct. 2006, at 34, 34–35.

180. DOUGLAS G. BAIRD, *ELEMENTS OF BANKRUPTCY* 34–35 (4th ed. 2006) (describing how the overwhelming majority of consumer cases are “short, uncomplicated,” and result in discharge).

181. 8 COLLIER ON BANKRUPTCY ¶ 1328.01 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2007).

182. 11 U.S.C. §§ 1305(c), 1306(a)(2), 1306(b), 549(a)(2)(B) (2000).

183. *See, e.g.*, Office of the Chapter 13 Trustee Thomas J. King, Profile, <http://www.ch13oshkosh.com/profile.html#newcredit> (last visited Apr. 1, 2008). The Administrative Office of the U.S. Courts includes the limitation on new credit in its public information about Chapter 13 Bankruptcy. *See* Admin. Office of the U.S. Courts, Chapter 13 Bankruptcy Basics, <http://>

trustees may liberally grant such requests.¹⁸⁴ Research on actual borrowing by Chapter 13 debtors could illuminate the extent to which this credit restraint operates to curb the desires of lenders and bankruptcy debtors for borrowing during Chapter 13 cases.¹⁸⁵

A brief analysis of credit marketing to Chapter 13 families powerfully illustrates how bankruptcy law shapes the incentives of the lending industry. Most families who file Chapter 13 bankruptcy receive credit solicitations.¹⁸⁶ More than three-quarters of families (76.7%) said that lenders had sent them credit offers in the first year after their bankruptcy filing. However, Chapter 13 families are significantly less likely to receive credit offers than Chapter 7 families.¹⁸⁷ The reported rate for Chapter 13 families is significantly lower than the 96.1% of Chapter 7 debtors who receive credit offers after filing bankruptcy. At least in the short term, Chapter 13 seems to be a modest deterrent to the credit industry's efforts to turn bankrupt families into customers.

Figure 5 shows the frequency with which Chapter 13 filers reported being offered different types of credit during the first postbankruptcy year and illustrates the comparative difference with Chapter 7 debtors. The differences were significant for all credit offers except retail cards.¹⁸⁸ Lenders' preference for Chapter 7 bankruptcy debtors is most pronounced with regard to secured-credit loans. Both car loans and second mortgages were significantly less available to families who filed Chapter 13 than families who filed Chapter 7. Perhaps the need to obtain permission for post-filing credit in Chapter 13 deters lenders; this requirement theoretically adds

www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html (last visited Apr. 1, 2008).

184. See Braucher, *supra* note 73, at 539 & n.130 (1993) (stating that "chapter 13 trustees are receptive to new credit requests").

185. Further research could yield insights on how actual credit use during a Chapter 13 case may influence Chapter 13 outcomes as measured by plan completion and discharge.

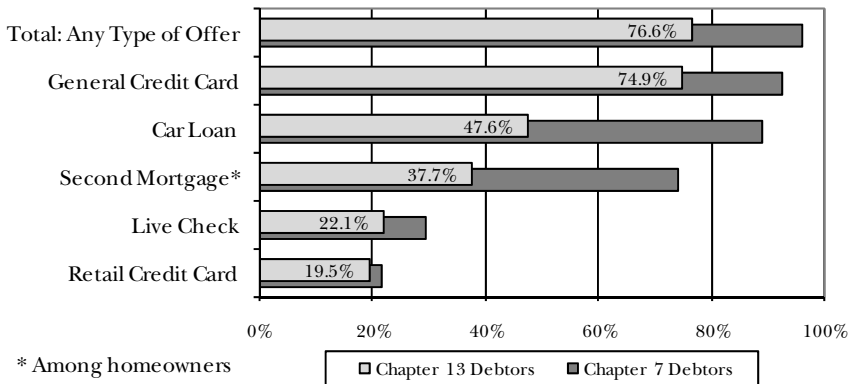
186. These data come from the Chapter 13 cases collected in the core sample in which a first-round telephone interview was completed. The same method was used for the Chapter 7 sample considered in Parts II.A–D. First-round interviews were completed by 243 families who filed Chapter 13; this figure represents 51.5% of the 470 total Chapter 13 cases in the core sample. Note that these data reflect all families who *filed* Chapter 13 bankruptcy, but that some portion of these families may have dismissed their Chapter 13 cases before the interview was conducted at one year postbankruptcy filing. Indeed, the completion rate for Chapter 13 is notoriously low. See Jean Braucher, *An Empirical Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown*, 9 AM. BANKR. L. REV. 557, 571–74 (2001) (summarizing variations in the Chapter 13 completion rates in various studies); Scott Norberg, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 CREIGHTON L. REV. 473, 476 (2006) (finding that sixty-seven percent of chapter 13 filings were either dismissed or converted before completion). I do not exclude cases that were dismissed or converted to Chapter 7 bankruptcy because I am focused on creditor reaction to a debtor's bankruptcy choice, rather than how debtors use credit during the postbankruptcy period.

