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PERSONAL BANKRUPTCY

The Credit Research Center Report on Debtors' Ability To Pay

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The Honorable Charles E. Grassley, Chairman
The Honorable Richard J. Durbin
Ranking Minority Member
Subcommittee on Administrative Oversight
and the Courts
Committee on the Judiciary
United States Senate

This report provides information on the results of our review of the Credit Research Center (the Center) report on personal bankruptcies. The Center report addressed a major public policy issue—the amount of income that those who file for personal bankruptcy have available to pay their debts. Specifically, you requested that we evaluate the report's research methodology and formula for estimating the income that debtors have available to pay debts.

Background

Debtors who file personal bankruptcy petitions usually file under chapters 7 or 13 of the bankruptcy code. Generally, debtors who file under chapter 7 of the bankruptcy code seek a discharge of all their eligible dischargeable debts.[1] Debtors who file under chapter 13 submit a repayment plan, which must be confirmed by the bankruptcy court, for paying all or a portion of their debts over a 3-year period unless for cause the court approves a period not to exceed 5 years. The Center report was based on data from 3,798[2] personal bankruptcy petitions filed principally in May and June 1996 in 13 of the more than 180 bankruptcy court locations. The petitions included 2,441 chapter 7 and 1,357 chapter 13 petitions.

The researchers collected a wide variety of information about debtors' income, expenditures, and debts from the schedules the debtors filed with their bankruptcy petitions. Because the debtors' schedules used in the report must be obtained from the case files at each court location, obtaining the data used for the Center report represented a considerable investment of Center time and money. The data are not available from the automated databases maintained by the federal judiciary or the Executive Office of U.S. Trustees, the two principal sources of automated data on bankruptcy cases.

[1]Eligible debts may be discharged in bankruptcy proceedings. A dischargeable debt is a debt for which the bankruptcy code allows the debtor's personal liability to be eliminated.

[2]This is the number of petitions the Center's report said were usable for analysis.

On the basis of the Center report's assumptions and the formula used to determine income available for repayment of nonpriority, nonhousing debt,[3] the report estimated that about 50 percent of the chapter 13 debtors in the 13 locations combined would have sufficient income, after living expenses, to repay all of their nonpriority, nonhousing debt over a 5-year period; and an additional 19 percent could pay 60 percent or more over the same period. The report estimated that 5 percent of the chapter 7 debtors in the 13 locations combined could repay all of their nonpriority, nonhousing debt over 5 years; 10 percent could repay at least 78 percent, and 25 percent could repay at least 30 percent.[4] The Center report also estimated that about 11 percent of chapter 13 debtors and about 56 percent of chapter 7 debtors were expected to have no income available to repay nonhousing debts.

Results in Brief

Overall, the Center report represents a useful first step in analyzing the ability of bankruptcy debtors to pay their debts. Because there is little empirical basis on which to assess the accuracy of the data used in the report's analysis, and because the data provided by the authors showed considerable variation among the 13 locations used for analysis, the report's general findings must be interpreted with caution. Our review of the Center report suggests that additional research and clarification would be needed to confirm the accuracy of the report's conclusions regarding the proportion of debtors who may have the ability to repay at least a portion of their nonpriority, nonhousing debts.

We found five areas of concern with the Center report that could affect interpretation of the report's conclusions: (1) the report's assumptions about the information debtors provide at the time of filing bankruptcy regarding their income, expenses, and debts and the stability of their income and expenses over a 5-year period were not validated; (2) the report did not clearly define the universe of debts for which it estimated debtors' ability to pay; (3) payments on nonhousing debts that debtors stated they intended to reaffirm—voluntarily agree to repay—were not included in debtor expenses in determining the net income debtors had

[3]The Center report assumed that debtors would repay their home mortgage debt and "priority debts." As discussed later, the report defined priority debt as "unsecured priority debt." The report did not clearly define unsecured priority debts nor explain why the report's analysis assumed that debtors would repay their unsecured priority debts.

[4]The 10 percent and 30 percent figures were cumulative. That is, the 10 percent figure included all debtors the report estimated would be able to pay 78 percent or more, and the 25 percent figure included all debtors the report estimated would be able to pay 30 percent or more of their nonhousing debt.

available to pay their nonpriority, nonhousing debts; (4) the report presented results based on data from all 13 locations combined and provided little discussion of the considerable variation among the 13 locations used in the analysis; and (5) a scientific, random sampling methodology was not used to select the 13 bankruptcy locations or the bankruptcy petitions used in the analysis.

First, the report's analysis and conclusions about the income debtors had available for repayment of nonpriority, nonhousing debt rest on two fundamental assumptions: (1) the debtors' schedules of current estimated income, current estimated monthly expenditures, and debts, generally filed at the same time as the bankruptcy petitions,[5] were accurate; (2) the debtors' current estimated income and living expenses, as reported in those schedules, could be used to satisfactorily forecast their income and living expenses for a 5 year debt repayment period. These assumptions have been the subject of considerable debate, and the researchers did not test their validity.

With regard to the accuracy of the data in the debtors' initial schedules, the National Bankruptcy Review Commission's October 1997 report[6] noted that there has been no empirical study of the accuracy of the financial data initially reported by bankruptcy debtors, and it recommended random audits of such data. The Center report acknowledged that there were inherent uncertainties in using the data from debtors' schedules of income and expenses, but it stated that the assumptions used in the analysis regarding debtors' net income available to repay nonpriority, nonhousing debts were conservative and may actually understate net income.

With regard to the 5-year stability in debtors' income and expenses, the data reported in the debtors' initial schedules represent a snapshot in time, and there is some empirical evidence that these data may not necessarily provide a reliable foundation for forecasting debtors' income and expenses for a 5-year period. A 1994 study by the Administrative Office of the U.S. Courts (AOUSC)[7] found that only about 36 percent of debtors who voluntarily entered a 3 to 5 year bankruptcy debt repayment plan under chapter 13 were able to successfully complete their repayment plans and

[5]Federal bankruptcy rule 1007 provides that, among other things, schedules and statements other than the statement of intention shall be filed with the bankruptcy petition in a voluntary case, or if the petition is accompanied by a list containing the names and addresses of all the debtor's creditors, within 15 days thereafter.

[6]Bankruptcy: The Next Twenty Years, October 20, 1997.

[7]Bankruptcy Statistical Trends: Chapter 13 Dispositions, October 1994.

obtained discharges.[8] Another 14 percent of these debtors were unable to complete their chapter 13 plans and had their eligible debts discharged after their cases were converted to chapter 7. About 49 percent had their cases dismissed and did not receive a discharge of their eligible dischargeable debts. This suggests that the Center report's second assumption—that debtors' income and expenses would remain unchanged for a 5-year period—may be optimistic (at least for a portion of debtors) and that further research may be necessary to validate this assumption.

Second, the report did not clearly define the universe of nonhousing debts for which it estimated debtors' ability to pay. There is some evidence in the Center report that the intent of the analysis was to estimate debtors' ability to pay their eligible dischargeable nonhousing debts—secured and unsecured. However, this is not explicitly stated. The Center report defined the net income that debtors had available to pay nonhousing debts as the debtor's net annual take-home pay less (1) annual living expenses (as defined in the report) and (2) annual payments toward "unsecured priority debt."[9] The report stated that its analysis assumed that all unsecured priority debt would be paid in full over a 5 year repayment period. The report also noted that the two most common unsecured priority debts that debtors listed were back taxes and past-due child support. These are debts that are generally nondischargeable in bankruptcy proceedings.[10] However, the categories of debts listed on the schedule of unsecured priority debts filed by the debtor[11] can, in some cases, include both debts that are dischargeable and debts that are

[8]This total included "hardship discharges." A hardship discharge generally may be granted to a chapter 13 debtor who fails to complete the plan payments due to circumstances for which the debtor should not justly be held accountable. An AOUSC official and the Executive Office of U.S. Trustees said such chapter 13 discharges were rare.

[9]The distinction between priority and nonpriority unsecured debt in chapter 7 cases is most evident in those chapter 7 bankruptcy cases in which money from the sale of a debtor's nonexempt assets is available for distribution to creditors. Such chapter 7 "asset" cases are a very small proportion of total chapter 7 personal bankruptcy cases. In such asset cases, the proceeds from the sale of the nonexempt assets are distributed to creditors in a statutorily defined order—unsecured priority and unsecured nonpriority. In no-asset chapter 7 cases, the debtor's eligible dischargeable unsecured debts—priority and nonpriority—that have not been reaffirmed are usually discharged (with limited exceptions).