187. $P \leq .001$.

188. $P \leq .05$.

expense and hassle to the loan transaction costs. Alternatively (and to my mind, more plausibly), this difference may reflect the practical needs of Chapter 7 and Chapter 13 bankruptcy debtors. Families who file Chapter 13 may retain nonexempt assets, such as a car or home, and continue making payments on the debt through their Chapter 13 plan, curing any default that existed at the time of the bankruptcy.¹⁸⁹ In contrast, Chapter 7 debtors often surrender these assets in bankruptcy or are less likely to own them in the first place.¹⁹⁰ Thus, lenders may exert less effort marketing secured loans to Chapter 13 families because these families may be less responsive to such offers.

Figure 5. Chapter 13 Debtors Receiving Different Types of Postbankruptcy Credit Offers Compared to Chapter 7 Debtors



Even if Chapter 7 and Chapter 13 debtors have identical postbankruptcy borrowing preferences,¹⁹¹ the law creates different lending risks for creditors based on the type of bankruptcy filed. Because consumers can convert their bankruptcies from Chapter 13 to Chapter 7,¹⁹² unsecured credit extended to a Chapter 13 debtor after the initial bankruptcy filing

189. See 11 U.S.C. § 1322(b)(3) (2000); see also ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 281 (5th ed. 2006).

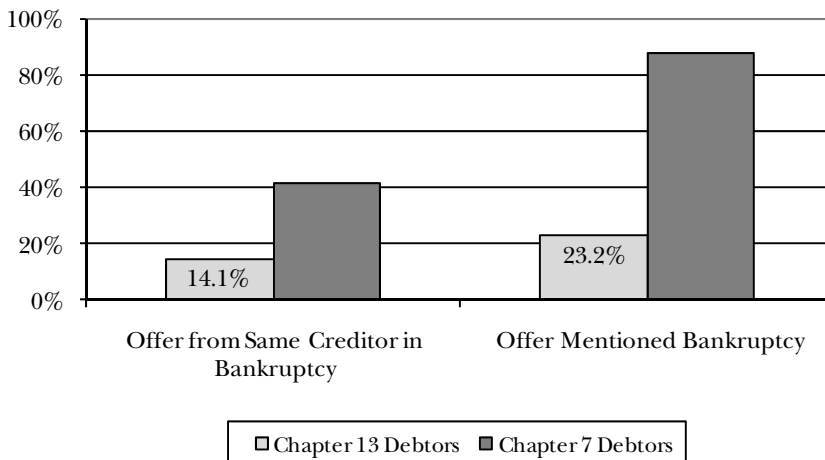
190. SULLIVAN ET AL., *supra* note 5, at 205 n.27.

191. I do not make any assumption that families who chose Chapter 7 and Chapter 13 would, in fact, have the same desire for or beliefs about the availability of postbankruptcy credit. Scholars have expended considerable effort to explain why debtors chose the chapter of relief that they did, see, e.g., Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Experience From the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801, 814–15 (1994), but no study has extensively considered the role of the availability of postbankruptcy credit as a factor in shaping a debtor's decision. Jean Braucher's research on lawyers' role in debtors' filing decisions may be the best effort to date. See Braucher, *supra* note 73.

192. See 11 U.S.C. § 1307(a) (2000).

would be subject to discharge if the case were converted to Chapter 7.¹⁹³ This effect may constrain the availability of credit cards to Chapter 13 debtors while they are paying into their plans. Data on the number of credit offers could help test this hypothesis. Chapter 13 filers reported that they received an average of 8.65 credit offers per month; Table 1, *supra*, shows Chapter 7 filers' average was 14.56 offers per month.¹⁹⁴ A similar margin existed at the median, with the typical Chapter 13 debtor receiving half (five per month) the number of offers of the typical Chapter 7 debtor (ten per month). The data do not permit a complete understanding of the reasons for Chapter 7 and Chapter 13 credit marketing. The less frequent credit solicitations to Chapter 13 families may reflect the fact that some lenders simply avoid Chapter 13 debtors entirely. Marketers, in turn, may have more success selling data on Chapter 7 filers, whom lenders prefer as customers. Chapter 13 families were substantially less likely to report receiving a credit offer that mentioned their bankruptcy or that came from a prebankruptcy creditor. Figure 6 shows these findings and comparative data from Chapter 7 debtors.

Figure 6. Differential Treatment by Chapter:
Bankruptcy as Factor in Credit Solicitation



Overall, lenders exhibit a customer preference for Chapter 7 filers over Chapter 13 filers. This preference does not square with the credit industry's backing of bankruptcy reform that allegedly would screen more families into Chapter 13 bankruptcy. Despite their rhetoric championing Chapter 13 as

193. See Braucher, *supra* note 73, at 538.

194. $P \leq .001$.

the “honorable” path for families in serious financial trouble, the lending industry is more likely to cast away a family who chooses Chapter 13. Congressional representatives repeatedly emphasized the policy importance of partial debt repayment in Chapter 13.¹⁹⁵ However, lenders are less likely to reward families who chose Chapter 13 by offering them additional credit. This differential treatment by creditors has implications for the design of bankruptcy law.