[10]By statute, some types of debts and obligations, such as alimony, child support, some student loans, and certain taxes, cannot generally be discharged in bankruptcy proceedings. The debtor remains financially responsible for nondischargeable debts after the close of his or her bankruptcy case.

[11]Schedule E "Creditors Holding Unsecured Priority Claims."

generally nondischargeable.[12] The Center report did not state whether the report's assumption about the repayment of unsecured priority debts included dischargeable as well as nondischargeable debts. Moreover, not all debts that are generally nondischargeable would be appropriately listed in the debtor's schedule of unsecured priority debts. To the extent that the Center report understated nondischargeable debts, it would have overstated the net income that debtors would have available to pay dischargeable debts. Conversely, to the extent that the report overstated nondischargeable debts, it would have understated debtors' net income available to pay dischargeable debts. In addition, to the extent that the report assumed that all dischargeable unsecured priority debts would be paid, it would have created a disparity in the report's treatment of nonhousing dischargeable debts.

Third, the Center report did not include in debtors' expenses the payments required to repay the nonhousing debts that debtors stated it was their intention to reaffirm.[13] In each of the report's 13 locations, debtors stated their intention to reaffirm, or repay, at least some of their nonhousing debts. For 12 of the 13 locations in the Center report (Dallas reaffirmation data were incomplete), the average amount of secured nonhousing debt that debtors indicated they intended to reaffirm ranged from $1,362 per debtor in Los Angeles to $6,706 per debtor in Memphis.[14] To the extent that debtors in the Center report reaffirmed nonhousing debts and maintained payments on those debts, these debtors would have less estimated income to pay their eligible dischargeable debts that were not reaffirmed.

Fourth, the Center report presented results based on data from all 13 locations combined. However, the data provided to us by the report's authors, but not included in the report, showed wide variation among the report's 13 locations in debtors' estimated ability to pay. In the 12 locations for which the Center said its reaffirmation data were complete, the data also showed wide variation in the percentage of debtors who stated their intention to reaffirm at least some nonhousing debts and the

[12]As a practical matter, with the exception of alimony, child support, and taxes—debts that are generally nondischargeable in chapter 7 cases—the priority of unsecured claims set forth in section 507(a) of the bankruptcy code (and listed on Schedule E) does not play a very meaningful role in no-asset chapter 7 cases. This is because the eligible dischargeable debts on Schedule E, if applicable, are usually discharged in no-asset chapter 7 cases.

[13]A reaffirmation of a debt is a formal agreement whereby the debtor agrees to remain personally liable for a debt, despite the bankruptcy discharge being granted by the bankruptcy court.

[14]In no location did debtors state their intention to reaffirm more than 1 percent of their unsecured nonhousing debt.

average amount of nonhousing debt to be reaffirmed. These variations may in part reflect the influence of varying local bankruptcy practices. Given these variations, we believe it is appropriate to be cautious in making general statements about the debtors across all 13 locations.

Finally, the Center's researchers selected the 13 bankruptcy locations and 3,798 personal bankruptcy petitions without using scientific random sampling techniques. As a result, the national estimates presented in the report are not based on representative probability sampling methods. In addition, standard statistical methods, such as the calculation of statistical error rates, cannot be used to evaluate the likely accuracy of the results in the Center report. Consequently, the methods used in the Center's analysis do not provide a sound basis for generalizing the Center report's findings to the annual 1996 filings in each of the 13 locations nor to the national population of personal bankruptcy filings.

Study's Fundamental Assumptions Were Not Validated

The Center report's analysis was based on data from the initial schedules of current estimated monthly income, current estimated average monthly expenditures, and debts that debtors submitted at the time they filed for bankruptcy. There are two reasons to question whether broad conclusions about debtors' ability to pay nonhousing debt can be made on the basis of the debtors' statements of estimated income and estimated expenses at the time of filing for bankruptcy:

- The accuracy of the data in the debtors' initial schedules is unknown, and no empirical study has been done to assess their accuracy. Moreover, debtors may generally amend these schedules as a matter of course at any time prior to final disposition of the debtors' bankruptcy cases.

  The Center report assumed that debtors' income and living expenses, as reported in those schedules, could be used to satisfactorily forecast debtors' income and living expenses for a 5 year debt repayment period. However, the report did not include empirical evidence to support this assumption. There is some empirical evidence that this assumption may not be appropriate, at least for a portion of debtors who file for bankruptcy.

Accuracy of Data on Debtors' Schedules of Income, Expenses, and Debts Not Known

The Center report relied on debtors' self-reported data on current estimated income, current estimated expenditures, and debts at the time of filing and assumed that these data were accurate. Although the data in the various schedules are the only such information available at the time a debtor files for bankruptcy, the National Bankruptcy Review Commission report noted that "no study has yet been done to test the accuracy of the data as initially reported by debtors," and it recommended random audits of debtors' initial schedules. The effect of any inaccuracies in these schedules could be that the debtor's actual net income is overstated or understated.

The schedules that debtors complete on their current average monthly income[15] and current average monthly expenditures[16] indicate that debtors should estimate their income and expenditures. The data that debtors report in these schedules represent a snapshot in time, and debtors may generally amend their schedules at any time prior to final disposition of their bankruptcy cases. Such amendments were not included in the Center's analysis. Amendments may be made for a variety of reasons, but there are no readily available empirical data on how frequently schedules are actually amended and the effect of such amendments on the income, expenditures, and debts that debtors report on their initial schedules.

Assumption That Debtors' Reported Income and Expenses Could Be Used to Satisfactorily Forecast Income and Expenses for 5 Years

The Center report's analysis assumed that the debtor's income and expenses, as reported on the schedules filed with the bankruptcy petition, could be used to satisfactorily forecast his or her income and expenses during the course of a 5 year debt repayment period. In other words, the Center report assumed that a debtor's reported income and expenses would remain uninterrupted and unchanged over the 5 years. This assumption is critical to the report's estimate of the percentage of nonhousing debt that debtors could repay over 5 years. However, the Center report provided no empirical support for this assumption.

A couple of factors raise questions about the validity of this assumption. First, the Center report provided evidence of instability in debtor income in the year preceding the debtor's bankruptcy filing. About 77 percent of the 2,441 chapter 7 debtors and about 85 percent of the 1,357 chapter 13

[15]Schedule I "Current Income of Individual Debtor(s)." The schedule includes such categories as monthly gross wages, salary, and commissions; payroll deductions; and income from nonwage sources, such as interest and dividends, alimony, and Social Security.

[16]Schedule J "Current Expenditures of Individual Debtor(s)." The schedule includes such expenditure categories as housing, utilities, food, laundry, medical and dental, insurance, and transportation.

debtors in the Center's analysis reported having some wage income at the time of filing. However, about 68 percent of the chapter 7 debtors and about 50 percent of the chapter 13 debtors in the Center's report also reported they had experienced a reduction in income during the 12 months prior to filing bankruptcy. As the Center report noted, it is not surprising that those who file for bankruptcy have suffered a loss of income prior to filing.

Second, there is also some evidence that debtors may experience fluctuating income or expenses in the 5 years following the filing of their bankruptcy petitions. The findings of a 1994 report by AOUSC suggest that at least a portion of debtors could be expected to experience deterioration in their financial circumstances during the 5 years after filing for bankruptcy. AOUSC reviewed the outcomes of 953,180 chapter 13 cases filed between calendar years 1980 and 1988 and terminated by September 30, 1993.[17] AOUSC found that debtors received a discharge in only about 36 percent of all chapter 13 cases terminated.[18] A chapter 13 discharge is generally granted when a debtor successfully completes a court-approved repayment plan. A hardship discharge may be granted to chapter 13 debtors who fail to complete the plan payments due to circumstances for which the debtor should not justly be held accountable.[19] AOUSC found that in about 14 percent of all chapter 13 cases terminated, the debtors were unable to maintain their payments; prior to termination, their cases were converted to chapter 7 liquidation, in which all eligible debts were discharged.[20] The typical case that converted to chapter 7 did so about 2 years after the case was filed. AOUSC also found that about 49 percent of all chapter 13 cases terminated were dismissed, but data were not available

[17]As of September 30, 1993, almost 97 percent of the 985,212 chapter 13 cases filed between calendar years 1980 and 1988 had been terminated. According to data in the AOUSC report, each year during this period nonbusiness debtors accounted for at least 91 percent of all chapter 13 petitions filed. However, AOUSC's report on case results did not distinguish between business and nonbusiness chapter 13 debtors, and it is possible that the results for nonbusiness debtors could have differed from that of business debtors.

[18]The percentage of cases for which debtors received a discharge remained relatively stable at between 34 percent and 37 percent of all cases terminated from 1982 to 1987. Although the percentage of terminated cases that resulted in discharges dropped to 31 percent in 1988, AOUSC noted that the percentage would have been expected to increase as more 1988 cases were closed.

[19]AOUSC did not report data on the number of chapter 13 hardship discharges.

[20]The percent of chapter 13 cases that converted to chapter 7 was relatively stable at between 13 and 16 percent for cases filed each year between 1980 and 1988.

on the reasons for the dismissals.[21] The results of the AOUSC report caution against making broad conclusions about debtors' ability to maintain debt payments over a 5-year period based on the data in the initial schedules alone.

Center Report Did Not Clearly Define the Universe of Nonhousing Debts for Which It Estimated Debtors' Ability to Pay

There is some evidence in the Center report that the intent of the analysis was to estimate debtors' ability to pay their eligible dischargeable nonhousing debts—secured and unsecured. However, this is not explicitly stated, and the Center report did not clearly define the universe of nonhousing debts for which it estimated debtors' ability to pay. The Center report defined the net income that debtors had available to pay nonhousing debts as the debtor's net annual take-home pay less (1) living expenses (as defined in the report) and (2) payments toward "unsecured priority debt."[22] As examples of such debts, the report mentioned back taxes and past-due child support. These are examples of debts that are generally nondischargeable in bankruptcy proceedings.

Debtors report unsecured priority debts on Schedule E.[23] However, the debts to be listed in Schedule E can, in some cases, include both debts that are dischargeable and debts that are generally nondischargeable. Moreover, not all nondischargeable debts can be found in Schedule E.[24] For example, certain student loans, debts arising out of drunk driving, criminal restitution, and criminal court fines are not dischargeable in bankruptcy, but such obligations would be appropriately listed as

[21]Chapter 13 cases may be dismissed for a variety of reasons, including failure to pay the case filing fee, the debtor's failure to attend the required meeting with the chapter 13 trustee and the debtor's creditors, failure to file a plan in a timely manner, denial of confirmation of a repayment plan, failure to begin making plan payments, or material default by the debtor with respect to a term of a confirmed plan.

[22]The distinction between priority and nonpriority unsecured debt in chapter 7 cases is most evident in those chapter 7 bankruptcy cases in which money from the sale of a debtor's nonexempt assets is available for distribution to creditors. Such chapter 7 "asset" cases are a very small proportion of total chapter 7 personal bankruptcy cases. In such asset cases, the proceeds from the sale of the nonexempt assets are distributed to creditors in a statutorily defined order—unsecured priority and unsecured nonpriority. In no-asset chapter 7 cases, the debtor's eligible dischargeable unsecured debts—priority or nonpriority—that have not been reaffirmed are usually discharged (with limited exceptions).

[23]Schedule E "Creditors Holding Unsecured Priority Claims."

[24]The Center report apparently did include in debtors' living expenses any reported alimony payments debtors listed in Schedule J. Alimony payments are also generally nondischargeable debts. It should be noted that under the bankruptcy code, nondischargeable child support, alimony, and taxes must be paid in full in chapter 13 repayment plans. These obligations would appropriately be listed on Schedule E. The Center report assumed that unsecured priority debts would be paid in full over a 5-year period in either chapter 7 or chapter 13 bankruptcies.

"unsecured nonpriority debt" on Schedule F.[25] The Center report included student loans in unsecured nonpriority debt. However, it is not clear if these student loans represented only loans that were eligible for discharge. Thus, the Center report may not have identified all generally nondischargeable debts for which the debtor would still be responsible following the close of his or her bankruptcy case.[26]

To the extent that the Center report understated nondischargeable debts, it would have overstated the net income that debtors would have available to pay dischargeable nonhousing debts. Conversely, to the extent that the report overstated nondischargeable debts, it would have understated debtors' net income available to pay dischargeable debts. In addition, to the extent that the report assumed that dischargeable unsecured priority debts would be paid, it would have created a disparity in the report's treatment of dischargeable nonhousing debts.

Center Report's Determination of Debtors' Net Income to Pay Nonhousing Debt Excluded Payments on Nonhousing Debts That Were to Be Reaffirmed

A portion of personal bankruptcy debtors voluntarily agree to reaffirm, or repay, some of their dischargeable debts by entering into a reaffirmation agreement to remain personally liable for reaffirmed debts.[27] According to the Executive Office of the U.S. Trustees, debtors tend to reaffirm secured debt, such as a home mortgage or car loan. By reaffirming these debts and keeping current on the payments, the debtors retain possession of the property secured by the debt. To the extent that debtors maintain their payments on reaffirmed debt, it would reduce the amount of income debtors have to pay eligible dischargeable debts that were not reaffirmed.

The Center report included in debtors' living expenses the full value of any home mortgage payments the debtors listed in Schedule J. To the extent that the listed home mortgage payments actually represent the full payments required for home mortgage debt, the Center report assumed that debtors had reaffirmed their housing debt. However, the Center report did not deduct from debtors' income the value of the payments required to pay the nonhousing debts that debtors stated it was their

[25]Schedule F "Creditors Holding Unsecured Nonpriority Claims."

[26]It is possible that the Center report understated total nonhousing debts that are dischargeable. Based on our review of data provided by the authors of the Center report, it appeared that the Center report did not include data from Schedule G "Executory Contracts and Unexpired Leases" or Schedule H "Codebtors." For the purposes of identifying debtors' total nonhousing debts that were eligible for discharge, perhaps the most relevant data from these schedules would be information on debtors' obligations for unexpired leases on real or personal property, such as automobile leases.

[27]The reaffirmation agreement must meet certain statutory requirements.

intention to reaffirm.[28] Data provided by the authors of the Center report showed that for 12 of the 13 locations in the report (Dallas reaffirmation data were incomplete), secured nonhousing debt accounted for virtually all the average nonhousing debt that debtors intended to reaffirm. The average percent of total unsecured debt that debtors indicated they intended to reaffirm did not exceed 1 percent in any of the 12 locations.[29]

The effect of deducting from chapter 7 debtors' income the payments required to repay reaffirmed secured nonhousing debts would be expected to vary across the 13 locations in the Center report because of the wide variation in intended reaffirmations by location. Using data provided by the authors of the Center report, we show in table 1 the percentage of chapter 7 debtors in each of the report's 13 locations who stated their intent to reaffirm at least some of their secured nonhousing debts, the average percent of total secured nonhousing debt to be reaffirmed, and the average total dollar amount of secured nonhousing debts to be reaffirmed. The percentage of chapter 7 debtors who, according to the Center's data, stated their intent to reaffirm at least some of their secured nonhousing debt ranged from about 23 percent in Los Angeles to about 73 percent in Indianapolis. The data also showed considerable differences for those locations within the same state. About 23 percent of chapter 7 debtors in Los Angeles reported their intent to reaffirm at least some secured nonhousing debt compared to about 42 percent in San Diego. The average percentage of secured nonhousing debt that chapter 7 debtors stated they intended to reaffirm ranged from about 23 percent in Los Angeles to about 61 percent in Memphis. The average amount of total debt to be reaffirmed ranged from about $1,362 per debtor in Los Angeles to $6,706 per debtor in Memphis. The averages for any specific location may be based on wide variation in the amount of debt that individual debtors stated it was their intent to reaffirm.

[28]The Center's data on intended reaffirmations are based on information from the form, "Individual Debtor's Statement of Intention." The debts that are ultimately reaffirmed may differ from those included in this statement of intention.

[29]Based on data provided by the authors of the Center report, among the 12 locations for which complete reaffirmation data were available, the average dollar value of the unsecured nonhousing debt that debtors stated they intended to reaffirm did not exceed about $300. Given that the statement of intent form principally focuses on property that the debtor intends to surrender or retain, it is not surprising that debtors listed little unsecured debt on their statement of intention.

Table 1: Credit Research Center Data on the Average Percent of Chapter 7 Debtors Who Stated an Intent to Reaffirm at Least Some Secured Nonhousing Debt, the Average Percent of Total Secured Nonhousing Debt to Be Reaffirmed, and the Average Dollar Amount of Secured Nonhousing Debt to Be Reaffirmed, by Court Location

	Chapter 7 debtors' voluntary reaffirmation of secured nonhousing debts		
Court location	Percent of debtors who stated an intent to reaffirm at least some secured nonhousing debt	Average percent of total secured nonhousing debt to be reaffirmed	Average dollar amount of secured nonhousing debt to be reaffirmed
Atlanta, GA	70.2%	58.8%	$5,936
Chicago, IL	62.1	54.4	4,263
Houston, TX	57.4	46.7	5,353
Hartford, CT	37.8	36.1	1,799
Indianapolis, IN	72.6	59.2	4,655
Kansas City, MO	46.5	37.8	3,613
Los Angeles, CA	22.6	22.6	1,362
San Diego, CA	42.3	38.9	1,535
Memphis, TN	65.2	61.2	6,706
Phoenix, AZ	66.4	49.1	4,680
Pittsburgh, PA	52.3	42.4	5,897
Tampa, FL	54.3	46.0	5,217

[a]According to the Credit Research Center, the Dallas data provided to us on debtors' statements of intent were incomplete because the Center did not have all the statements of intent at that time. Therefore, Dallas data were excluded from this table.