Despite debtors’ trepidations and creditors’ warnings before bankruptcy, not only is borrowing after bankruptcy possible, but the credit industry actively encourages it. These data suggest that creditors’ threats to refuse credit after bankruptcy are hollow. The credit industry may tell consumers that creditors will not lend after bankruptcy and that paying one’s debts is the only option to maintain credit access, but such statements are largely untrue. Rather than resulting from a marketing mistake, the widespread availability of postbankruptcy credit more likely reflects a careful calculus about the profits of lending to customers vulnerable to financial distress.

III. IMPLICATIONS

A. UNRAVELING THE “STRATEGIC” STORY

The findings about postbankruptcy credit solicitation undercut the plausibility that lenders accept the strategic-debtor model. Advocates of bankruptcy reform often conflated prodigality with immorality, making it difficult to unravel the exact behavior by debtors (other than the act of filing bankruptcy) that was undesirable. Some policymakers conjectured that the stigma of bankruptcy had declined and suggested that families lacked the moral fiber to honor their obligations.¹⁹⁶ This view of bankrupt families suggests that debtors have serious character flaws. Lenders’ rampant solicitation of bankruptcy debtors refutes the idea that they consider bankruptcy filers to be untrustworthy. If lenders believed that bankruptcy filers were inherent promise-breakers, they would not pursue them as customers. Positioned with public knowledge of the bankruptcy and impressive technology for assessing risk, the credit industry chooses to target

195. See 145 CONG. REC. 8580 (1999) (statement of Rep. DeLay) (“Mr. Chairman, the bankruptcy bill under consideration today is based on the premise that those debtors who can afford to repay their debt should do so, rather than have it forgiven. To accomplish this seemingly simple goal, an income-based means test is employed to determine if a debtor could do one of three things: have debt forgiven; reorganize and enter into a repayment plan; or refrain from filing bankruptcy at all.”).

196. See, e.g., 146 CONG. REC. 60 (2000) (statement of Sen. Hatch) (“Not long ago in our Nation’s past, there was an expectation that people should repay what they have borrowed. Hand in hand with this expectation was a stigma that attached to those who filed bankruptcy.”); see also Elizabeth Warren & Robert Lawless, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743, 784 (2005).

bankruptcy debtors with credit solicitations. Such marketing efforts by sophisticated risk-takers call into serious question the characterizations of bankruptcy filers as people who do not intend to honor their obligations.

The obvious response to this critique is that lenders market to recent bankrupts because the law prohibits a successive bankruptcy discharge for a period of years after a previous bankruptcy filing. This prohibition effectively guards against brutally rational actors, who ratchet up debt with the intent to use bankruptcy law to escape repayment.¹⁹⁷ This economic-incentive analysis of consumer default emphasizes the moral hazard of bankruptcy discharge rather than debtors' moral character that exists without regard to the effects of the law.¹⁹⁸ This theory of consumer borrowing would not expect families to default immediately after their bankruptcy because the law prohibits repeated bankruptcy discharges in close proximity.¹⁹⁹ Thus, creditors can market safely to these families because the law assures them that bankruptcy will not be an immediate consequence of the borrowing.

Without doubt, the ban on subsequent bankruptcy discharges has some effect on credit marketing.²⁰⁰ But it alone may be insufficient to explain the desirability of postbankruptcy families as customers. The basic economics of default and Chapter 7 support this point. Most consumers default without filing bankruptcy and do so before bankruptcy; the amount of written-off debt significantly exceeds the amount of debt discharged in bankruptcy.²⁰¹ The simple truth is that creditors can go unpaid with or without a bankruptcy discharge. More than ninety-six percent of Chapter 7 filings are no-asset cases, suggesting that many families may be judgment-proof or nearly so.²⁰² This reality means that lenders do not necessarily recover less because a family chooses bankruptcy instead of "informal" bankruptcy—sustained nonpayment backed by nonbankruptcy law's limits on debt collection.²⁰³ Similarly, after Chapter 7 bankruptcy, a majority of families

197. See Block-Lieb & Janger, *supra* note 2, at 1483–85.

198. *Id.* at 1491.

199. At the time these data were gathered from 2001 through 2004, the ban on subsequent filings was six years. See 11 U.S.C. § 727(a)(8) (2000) (current version at 11 U.S.C. § 727(a)(8) (Supp. V 2005)).

200. See Part III.B, *infra*, for a discussion of ways in which bankruptcy law facilitates postbankruptcy credit opportunity.