Source: GAO analysis of Credit Research Center data.

Locations in the Report Varied in Indicators of Ability to Pay

The Center report presented data that combined results from all 13 locations on debtors' available income to pay nonhousing debt. Because the Center report focused on the results from all 13 locations combined, it included little discussion of the considerable variations among the 13 locations used in the study. As previously discussed, Center data not included in the report showed a wide variation across the 12 locations with complete data for chapter 7 debtors' intended reaffirmations of secured nonhousing debt. Specifically, as shown in table 1, the percentage of chapter 7 debtors reaffirming at least some secured nonhousing debt ranged from about 23 percent to 73 percent, and the average amount of total debt to be reaffirmed ranged from about $1,362 to $6,706. Data provided by the report's authors showed that the percentage of chapter 7 debtors with at least some income available to pay nonpriority, nonhousing debt ranged from about 32 percent in San Diego to about 67 percent in Dallas.

Other studies have also concluded that there is considerable variation among bankruptcy districts. The National Bankruptcy Review Commission found, for example, that chapter 13 practices "differ dramatically from state to state, district to district, and even from judge to judge in the same district." The Commission report noted that divergent local interpretations of the chapter 13 system create a situation in which expert legal advice is necessary to develop, confirm, modify, and complete a chapter 13 plan; and debtors in very similar circumstances encounter extremely different chapter 13 systems across the nation.

The AOUSC report on chapter 13 cases discussed earlier found considerable variation in case results among all bankruptcy districts and among the 13 districts included in the Center report.[30] As shown in table 2, the percentage of terminated chapter 13 cases that resulted in the discharge of a successful repayment plan ranged from about 15 percent in Central California (which includes Los Angeles) to about 40 percent in Western Missouri (which includes Kansas City). The percentage of chapter 13 cases that were converted to chapter 7 liquidation prior to termination ranged from about 8 percent in Western Tennessee (which includes Memphis) to about 43 percent in Western Pennsylvania (which includes Pittsburgh).

[30]AOUSC's data do not correspond directly to the locations included in the Center report. AOUSC's analysis included all cases filed or terminated in each district. Due to resource constraints, the Center selected petitions from 1 location in each of the 13 districts included in its analysis. For example, the Central District of California includes bankruptcy court locations in Los Angeles, San Bernardino, Santa Barbara, Santa Ana, and Woodland Hills. The Center selected petitions from Los Angeles but not the other locations.

Table 2: Type of Disposition for All Chapter 13 Cases Filed Between Calendar Years 1980 and 1988 and Terminated by September 30, 1993, in the Districts From Which the Petitions Used in the Credit Research Center Report Were Selected

District (Center location)	Total terminated	Percent of terminated cases that were: Dismissed	Discharged	Converted to chapter 7	Other
GA, Northern (Atlanta)	41,897	55.3	34.8	9.8	0.1
IL, Northern (Chicago)	59,088	47.6	38.6	13.6	0.2
TX, Northern (Dallas)	15,657	60.2	21.4	17.4	1.0
TX, Southern (Houston)	22,378	60.3	19.6	19.7	0.4
CT (Hartford)	2,106	42.2	31.3	25.0	1.5
IN, Southern (Indianapolis)	3,309	32.1	33.2	29.7	5.1
MO, Western (Kansas City)	5,017	39.3	39.6	20.2	0.9
CA, Central (Los Angeles)	72,769	77.0	14.5	8.2	0.3
CA, Southern (San Diego)	19,953	59.7	32.4	7.8	0.1
TN, Western (Memphis)	46,348	61.5	30.7	7.5	0.3
AZ (Phoenix)	6,393	40.0	32.8	24.7	2.6
PA, Western (Pittsburgh)	2,883	31.9	22.9	42.9	2.3
FL, Middle (Tampa)	4,728	45.7	24.9	25.2	4.3

Note: Cities in parentheses are court locations within each district from which petitions were drawn for the Credit Research Center report.

Source: 1994 AOUSC study of chapter 13 dispositions.

These variations among bankruptcy districts—for percentage of debtors with at least some income to pay debts, for reaffirmations, and for the final disposition of chapter 13 cases—suggest that one should be cautious in generalizing about debtors across all 13 locations in the Center's report.

The Method of Selecting Locations and Petitions Does Not Support Generalization of the Report's Results

The Center's researchers selected the 13 bankruptcy locations and 3,798 personal bankruptcy petitions without using scientific random sampling techniques. As a result, the national estimates presented in the report's conclusions were not based on representative probability sampling methods. In addition, standard statistical methods cannot be used to evaluate the likely accuracy of the Center report's results. Consequently, the methods used in the Center's analysis do not provide a sound basis for generalizing the Center report's findings to the annual 1996 filings in each of the 13 locations nor to the national population of personal bankruptcy filings.

Locations Judgmentally Selected

The 13 court locations used in the report were judgmentally selected from large urban areas with a Credit Counseling Center[31] and large bankruptcy caseloads. The locations were also chosen to include variations in other characteristics, such as the growth in bankruptcy filings, the split between chapter 7 and chapter 13 filings, and state-specific asset exemption levels for chapter 7. Indeed, the Center report showed that the courts that were included differed considerably in the total number of filings, the proportion that were chapter 7 and chapter 13 personal bankruptcy filings, and the change in the total number of filings from 1995 to 1996. Neither the court locations nor petitions were chosen with the objective of identifying the range of debts—lowest to highest—that bankruptcy debtors could repay.

The total number of personal bankruptcy petitions filed in 1996 varied greatly among the 13 court locations. To account for this fact, the Center report stated that the sample was weighted so that the report's weighted estimates that combined information from all locations represented the total filings from these 13 court locations. This means that the Center report's estimates were strongly affected by those court locations that had the highest number of personal bankruptcy petitions filed in 1996. For example, about 41 percent of all 1996 chapter 7 filings in the 13 court locations were from Chicago and Los Angeles. The 17 percent of the sampled chapter 7 filings from Chicago and Los Angeles were therefore inflated to correctly represent the relative size of the Chicago and Los Angeles locations among the 13 locations. All of the Center report's weighted estimates, including those labeled as national estimates, were weighted to represent only these 13 locations.

[31]According to the report's authors, locations with Credit Counseling Centers were chosen because the report we reviewed was part of a larger research effort. One purpose of this larger effort was to compare debtors who did and did not use credit counseling in these 13 locations.

The Center report's authors provided us with data, not included in the report, that indicated that the predicted abilities of those who filed for chapter 7 personal bankruptcy to repay debts varied considerably among the 13 court locations (see table 3). For example, the percent of chapter 7 debtors whom the report determined had some income available to repay debt ranged from a low of about 32 percent in San Diego to a high of about 67 percent in Dallas. The considerable variation among locations indicates that the repayment rate at other locations, and for the nation as a whole, could differ from the combined, weighted estimate for these 13 locations.

Table 3: Percent of Chapter 7 Debtors in Each Court Location Whom the Credit Center Determined to Have Positive Net Income That Could Be Applied to the Payment of Nonhousing Debt

Court location	Percent of chapter 7 debtors with positive net income available to pay nonpriority, nonhousing debts
Atlanta, GA	52.7
Chicago, IL.	49.8
Dallas, TX	67.1
Houston, TX	60.2
Hartford, CT	52.2
Indianapolis, IN	43.1
Kansas City, MO	56.9
Los Angeles, CA	32.9
San Diego, CA	31.7
Memphis, TN	50.0
Phoenix, AZ	50.4
Pittsburgh, PA	34.0
Tampa, FL	36.8

Source: Credit Research Center data.

The Center report's authors stated that its results cannot be generalized to all personal bankruptcy petitions filed nationally because the sample was not designed for this purpose. Consequently, the national estimates presented in the conclusion of the Center report are not supported by the report's study methods.