201. Ausubel, *supra* note 45, at 253 & fig.1.

202. See sources cited *supra* note 166; see also WARREN & WESTBROOK, *supra* note 189, at 350–51.

203. See Amanda E. Dawsey & Lawrence M. Ausubel, *Informal Bankruptcy 2* (April 12, 2004) (unpublished manuscript), available at <http://www.ausubel.com/creditcard-papers/informal-bankruptcy.pdf> (reporting that "50.7% of all charged-off [credit card] accounts (and 45.8% of credit losses in dollars) occurred without the debtor filing for bankruptcy"). See generally Michelle J. White, *Why Don't More Households File for Bankruptcy?*, 14 J.L. ECON. & ORG. 205 (1998) (exploring the reasons why many debtors default but do not file bankruptcy).

could likely evade repaying any postbankruptcy borrowing because they would continue to be judgment-proof. Future research could examine whether lenders continue to offer credit as the time after bankruptcy elapses. To the extent that they do so, it suggests that the ability to discharge debt in bankruptcy is not a major consideration in driving lenders' evaluations of a family's desirability as a customer.

The findings on postbankruptcy credit marketing are inconsistent with lenders' professed belief in the strategic-actor theory of bankruptcy debtors. To the extent that lenders believe that bankruptcy indicates poor character, the public act of bankruptcy guarantees that lenders can identify these families and refuse them new credit. In this way, bankruptcy solves the information asymmetry problem by flagging for lenders those families who are willing to file bankruptcy.²⁰⁴ More pointedly, if lenders are seriously worried about the stigma of bankruptcy declining, they are in an ideal position to deter such an effect. If creditors refused to lend to families after bankruptcy, families who are considering bankruptcy might be more inclined to continue to struggle to repay their debts. For this reason, lenders did not necessarily need bankruptcy reform to address the stigma "problem"; they themselves could have sharpened the consequences of bankruptcy. Instead, lenders engaged in behavior contrary to their professed beliefs about the need for bankruptcy reform. The postbankruptcy credit findings show lenders making "strategic" decisions of their own. During the very same years in which the credit industry pushed policymakers to enact bankruptcy reform,²⁰⁵ creditors were hard at work trying to lure bankruptcy debtors as new customers.

The extent of credit solicitation after bankruptcy is suggestive of lenders' actual beliefs about the causes of bankruptcy. Efforts to lend to postbankruptcy families are more consistent with an adverse-events model of bankruptcy than the "deadbeat" debtor model.²⁰⁶ The data are not conclusive on this point; a bankruptcy filing clearly changes the ability of a consumer to engage in strategic borrowing. However, lenders' intense solicitation of postbankruptcy families is consistent with an understanding of

204. See Block-Lieb & Janger, *supra* note 2, at 1496 (describing the concern of economist William Meckling that lenders could not effectively distinguish consumers' risk of bankruptcy).

205. Bankruptcy cases in this sample were filed in 2001, and the first and second longitudinal interviews were conducted in 2002 and 2004 respectively. Bankruptcy-reform bills were introduced in each Congress during this period. See Mann, *supra* note 1, at 383 tbl.1.

206. I put this term in quotes because credit card issuers allegedly call people who pay off their balances in full each month "deadbeats." Those who accumulate balances and make minimal payments are termed "revolvers," a group that the top lobbyist for the American Bankers Association called the "sweet spot" of lending. See Interview by Frontline with Edward Yingling, President, Am. Bankers Ass'n (Sept. 16, 2004) [hereinafter Frontline Yingling Interview], available at <http://www.pbs.org/wgbh/pages/frontline/shows/credit/interviews/yingling.html> ("I think it is generally understood that those that use the revolving part of the credit card are kind of the sweet spot.").

the consumer bankruptcy system as a refuge for honest families reacting to adverse events such as job loss or illness.²⁰⁷ These events are exogenous to a consumer's desire or intent to repay. If bankruptcy were endogenous in origin and primarily reflected a family's willingness to engage in ruthless default, lenders should avoid these families after bankruptcy for fear of future nonpayment.

Creditors' actions speak louder than their words. Despite public protests about declining stigma and strategic debtors, creditors want to count these families among their customers.²⁰⁸ Lenders' behavior toward postbankruptcy families highlights the need for policymakers to consider how credit policy facilitates strategic *lending* and ways in which the law could reduce undesirable consequences of such behavior.²⁰⁹

B. BANKRUPTCY INCENTIVES

The debtor focus of the bankruptcy reform debate hindered careful study of how bankruptcy law shapes the behavior of creditors. This Section identifies three ways in which this Article's findings on postbankruptcy credit opportunity could be useful in crafting bankruptcy policy. Such efforts to alter creditors' legal incentives would capitalize on creditors' rationality as a tool for improving the bankruptcy system.

Widespread postbankruptcy credit marketing is not inevitable but is a product of existing bankruptcy law. Bankruptcy discharges are not unlimited goods.²¹⁰ The law's prohibition on repeat bankruptcy discharges facilitates creditors' ability to profit from lending to recent bankruptcy debtors. Eliminating a bankruptcy discharge removes one barrier to collecting debt and frees the creditor to continue collecting, during which time interest and fees accumulate. The ban on repeat bankruptcy helps to insulate lenders from the risk of ultimate nonpayment (but does not guarantee repayment). In this way, the discharge limitation increases credit marketing to bankruptcy debtors.