Petitions Not Randomly Selected Among Months of the Year or Days of the Month

The Center report states that the sampling procedures used to select petitions from the 13 court locations resulted in a sample that was representative of all petitions filed in those locations. From our review of available information on the report's sample design, we have determined that statistical probability sampling methods were not used to select the

petitions filed within each court location. The Center's petitions were gathered from several months and generally included the petitions filed in the first few days of the months of May and June (eight locations); June only (three locations); or July only (one location) of 1996. In the remaining location, the petitions were selected by the clerk of the bankruptcy court during April, May, and June 1996. Because the sample procedure for selecting filings within bankruptcy court locations was not random, the characteristics of the petitions drawn may be systematically influenced by variation in the types of filings that can occur (1) in different months throughout the year and (2) for days within the month. Consequently, standard statistical sampling methods cannot be used to determine whether the results in the Center report were likely to be representative of all bankruptcy filings in each of the 13 court locations.

The Center report evaluated the possibility that the petitions from May to July that were included in the analysis might differ from those filed during other months of the year by examining supplementary data for other seasons from Indianapolis. On the basis of the Indianapolis analysis, the authors conclude that "a concern that seasonal differences in petitions could lead to an overstatement of the ability to repay debt across all petitions filed during 1996 is unwarranted." The Center report provided no basis for judging whether the lack of monthly variation in Indianapolis could be expected in all 13 court locations.

The petitions within each court location were not selected from filings over complete monthly periods and, therefore, could be affected by variations in the characteristics of petitions filed at different times of the month. In a few court locations, because of especially high filing volumes, the sample quotas were reached in the first day or two of the month. For example, our analysis of the Center's data showed that about 95 percent of the petitions selected in Dallas and Houston, Texas, were filed by the third day of the month. At both of these locations, the petitions drawn had been filed prior to the first Tuesday of the month, the date on which mortgages are foreclosed in Texas. Thus, the petitions used from these two locations may have included a disproportionate number of debtors who sought to avoid mortgage foreclosures under chapter 13. The income and expenses for such filers may vary from those of debtors who filed in these locations later in the month. The report's authors told us that they planned to sample additional petitions in Dallas and Houston to examine this possibility.

Scope and Methodology

The comments and observations in our report are based on a review of the final version of the Center report, dated October 6, 1997;[32] some additional information we requested from the report's authors; data and analyses provided by the Federal Judicial Center (FJC) on bankruptcy filings in the 13 locations used in the Center report; telephone interviews with bankruptcy judges and trustees; and our experience in research design and evaluation. On November 13, 1997, we met with Professor Michael Staten, coauthor of the report, to discuss our questions and observations about the report. Following this meeting, Professor Staten and his coauthor, Professor John Barron, provided additional information about the report's methodology and some additional data that we requested. We received the last of these data on December 23, 1997. The authors declined to provide a copy of the automated database used for their analysis, citing their interest in retaining its proprietary value.

The team that reviewed the report included economists from our Office of Chief Economist and specialists in program evaluation, statistical sampling, and statistical analysis from our General Government Division's Design, Methodology, and Technical Assistance group. We did our work principally between October 1997 and January 1998 in Washington, D.C.

Comments From Study Authors

Professors Michael E. Staten and John M. Barron, authors of the Center's report, provided written comments on a draft of this report. (See app. I.) The authors discussed each of the report's five areas of concern that, together, led to our conclusion that additional research and clarification would be needed to confirm the accuracy of the Center's report's conclusions regarding the proportion of debtors who may have the ability to repay at least a portion of their nonpriority, nonhousing debts and the amount of debt such debtors could repay. In discussing the five areas of concern, the authors agreed with some concerns but believed that other concerns were either overstated or unwarranted.

Their specific comments on the concerns raised in this report are discussed and evaluated at the end of appendix I. We focus here on the authors' major comments and our evaluation of those comments. Basically, the authors disagreed with us over the implications of the concerns we raised. They believe that the sample of bankruptcy cases they examined was large enough and was taken from a sufficiently varied

[32]John M. Barron, Ph.D., and Michael E. Staten, Ph.D., Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay, October 6, 1997. Earlier reports of the research findings were included in testimony before the National Bankruptcy Review Commission on December 17, 1996, and January 23, 1997, and before the Senate Judiciary Subcommittee on Administrative Oversight and the Courts, April 11, 1997.

cross-section of cities and courts to (1) reveal a significant number of chapter 7 petitioners with some capacity to repay their debts and (2) suggest a need for policymakers to reexamine whether the current bankruptcy statutes should be changed. They also believe that determining debtors' ability to pay their eligible dischargeable nonhousing debts, which the Center report did not do, was an interesting but unimportant side issue. Although they agreed that it would be difficult to use their results to estimate with any precision the repayment ability of chapter 7 debtors outside of their sample, they believed that their sample results, regardless of the concerns we found, strongly suggest a widespread substantial repayment capacity. They provided additional data and analysis, not included in the Center's report, on reaffirmations of secured nonhousing debt to further support their conclusions.

We continue to believe that the concerns we found strongly suggest that additional research and clarification are needed to determine the accuracy of the Center report's conclusions regarding the proportion of debtors who may have the ability to repay at least a portion of their nonhousing debts and the amount of debt they could potentially repay. We note in this regard that the Credit Research Center is currently conducting additional research with its bankruptcy database, and the accounting firm of Ernst & Young is conducting a study to address the concerns we raise in this report. The Center commented that the study clearly indicates a widespread and "substantial" repayment capacity across all 13 locations in the study. We agree that the data and indicators used by the Center showed that the percentage of debtors in each location with at least some positive net income available for debt repayment was not so small as to be negligible. However, the assumptions, data, and sampling procedures used in the Center report raise questions concerning the accuracy and usefulness of the report's estimates and require the reader to use caution in interpreting the types of firm conclusions found in the Center report. For example, the Center's estimate of the percentage of debtors who have at least some capacity to pay included all debtors whose monthly net income after expenses was greater than zero, whether that amount was $1 or $1,000. We were not able to conclude, as the Center did, that there is a "substantial" repayment capacity in every city because (1) we do not have a basis for determining how much repayment capacity should be considered substantial; and (2) we cannot conclude that the petitioners' net income, as derived from data in their initial schedules, can be accepted as an accurate estimate of debtors' net income available for debt repayment for the following 5 years.

Several factors suggest to us that those debtors with at least some capacity to pay would not be able to repay as much debt as the Center report assumed. For example, historically only about one-third of chapter 13 debtors have completed their repayment plans, suggesting that for two-thirds of debtors something changed between the time the plans were confirmed by the bankruptcy court and the time the actual repayment plan was to be successfully completed. To the extent that debtors are unable to maintain their debt repayments for the full 5-year period assumed in the report, the amount of debt repaid would be less than that assumed in the report. In addition, the Center's estimates of repayment capacity do not include any provision for the administrative costs of administering a repayment plan. In fiscal year 1996, 14 percent of the payments from chapter 13 debtors was used to pay administrative and legal costs.

The Center report provided an estimate of the potential repayment capacity of debtors who have filed for bankruptcy to pay their nonpriority, nonhousing debts. We do not agree with the Center that identifying the universe of dischargeable debts that a debtor may have the capacity to repay is an interesting, but unimportant, side issue in assessing a debtor's ability to repay his or her nonhousing debts. It is the debtor's total eligible dischargeable debts that represent the potential loss to creditors if the bankruptcy court grants the debtor a discharge of all his or her eligible dischargeable debts. The Center report did not attempt to identify this universe of debts in its analysis. Creditors are not at risk in the bankruptcy process for debts that are nondischargeable or debts that the debtor reaffirms. Similarly, creditors are not at risk through the bankruptcy process for the dischargeable debts of those debtors whose bankruptcy cases are dismissed. With few exceptions, these debtors remain personally responsible for all their debts. The relevant universe of debtors who pose a risk of nonpayment to creditors through bankruptcy are those who complete the bankruptcy process and receive a discharge of all or part of their eligible dischargeable debts. The Center report did not attempt to estimate the capacity to pay of this universe of debtors. Instead, the Center's assessment of capacity to pay included those debtors who may have received a discharge plus those debtors whose cases were dismissed and did not receive a discharge. Consequently, the Center report's universe of debtors included debtors who remained responsible for their eligible dischargeable debts because their cases were dismissed.

The Center agrees that the Center report's findings were not based on data from a nationally representative scientific, random sample. The Center comments that the researchers did not intend to obtain a nationally

representative sample and that much useful information can come from samples that are not nationally representative. Although decisions with nationwide implications could be based on evidence from selected locations, we believe that the assumptions, data, and methods used in the Center report require that its conclusions—which, in some cases, are stated as broad national estimates—be interpreted with caution.

The additional data provided in the comment letter are helpful; but, as discussed in our comments at the end of appendix I, we did not have the database used for these analyses to verify the results. More importantly, these new data do not resolve many of the concerns we raise in this report. For example, the weighting methodology used to develop the weighted estimates presented in the new tables is the same methodology used for the Center report's other estimates and is subject to the same limitations we discussed in our report. As with the Center's other estimates, the assumptions used in the new analyses assumed that 100 percent of debtors' discretionary income and 100 percent of the proceeds from the sale of the debtors' nonexempt assets would be used to repay debt. In practice, administrative costs would reduce the amount paid to creditors.

Thus, notwithstanding the comments and additional information provided by the Center report's authors, we continue to believe that more research would be needed to verify and refine the Center report's estimates of debtors' repayment capacity to better inform policymakers.

We are providing copies of this report to the Chairman and Ranking Minority Member of the Senate and House Committees on the Judiciary; the Chairman and Ranking Minority Member of the Subcommittee on Commercial and Administrative Law, House Committee on the Judiciary; and to the authors of the Credit Research Center report. We will also make copies available to others upon request.

If you have any questions, please call me at 512-8777.

Richard M. Stana
Associate Director
Administration of Justice Issues

Comments From the Credit Research Center

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

GEORGETOWN UNIVERSITY

January 21, 1998

Mr. Richard M. Stana
Associate Director
Administration of Justice Issues
U.S. General Accounting Office
441 G St., N.W.
Washington, D.C. 20548

Dear Mr. Stana,

Thank you for the invitation to provide comments for inclusion in the GAO's report which evaluates *Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay* (Credit Research Center Monograph #33, October, 1997). Professor John Barron and I appreciate your interest in our research. Our comments are provided in the enclosed document.

If you have additional questions don't hesitate to call me at (202) 625-0103.

Sincerely,

Michael Staten
Director

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Response from Professors Michael E. Staten (Georgetown University School of Business) and John M. Barron (Krannert Graduate School of Management, Purdue University), authors of the Credit Research Center study "Personal Bankruptcy: A Report on Petitioners' Ability to Pay".

We welcome the GAO's invitation to comment on their assessment of the strengths and limitations of our report, *Personal Bankruptcy: A Report on Petitioners' Ability to Pay,* (Monograph #33, Credit Research Center, Georgetown University School of Business, October, 1997). We also appreciate the GAO's conclusion that "overall, the Center report represents a useful first step in analyzing the ability of bankruptcy debtors to pay their debts."

GAO analysts go on to note that the report's findings should be interpreted with caution, and that "additional research and clarification would be needed to confirm the accuracy of the report's conclusions regarding the proportion of debtors who may have the ability to repay at least a portion of their nonpriority, nonhousing debts." The GAO indicates five areas of concern which give rise to their suggestion for caution when interpreting the general findings.

In the following sections we provide some background information that should be helpful for interpreting the methods we used in this project. We then offer some discussion regarding each of the GAO's five areas of concern. In some cases, we agree with the identified limitations and discuss the implications for our results. In other cases, we provide some additional data which should clarify those areas where we believe concern is overstated or unwarranted.

BACKGROUND ON THE BANKRUPTCY PROJECT

The General Accounting Office (GAO) reviewed the first of several reports stemming from a large study of consumer insolvency choices. initiated by the Credit Research Center in the summer of 1996. The project was designed to address the following sets of questions.

1. What factors influence the choice of bankruptcy (either Chapter 7 or Chapter 13) as opposed to non-bankruptcy alternatives for solving serious financial problems?

2. For those consumers who choose to file for bankruptcy, what factors influence the choice of Chapter 7 vs. Chapter 13?

3. For those consumers who file, what is their apparent ability to repay debts?

A key objective of the project was to assemble an extensive "bankruptcy" data base that would provide the empirical foundation for analysis. Our sample of 3,798 families who filed for bankruptcy in 13 major U.S. cities during the spring and summer of 1996 is the most geographically diverse sample of bankrupt consumers ever assembled. In addition to obtaining the full petition for each filing, we also obtained mail survey responses from over 1,200 of these families regarding 35 questions about their bankruptcy experience, including their views about the underlying causes and events leading to their financial problems and their awareness of non-bankruptcy alternatives.

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In organizing the research tasks to be undertaken with these data we discussed whether to consolidate all the analyses into a single, book-length report prior to release, or to sequence the tasks and release a series of smaller, interim reports that addressed subsets of the questions listed above. Several years of analysis will be required to exhaust the depth and breadth of our combined data bases. Given the accelerating legislative interest in bankruptcy during 1997, we decided to direct our efforts to producing a series of shorter reports so that information on specific issues could be made available more quickly. Consequently, the first report evaluated by the GAO engages only a small subset of the questions which we will ultimately address. This is very much work in progress.

DISCUSSION OF GAO EVALUATION

GAO Concern #1: ***"The report's assumptions about the information debtors provide at the time of filing bankruptcy regarding their income, expenses, and debts and the stability of their income and expenses over a 5-year period were not validated."***

See comment 1.

We agree. Virtually everyone involved with bankruptcy reform, including the National Bankruptcy Review Commission recognizes the need for auditing debtor financial schedules. In the absence of such auditing, what recourse does a researcher (or the court) have but to accept what the debtor tells the court under oath? Put another way, what data could we use in place of the debtor's own statement that would be judged by reviewers of our work as a more accurate reflection of the debtor's circumstance? Furthermore, ***if*** there is bias in the unaudited schedules, one would expect that the petitioner would have used the income and expense schedules to understate, not overstate, their capacity to repay.

See comment 2.

The point regarding stability of income (and expenses) is a good one. Neither we nor the court evaluating a payment plan can know what will happen to a given debtor's income over the subsequent 5 years. For lack of a better alternative, our calculations take current income as the base and calculate percentage repayable *if income remained unchanged relative to expenses.* This method of calculation provides a benchmark that can easily accommodate whatever assumptions about possible income changes the reader wishes to make. Indeed, incorporating a cushion into a Chapter 13 payment plan to guard against income interruptions or unexpected expenses seems a prudent step.

We wish to raise one qualifying point regarding the GAO's reference to observed Chapter 13 failure rates in support of its concern that debtor income may be unstable over a 5-year repayment plan. A 1994 study by the Administrative Office of the U.S. Courts (AOUSC) found that only 36 percent of debtors who voluntarily entered Chapter 13 repayment plans between 1980 and 1988 actually completed their plans. It is not clear from that study why the remaining 64% failed to complete their plans. Consequently, the outcomes tell us little about income stability, or the viability of the plan. In fact, if further income interruptions were the primary cause of failure, we would expect the bulk of Chapter 13 failures to end up being converted to Chapter 7 cases. However, the AOUSC found that only 14% of all Chapter 13 cases were converted to Chapter 7.

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The remaining plans failed for unknown reasons. Even among those which converted to Chapter 7, we don't know if they convert because they can't make the payments, or simply choose not to continue repayment. Clearly, more research is needed on the effectiveness of Chapter 13 repayment programs. This is an important component of our ongoing bankruptcy project as we follow the progress of over 1,200 Chapter 13 petitioners in our sample.

GAO Concern #2: ***"The report did not clearly define the universe of debts for which it estimated debtors' ability to pay."***

See comment 3.

The report clearly states that we calculate the percent of non-housing debt repayable out of future income, without liquidation of assets. Thus, **the basic calculations include all debt not secured by real estate**, without drawing a distinction between secured vs. unsecured, priority vs. non-priority, or dischargeable vs. non-dischargeable.

If anything, we appear to have defined the debts to be repaid too broadly for the liking of the GAO analysts. Certainly, they raise this issue in regard to the potential for repaying secured vs. unsecured debt. Additional information on this breakdown was provided above. The distinction they raise between dischargeable and non-dischargeable debts is an interesting side issue, but somewhat beside the point if our intent is to assess the debtor's overall ability to meet their obligations. As for our treatment of unsecured, priority claims, we subtract payments on those claims from the debtor's income before calculating the percent of non-priority unsecured debt repayable, under the assumption that priority claims will be paid first. Unsecured, priority debt is not included in the base of total unsecured debt for purposes of the many percentage repayment calculations imbedded in the report.

GAO Concern #3: ***"Payments on nonhousing debts that debtors stated they intended to reaffirm - voluntarily agree to repay - were not included in debtor expenses in determining the net income debtors had available to pay their nonpriority, nonhousing debts."***

See comment 4.