Current law permits a Chapter 7 discharge only if a debtor has not received a discharge in the prior eight years.²¹¹ This time period was lengthened as part of BAPCPA,²¹² a change that should increase

207. See sources cited *supra* note 17.

208. See Frontline Yingling Interview, *supra* note 206.

209. See Block-Lieb & Janger, *supra* note 2, at 1565 ("To the 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. Those who would seek to reduce the bankruptcy filing rate should focus there as well."); Pottow, *supra* note 9, at 429 (noting that it takes "two to tango" with bankruptcy-causing debt and suggesting that bankruptcy lawmaking could have usefully considered ways to change creditor behavior).

210. See 11 U.S.C. § 727(a) (2000 & Supp. V 2005).

211. 11 U.S.C. § 727(a)(8) (Supp. V 2005).

212. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 312, 119 Stat. 23, 87 (codified at 11 U.S.C. § 727(a)(8) (Supp. V 2005)). The

postbankruptcy credit marketing. Policymakers advocated this reform as necessary to reduce debtors' incentives to file bankruptcy as a financial-planning strategy. However, the sharpest effect of a discharge limitation may be on creditors, not debtors. The repeat-filing rate for Chapter 7 bankruptcies already was very low before BAPCPA.²¹³ Now, lenders can exploit the extended prohibition on discharge to maximize profits from postbankruptcy lending. Because many families continue to struggle to make ends meet after bankruptcy,²¹⁴ postbankruptcy families are ideal revenue sources for fee and interest income.

The practical effect of a bankruptcy discharge also aids creditors who lend after bankruptcy. A bankruptcy discharge frees a debtor from servicing prebankruptcy debts. From the new lender's perspective, the discharge has eliminated the competition for repayment. Instead of joining a heap of other unpaid debts, early postbankruptcy creditors occupy an enviable position. The odds of receiving payment are improved, and the ability to file bankruptcy is curtailed.

An exclusive focus on debtors has impoverished prior policymaking on the optimal scope of the bankruptcy discharge. The discharge does not just affect prebankruptcy debts; it also has powerful consequences for debtors' fresh starts after bankruptcy because it changes the context for future borrowing. Acknowledging how creditors respond to bankruptcy enriches our ability to evaluate the ideal boundaries of discharge. The findings on credit solicitation presented here do not conclusively point to a particular reform, which should be supported by research on how debtors actually use postbankruptcy credit. The data do suggest some immediate recommendations for bankruptcy's new financial-education requirement.²¹⁵ Education providers need to be responsive to the reality of postbankruptcy credit solicitation in their curricula.²¹⁶ The debtors' reactions of frustration, anger, and fear about postbankruptcy credit marketing emphasize the need to educate families about their ability to use existing law to opt out of prescreened credit offers. This modest recommendation integrates existing consumer protection law into BAPCPA's financial-education requirement to aid families in achieving a fresh start after bankruptcy. Debtors could choose to eliminate solicitations for credit and wrestle affirmative control of credit marketing from lenders.

bankruptcy cases in this Article's sample were filed in 2001 when the ban on repeat Chapter 7 discharges was six years. *See* 11 U.S.C. § 727(a)(8) (2000).

213. TERESA A. SULLIVAN ET AL., *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* 192 (1989) (stating that of the 1502 petitions in their sample only eight percent were repeat filers).

214. Porter & Thorne, *supra* note 62, at 69–70.

215. 11 U.S.C. § 727(a)(11) (Supp. V 2005).

216. *See* Thorne & Porter, *supra* note 172, at 15, 16 (articulating how the educational needs of bankrupt families may differ from the general population for financial education).

The second implication for bankruptcy law derives from the findings on the relative differences between the postbankruptcy availability of secured and unsecured credit. The data suggest a declining spectrum of credit availability from general credit cards to car loans to mortgage loans. This pattern may be the opposite of the ideal for facilitating financial recovery for debtors. Purchasing or refinancing a home is lauded as a wealth-building strategy,²¹⁷ yet after bankruptcy, this may be the most difficult credit transaction to complete. On the other hand, new empirical research suggests that credit cards, which are widely available after bankruptcy, may stimulate financial distress.²¹⁸ Current law does not attempt to influence these outcomes, perhaps due to a lack of prior research. The law could treat certain types of postbankruptcy debt differently in the event that a family experiences future hardship. While home-mortgage debt already gets favorable treatment in Chapter 13 bankruptcy,²¹⁹ the law could create further distinctions. For example, credit card loans made in the immediate aftermath of a prior bankruptcy could be subordinated to purchase-money secured obligations, or postbankruptcy credit card lenders could be barred from using wage garnishment as a collection tool. Alternatively, the law could prohibit credit solicitations for a cooling-off period after bankruptcy,²²⁰ or it could give debtors a defense of suitability for loans made after bankruptcy without evidence that the debtor is likely to be able to repay.²²¹ This Article's findings are alone insufficient, at least in my mind, to justify such reforms. Credit availability after bankruptcy could, in fact, be a powerful tool for helping families achieve financial well-being after bankruptcy.²²² The data on postbankruptcy credit marketing highlight the need for further longitudinal bankruptcy research.