Strictly speaking this comment is correct, because the objective was to measure how much non-housing debt ***could*** be repaid. Automobile loans and other secured, non-mortgage loans make up part of the non-housing debt whose repayment potential we are trying to calculate, Such loans also spawn many reaffirmation agreements as debtors realize that they'd like to keep the assets through bankruptcy. What GAO appears to be raising is the legitimate question of how much ***extra*** or uncommitted ability to pay exists among the sample, **after accounting for reaffirmation payments.** Although we had not prepared such analysis for our first report, we have since prepared Tables 1-3 to address the issue.

Table 1 displays average debt values, by chapter, for secured vs. unsecured debt, as well as housing vs. non-housing debt. These mean values provide a frame of reference for interpreting Tables 2 and 3. Table 2 examines repayment ability if debtors chose to reaffirm **none** of their secured, non-housing debt (The GAO report notes that our calculations assume housing debt will continue to be repaid. Consequently, the monthly payment is treated as a monthly living expense).

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Conversely, Table 3 examines repayment ability if debtors choose to reaffirm **all** of their non-housing debt. Of course, we know the actual experience of our sample must fall somewhere in between.

From our first report we know that 53% of Chapter 7 petitioners indicated an intent to reaffirm one or more of their secured non-housing debts. We also know that about 46% of the dollar amount of all secured non-housing debt was listed as an intended reaffirmation. However, we also know from testimony presented to the National Bankruptcy Review Commission that only 50-60% of intended reaffirmations translate into filed reaffirmation agreements (Culhane and White, Creighton University Law School, testimony before the National Bankruptcy Review Commission, February, 1997). Since we have not yet collected all of the filed reaffirmation agreements corresponding to the Chapter 7 petitions in our sample, we can't tell precisely how much non-housing debt is being retained vs. returned to creditors. Consequently, Tables 2 and 3 **provide useful upper and lower bounds for calculating how much *unsecured* debt could be repaid over a 5-year repayment plan.**

See comment 5.

If Chapter 7 debtors do not reaffirm any non-housing debts, the calculations displayed in Table 2 indicate they could repay, on average, a total of $5,224 toward their unsecured debt over a 5 year repayment period (line D). This number reflects the average dollars repayable across the entire sample of Chapter 7 petitioners. Of course, this average includes 39.7% of the sample who could pay something toward unsecured creditors (Line E), and 60.3% of the sample who could pay nothing (i.e., no available income after paying living expenses).

In contrast, if Chapter 7 debtors reaffirm **all** of their non-housing debts, the calculations displayed in Table 3 indicate they could repay, on average, a total of $3,570 toward their unsecured debt over a 5-year repayment period (line D). Once again, this average includes 31.6% of the sample who could repay something toward unsecured creditors (Line E) and 68.4% who could repay nothing. For those 31.6% of Chapter 7s who could repay something, they could repay, on average, 31.4% of their unsecured debts (Line F). Five percent of all Chapter 7 debtors could repay $20,100 or more toward their unsecured creditors over 5 years, even after reaffirming all of their unsecured debts (Line K).

To summarize, we estimate that petitioners in our Chapter 7 sample could make payments toward their unsecured debts that average between $3,570 and $5,224 over a 5 year period, depending upon the proportion of secured, non-housing debt reaffirmed. Of course, since these are averages across the entire sample, the actual payments made by the 30 - 40 percent who have available income will be substantially higher.

GAO Concern #4: ***"The report presented results based on data from all 13 locations combined, and provided little discussion of the considerable variation among the 13 locations used in the analysis."***

See comment 6.

The GAO's message here is that we should be cautious in extending the results of our repayment calculations to other locations given the substantial variability in repayment capacity across our 13 cities. We agree that it would be difficult to use our results to estimate with any precision the repayment ability of Chapter 7 debtors who filed in a particular city outside our

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sample. **On the other hand, we believe that the finding of substantial repayment capacity in every city in our sample, despite the great diversity in city/court characteristics, is a powerful result that strongly suggests a widespread phenomenon.**

Table 4 provides more detail for Chapter 7 debtors. Columns (1) and (2) display the average non-housing debt for petitioners in each city and the percent of debtors with a net positive income after subtracting all living expenses (43.3% of Chapter 7 debtors in the sampled courts). Columns (3) through (6) provide both the percentage and dollar amounts of debt repayable over 5 years (total debt and unsecured debt), **assuming no reaffirmations of secured, non-housing debt.** Columns (7) through (10) provide both the percentage and dollar amounts of debt repayable over 5 years **assuming reaffirmation of all secured, non-housing debt.**

Table 5 emphasizes the pervasiveness of the apparent capacity to repay. **The percent of Chapter 7 debtors who have income (net of all living expenses) available to make payments on unsecured debt ranges from a low of 24.1% in San Diego to 49.4% in Dallas, even assuming that all secured debt is reaffirmed.** In no city was the repayment capacity so low as to be considered negligible. Consequently, although there is substantial variation across cities, Tables 4 and 5 make clear that the summary statistics presented in our first report were not the result of an aberration of one or two cities. We believe these data should minimize any concern that the repayment phenomenon might be highly localized. Put another way, given these results from 13 major U.S. cities with wide diversity in geography and economic conditions, our view is that it is not necessary to determine a corresponding percentage for Seattle, or Philadelphia or Minneapolis (etc.) to suspect that the phenomenon is widespread.

GAO Concern #5: ***"A scientific, random sampling methodology was not used to select the 13 bankruptcy locations or the bankruptcy petitions used in the analysis."***

See comment 7.

To those unfamiliar with research methods the above statement undoubtedly sounds more damaging than is actually the case. In designing this project we never intended to obtain a nationally representative probability sample. The vast majority of social science research is conducted with samples that are not nationally representative probability samples. Much useful information is imbedded in samples which are technically less ambitious than the standard which the GAO has applied to our data base. Below we discuss each of the GAO's three specific concerns with our sampling methods, offer our reasons for proceeding as we did, and discuss the resulting limits on the analysis.

See comment 8.

Sampling Issue #1) We sampled approximately 300 cases from each of 13 bankruptcy courts/cities. The courts were chosen judgmentally, and may or may not be representative of the remaining 160+ courts in the U.S.

Response: The selection of courts for our study was specifically intended to obtain variation in a number of key characteristics believed to influence the decision to file. We utilized the same approach as past researchers on bankruptcy whose work has been widely recognized as providing a benchmark for our understanding of the system. Those studies include Sullivan, Warren and

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Westbrook (*As We Forgive our Debtors,* 1989), and the General Accounting Office (*Bankruptcy Reform Act of 1978 - A Before and After Look*, 1983).

We took this approach so that we could form and test hypotheses about potential causal factors. This approach differs, of course, from a national probability sample design that would be appropriate for producing descriptive statistics for all bankruptcies filed nationwide. The cities in our study were picked to achieve variance in several factors that either describe the operation of the bankruptcy system (e.g., proportion of cases filed under Chapter 7) or are hypothesized to affect observed filing patterns (e.g., regional economic conditions; state-level asset exemption laws; state law regarding wage garnishment as a credit collection tool).

Table 6 describes the data for four such factors, specifically, (1) the percentage of bankruptcies filed under Chapter 7 vs. 13, (2) recent growth rates in the number of petitions filed, (3) state-level exemption laws regarding the maximum home equity exempt from liquidation in Chapter 7, and (4) the local economic climate, as proxied by the unemployment rate. The source for the bankruptcy filing statistics is the Administrative Office of the U.S. Courts and applies to the 12 months ending June 30, 1996. The source on the homestead exemption data is a National Bankruptcy Review Commission memo, authored by Elizabeth Warren and Melissa Jacoby, dated April 11, 1997. Unemployment rate data derive from the Bureau of Labor Statistics and are city-specific as of June, 1996.

To illustrate the approach, we may wonder what impact an unlimited homestead exemption has on the debtor's choice of chapter under which to file. Because our sample of courts includes districts with and without such an exemption, it enables us to evaluate the effects of such factors with samples sufficiently large to make statistically valid conclusions about their influence. The choice between sampling in this way as opposed to selecting a few petitions from a large number of courts reflects a tradeoff imposed because we (like all other researchers before us on the topic, including the GAO's own study published in 1983) had limited resources, and the costs of sampling rise sharply with the number of ***courts*** sampled (as opposed to the number of petitions). Nevertheless, even with only 13 courts, the filing volume in our sampled cities represented about 18% of the total U.S. volume in 1996.