Finally, the comparative findings on Chapter 7 and Chapter 13 credit availability are provocative for policies aimed at favoring repayment as part of consumer bankruptcy relief. BAPCPA's means test was framed as an effort

217. Edward M. Gramlich, Governor, Fed. Reserve Bd., Remarks at the Home Ownership Summit of the Local Initiatives Support Corporation (Nov. 8, 2001), *available at* <http://www.federalreserve.gov/boardDocs/speeches/2001/200111082/default.htm> ("For a family, a home is generally its most significant asset and serves as its primary wealth-building vehicle.")

218. See MANN, *supra* note 7, at 46–47; cf. Katherine Porter, *The Debt Dilemma*, 106 MICH. L. REV. 1167 (2008) (reviewing CHARGING AHEAD, *supra* note 7, and offering empirical data identifying the complexity of the relationship between cards and financial well-being).

219. See 11 U.S.C. § 1322(b)(2) (2000).

220. Cf. Enzer, Brigard & Lazar, *supra* note 66, at 90 (discussing a suggestion of "a six-month prohibition of credit" after bankruptcy that was found to be "very undesirable" due to problems of "feasibility" and "interference" with debtors' lives).

221. Cf. Kathleen C. Engle & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1317–66 (2002) (discussing government imposition of a suitability standard as a possible solution to the problem of predatory lending).

222. Cf. Pottow, *supra* note 9, at 418 (calling for careful development of policy prescriptions to focus specifically on "bad" credit rather than reduce the overall amount of credit).

to increase the number of debtors who choose Chapter 13 bankruptcy and attempt to repay some of their debts.²²³ The postbankruptcy data reinforce the improbability that creditors' purpose in lobbying for bankruptcy reform was to increase Chapter 13 filings as a proportion of bankruptcy cases.²²⁴ Creditors' own actions give overindebted consumers the opposite incentive—to choose Chapter 7 because it will afford them greater access to credit after bankruptcy. At least during the first years after filing, Chapter 13 debtors seem to have less credit access than Chapter 7 debtors and face legal obstacles to using credit. Additional research could illuminate whether Chapter 13 debtors do, in fact, have access to more affordable credit after completion of their Chapter 13 plans than do Chapter 7 debtors. These findings could have important implications for bankruptcy professionals who counsel potential debtors based on unsupported perceptions about the difference in credit availability by chapter. This Article's data suggest that families may be misled into thinking that Chapter 13 will improve their credit access, at least in the short term.²²⁵ Policy efforts to encourage Chapter 13 need to consider postbankruptcy borrowing and how the law could shift lenders' incentives to enhance the attractiveness of Chapter 13. Collectively, the findings reinforce the conclusion of Susan Block-Lieb and Edward Janger that “[i]t is senseless to look at consumers' incentives to borrow without also considering lenders' incentives to extend credit. Thus, consumer bankruptcy law (and, indeed, all consumer law) should be crafted with an understanding of both sides of a consumer finance transaction.”²²⁶

C. THE EXPENSE OF PROFIT

The story of postbankruptcy credit has implications beyond bankruptcy. Recent bankruptcy debtors are exemplars of financially vulnerable Americans. Confronting lenders' marketing to these families provokes

223. See 151 CONG. REC. H2053 (daily ed. Apr. 15, 2005) (statement of Rep. Goodlatte) (“The means test applies clear and well-defined standards to determine whether a debtor has the financial capability to pay his or her debts. The application of such objective standards will help ensure that the fresh start provisions of Chapter VII will be granted to those who need them, while debtors [who] can afford to repay some of their debts are steered toward filing [Chapter 13] bankruptcies.”).

224. I do not comment on Congress's purpose in enacting bankruptcy relief. My focus is on the purpose of creditors in supporting bankruptcy reform. Actual legislative history on BAPCPA is sparse, and courts must cope with the consequences of that reality. Efforts to substitute academic commentary on BAPCPA for legitimate legislative history are inappropriate and misguided, frequently missing the possibility of a distinction between why Congress voted for the bill and why creditors lobbied for it. See Mann, *supra* note 1, at 379 (arguing that credit card issuers could not have expected increased payouts from bankruptcy reform but instead hoped to increase profits before bankruptcy by raising obstacles to filing).

225. The data herein concern the frequency and type of credit solicitations and debtors self-reporting difficulty in obtaining credit. More extensive research on the costs and terms of credit could show significant differences in postbankruptcy credit that favor Chapter 13 filers.

226. Block-Lieb & Janger, *supra* note 2, at 1556–57.

consideration of the appropriate scope of lending to financially distressed individuals. Such transactions may generate profits for creditors but concomitantly may impose unacceptable costs on society and consumers.

Recent scholarship has posited that lending models no longer require full and timely repayment for profitability. John Pottow has observed that this profit model “turns the conventional paradigm of credit risk assessment on its head” and suggested that some of these loans may be “reckless.”²²⁷ Families who do not repay quickly or in full are the most profitable customers for some lending products.²²⁸ These creditors rely principally on income from late fees, over-the-limit fees, and accumulating interest to generate profits.²²⁹ Ronald Mann has detailed this profit model in the context of debt-based credit card issuers.²³⁰ Creditors making subprime mortgages and car loans may rely similarly on faltering repayment efforts to maximize profits; more research on these transactions is needed. Certainly, products targeted specifically at financially strapped borrowers—such as payday loans and auto-title loans—rely heavily on fee revenue.²³¹ Ultimate repayment may not be necessary for a highly profitable transaction. Block-Lieb and Janger have observed that this profit model explains why rational lenders would have continued to expand consumer credit and reduce their lending standards even as bankruptcy filings increased.²³² Lost profit from charge-offs or bankruptcy discharges can be offset by delinquency-derived revenues. In this economic model, the higher bankruptcy rate is merely a consequence of different lending criteria.²³³

Postbankruptcy debtors are even better candidates for the debt “sweatbox” or “reckless loans” than prebankruptcy debtors. While the American Bankers Association’s president has minimized credit card issuers’ interest in having financially distressed customers,²³⁴ a lending-industry

227. Pottow, *supra* note 9, at 414.

228. *Id.* at 414–17 (collecting research on profitability of possible or likely defaulting borrowers).

229. Mann, *supra* note 1, at 392 (“If we imagine borrowers who limp along, carrying [balances] for decades—neither discharging them in bankruptcy, nor ever paying them off entirely, perhaps making an occasional minor purchase—we can see how profitable this business model can be.”).

230. *See id.* at 384–92.

231. *See* JEAN ANN FOX & ELIZABETH GUY, CONSUMER FED’N OF AM., DRIVEN INTO DEBT: CFA CAR TITLE LOAN STORE AND ONLINE SURVEY 11–14 (2005), available at http://www.consumerfed.org/pdfs/Car_Title_Loan_Report_111705.pdf (describing fees for auto-title loans); Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 862 (2007) (noting that the economics of payday lending revolves around the standard fee per loan); *see also* Berkley, *supra* note 179, at 34 (noting that “[m]ost subprime lenders are relying on fees as a countermeasure” to consumers with “less-than-stellar credit”).

232. Block-Lieb & Janger, *supra* note 2, at 1488.

233. *Id.*

234. *See* Marlena Telvick, *Charge It!*, FRONTLINE: SECRET HISTORY OF THE CREDIT CARD, Nov. 23, 2004, <http://www.pbs.org/wgbh/pages/frontline/shows/credit/eight/responsibility.html>

publication has described the “trick” in subprime lending as finding a consumer who has “bottomed out” but is “looking to rebuild his life.”²³⁵ The reasons for this prescription are easiest to understand in the context of credit cards but could apply equally to other loan products. These families have previously relied on cards (and on debt financing generally), so borrowing is part of the family’s financial routine.²³⁶ They likely have few to no cards (and perhaps have other cancelled loans) when marketing begins after bankruptcy so that postbankruptcy lenders increase the chances that their card gets used frequently rather than stored in a drawer with dozens of others.²³⁷ In the postbankruptcy period, consumers may be particularly reluctant to switch lenders by transferring a balance (or refinancing a secured loan) for fears of adverse activity on their credit report. These families’ desperation to rebuild credit after bankruptcy helps lenders avoid the “switching” consequence of raising fees.²³⁸ Families may also believe that postbankruptcy credit options are uniformly expensive and fail to shop for alternatives.²³⁹ Thus, unlike with nonbankrupt consumers, a “great new rate

(“You just can’t build a long-term financial relationship with someone who mismanages their personal finances.” (quoting Edward Yingling, President, Am. Bankers Ass’n)). This statement is intriguing. First, it suggests that lenders may be seeking to maximize short-term profits from customers, dumping them if they fail to generate profits or generate significant losses. Second, the reference to mismanagement of personal finances is telling. If Mr. Yingling is correct, then the industry’s interest in bankruptcy debtors must suggest that lenders do not see bankruptcy as evidence of a family’s financial mismanagement but rather as the result of exogenous adverse financial events.

235. Berkley, *supra* note 179, at 35. Berkley writes:

“They said the trick in all this is to find the guy who has bottomed out and is looking to rebuild his life, to rebuild his credit and is on the way back. You don’t want to be lending money to the guy who is still sliding down So in essence they said that they go to the people who are in the worst situations but yet have procured a job—they have now been gainfully employed for some period of time and have the wherewithal to stabilize their situation to be able to pay.”

Id. (quoting Alan Weinberg, Managing Partner, Weltman, Weinberg & Reis Co. LPA).

236. Porter, *supra* note 218, at 1179 (providing data from CBP III showing that 91.44% of all debtors had at least one credit card debt when they filed bankruptcy).

237. See Mann, *supra* note 1, at 390 (explaining that the “worst [credit card] customers are those who accept cards and use them infrequently”).

238. This response of an elderly woman from Texas to her experience with credit cards after bankruptcy is illustrative of how debtors deal with cards after bankruptcy. “I accepted one credit card to re-establish my credit. I’ve been offered a number of offers, but I’m leery of credit; I have been for a long, long time.” Telephone Interview by Consumer Bankr. Project III with Respondent TX-07-101 (one year postbankruptcy). A married man in his thirties said that his family had accepted one new credit card from Capital One after bankruptcy. He explained his reasoning as follows: “It has a low limit—only \$300. I got it to re-establish myself. I’m trying to pay as much as I can [on the balance] and make sure it’s on time.” Telephone Interview by Consumer Bankr. Project III with Respondent TX-07-100 (one year postbankruptcy).

239. This belief may in fact be correct. Additional research on postbankruptcy credit could usefully help families, their bankruptcy attorneys, and financial educators evaluate options for postbankruptcy financing.

of 18%” may actually lure in customers.²⁴⁰ Finally, postbankruptcy families cannot discharge their debts in bankruptcy for a period of years, reducing one source of loss for lenders.

With the exception of the latter limitation on bankruptcy discharge, former bankrupts face financial circumstances similar to those of other populations that have attracted concern about undesirable credit marketing. Several researchers have advocated for restrictions on credit solicitations aimed at college students.²⁴¹ Like postbankruptcy debtors,²⁴² college students earn low incomes but are anticipating higher incomes and improved financial circumstances in the future. Thus, they may be attracted to borrowing to smooth consumption in anticipation of a better future. Yet, many people will overestimate their future prospects and ability to service debt.²⁴³ Similar to postbankruptcy debtors, college students also have few existing credit obligations compared to typical Americans, allowing an early lender to enjoy a sustained period of profitability. College students and postbankruptcy debtors both face difficulty in meeting bills without borrowing. The credit industry’s intense marketing to postbankruptcy families parallels their efforts to lure other vulnerable borrowers into lending relationships. Because bankruptcy is a public process, recent bankruptcy debtors offer a useful group to study to understand creditors’ strategies for profiting from financially vulnerable consumers.

If lenders’ intense solicitation of such customers indeed is driven by these families’ propensity to pay late, exceed the credit limit, and revolve large balances, society may wish to prohibit or constrain such lending.²⁴⁴ Lending strategies that profit from financial distress may be suboptimal because they force society to bear the costs of such distress.²⁴⁵ As Ronald Mann has observed in another context, “[T]he lender’s incentives differ from the ideal incentives just as much as the borrower’s incentives do.”²⁴⁶ Concern about the externalities of financial distress could motivate

240. Mann, *supra* note 1, at 389 (theorizing that lenders face difficulty in attracting nonbankrupt customers that could be vulnerable to distress without offering them unprofitably low initial interest rates).

241. MANN, *supra* note 7, at 158.

242. See Porter & Thorne, *supra* note 62, at 95–96.

243. Block-Lieb & Janger, *supra* note 2, at 1540–43 (collecting evidence of consumers’ cognitive-estimation bias in estimating future income); cf. Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, AM. ECON. REV., Mar. 1991, at 50, 70–71 (describing how consumers underestimate current and future borrowing).

244. See Pottow, *supra* note 9, at 455 (“Much hand wringing occurred in Congress regarding the death of personal responsibility that practically made bankruptcy reform a moral imperative. . . . [T]here was no concomitant call for personal responsibility of lenders.” (internal citations omitted)).

245. See *id.* at 412–13 (summarizing likely externalities but noting that evidence is more “intuitive than empirical at this juncture”).

246. Mann, *supra* note 177, at 649 n.89.

policymaking designed to deter lending opportunism by shifting these costs to creditors.

CONCLUSION

Consumer-credit policies and bankruptcy law affect the well-being of millions of American families. In the face of assumptions, theories, and lobbying rhetoric, empirical research reveals the real-world consequences of policymaking. This Article's findings on postbankruptcy credit highlight the shortcomings of the debtor-oriented debate about consumer credit and bankruptcy. Efforts to lure recent bankruptcy debtors to borrow after bankruptcy belie creditors' characterizations of these families as immoral strategic actors. Rather than eschewing them as profligates, the lending industry treats families who seek bankruptcy relief as a lucrative source of potential profits. The widespread marketing to families after bankruptcy provides a powerful example of the credit industry's willingness and ability to profit from financially distressed and vulnerable consumers. The law shapes creditors' decisions to market and lend to recently bankrupt families, but this effect was hidden during the past decade of bankruptcy reform. Understanding lenders' incentives in the current credit market yields useful ideas on how bankruptcy and other consumer law can improve credit policy and reduce the collective harms of financial distress.