We view the potential value of our approach for policymakers in the following way. In addition to providing a better understanding of the influence of specific factors (e.g., local unemployment), ***if a large sample from a varied cross-section of cities/courts reveals significant numbers of Chapter 7 petitioners with some capacity to repay their debts, it suggests a need for policymakers to re-examine the statutes to determine if this outcome is desired.*** On the other hand, if our sampling of 13 cities revealed few instances of substantial repayment capacity, then the policy issue of the consumer's free choice of chapter would be much diminished. Alternatively, if instances of repayment capacity were confined to a single court, then concern should appropriately shift away from the statutes and focus more directly on the local conditions that generated the result. We shall say more about the results of this approach below when we address the GAO's concerns about the variance in repayment percentages observed across the cities in our sample.

Sampling Issue #2: Seasonality: the sample was drawn from bankruptcies filed between April

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and July, 1996. It is conceptually possible that characteristics of petitions filed in the spring and summer months may not be representative of petitions filed at other times of the year.

See comment 9.

Response: **Ample evidence from previous researchers (and our own supplemental testing) suggests that the potential bias from focusing only on cases filed in the spring and summer months is negligible.** Certainly there are seasonal effects on petition *volume*, but Sullivan, Warren and Westbrook note the absence of month-to-month seasonality in petition *characteristics* in at least two of their publications, including their study of debtors who filed in 1981 as reported in *As We Forgive Our Debtors* (1989, pp 353-354). They reiterated this finding in their follow-up study of debtors who filed in 1991, as reported in "Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991," (*American Bankruptcy Law Journal,* vol. 68, 1994, p 148). We relied upon these findings in designing our own sample. Moreover, our follow-up work in the Indianapolis court (4 consecutive quarterly samples of 300 cases each, beginning in May-June, 1996) reveals no evidence of seasonal effects on the ability of petitioners to repay across the 12 month period.

Sampling Issue #3: Petitions were not randomly selected across days of the month.

See comment 10.

Response: Our sampling plan called for **drawing all cases filed sequentially within a court until specific case quotas were filled.** Since we relied upon either the bankruptcy court staff or a court-authorized copy service to physically obtain copies of petitions, the logistics of sampling were complicated in terms of both cost and consistency of the criteria used to pull the cases. We chose a sequential sampling plan to keep tight control of the sampling process and to minimize the uncertainty about the characteristics of cases which were selected vs. passed over. We did not randomly sample every **n**th case because ***we obtained the universe of cases filed during the observation period.***

In the majority of courts we began sampling on the first business day of each month. Consequently, there is greater representation of cases in the first week of every sample month than in the successive weeks. The overall distribution of approximately 3,500 cases in our sample (full sample minus cases from Pittsburgh, for which the court did not provide us the date of filing), by day of the month, is as follows:

Day 1-7	58%
Day 8-15	14%
Day 16-23	17%
Day 24-31	11%

It is conceptually possible that cases filed during the second, third and fourth weeks of the month may look different than those filed in the first week of the month. However, past research has indicated that only in Texas (among our sampled states) is there a specific reason to expect that case characteristics may relate consistently to the week of the month in which they are filed (Sullivan, Warren and Westbrook, 1989). This stems from a Texas statute which dictates that mortgage foreclosure proceedings commence on the first Tuesday of every month. Consequently, cases filed beginning on the first day of a month up until the first Tuesday might contain a disproportionately large share of homeowners who are behind on their mortgage debt and for

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whom a Chapter 13 petition offers a way to stop the imminent foreclosure on their home.

Indeed, this probably explains why our sequential sampling procedure produced a sample of 300 cases in Dallas, only 29% of which were filed under Chapter 7 (compared to 50% for all of 1996) and a 300-case sample in Houston with only 41% filed under Chapter 7 (vs. 49% for all of 1996). However, it is important to note that the direction of bias is well-established (disproportionate number of past-due home mortgages in Chapter 13). Moreover, while the surge in Chapter 13 filings during the first week of the month reduced the **number** of Chapter 7 cases we obtained in our sequential sampling, **it is not clear why the characteristics of those Chapter 7 cases would be any different relative to Chapter 7s filed at other times of the month.**

We are currently not aware of reasons to suspect day-of-month bias in our other courts, nor have previous researchers or the GAO suggested reasons to expect it in other states. We did conduct supplemental analysis of cases filed in the Indianapolis court with samples from different days of the month and months of the year. These include 300 cases filed in late November, early December, 1996; 300 cases filed in late February, early March, 1997, and 300 cases filed during June, 1997. We have found neither day-of-the month nor seasonal effects on the values of the variables which we use to measure ability to pay.

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Table 1
Secured Debt, Unsecured Debt, and the Presence of Available Income for Debt Repayment by Chapter

Variable	*Chapter 7*	*Chapter 13*
Percent of filings with secured debt	71.7%	92.8%
Amount of secured debt per filing	$48,793	$68,545
Percent of filings with unsecured debt	99.0%	85.6%
Amount of unsecured debt per filing	$41,228	$20,953
Percent of filings with secured housing debt	35.7%	59.3%
Amount of secured housing debt per filing	$39,915	$57,839
Percent of filings with secured non-housing debt	60.7%	70.8%
Amount of secured non-housing debt per filing	$8,878	$10,706
Percent of filings with non-housing debt	99.3%	92.0%
Amount of non-housing debt per filing	$50,105	$31,660
Percent of filings with positive available income to repay non-housing debt over a five year horizon.*	43.3%	81.7%

* Available income is income net of taxes minus living expenses. Living expenses include mortgage/rent payments and the repayment of priority debt (over a five-year period). Income and expense figures are taken from the bankruptcy petition. If available income is negative, it is set equal to zero. The figures reported are for a sample of 2,441 Chapter 7 filings and 1,357 Chapter 13 filings drawn from 13 bankruptcy courts across the country in 1996. The figures are weighted to reflect the relative rates of bankruptcy filings for these 13 bankruptcy courts. These 13 courts process close to 20% of all personal bankruptcy filings in the U.S. Further details on the sample are contained in Barron and Staten, "Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay", Credit Research Center monograph, 1997, Georgetown University, Washington, DC.

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Table 2
Repayment Capacity If Bankruptcy Petitioners Return All Assets Used as Collateral to Obtain Debt

Variable	*Chapter 7*	*Chapter 13*
A) Per filing repayment of secured debt from collateral if no secured debt is reaffirmed	$6,260	$8,172
B) Per filing repayment of debt from available income over five years if no secured debt is reaffirmed*	$6,144	$10,712
C) Per filing total repayment of debt from available income over five years and from collateral on secured debt if no secured debt is reaffirmed (A+B)	$12,404	$18,884
D) Per filing repayment of unsecured debt from available income over five years if no secured debt is reaffirmed	$5,224	$8,648
E) Percent of filings with positive available income to repay unsecured debt if no secured debt is reaffirmed	39.7%	74.0%
F) Across filings with positive available income, percent of unsecured debt repaid from available income over 5 years if no secured debt is reaffirmed	36.9%	49.0%
G) Minimum amount of unsecured debt that a petitioner in the top 25% can repay from available income over five years if no secured debt is reaffirmed	$6,436	$10,874
H) Minimum amount of unsecured debt that a petitioner in the top 20% can repay from available income over five years if no secured debt is reaffirmed	$9,398	$13,271
I) Minimum amount of unsecured debt that a petitioner in the top 15% can repay from available income over five years if no secured debt is reaffirmed	$13,140	$17,742
J) Minimum amount of unsecured debt that a petitioner in the top 10% can repay from available income over five years if no secured debt is reaffirmed	$18,060	$21,784
K) Minimum amount of unsecured debt that a petitioner in the top 5% can repay from available income over five years if no secured debt is reaffirmed	$26,007	$34,080

- Available income is income net of taxes minus living expenses. Living expenses include mortgage/rent payments and the repayment of priority debt (over a five-year period). Income and expense figures are taken from the bankruptcy petition. If available income is negative, it is set equal to zero. If all non-housing secured debt is reaffirmed, then available income is allocated first to the repayment of secured non-housing debt over a five-year horizon. A payment to unsecured debtors is only made if all secured debt is paid off over the five-year horizon. If no non-housing secured debt is reaffirmed, then the entire collateral backing secured non-housing debt is liquidated and the proceeds used to repay secured non-housing debt. Available income is then allocated first to the repayment of the remaining secured non-housing debt over a five-year horizon. The figures are weighted to reflect the relative rates of bankruptcy filings for these 13 bankruptcy courts.

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Table 3
Repayment Capacity If Bankruptcy Petitioners Attempt to Retain All Assets Used as Collateral to Obtain Debt

Variable	*Chapter 7*	*Chapter 13*
A) Per filing repayment of secured debt from collateral if all secured debt is reaffirmed	$0	$0
B) Per filing repayment of debt from available income over five years if all secured debt is reaffirmed*	$6,848	$14,891
C) Per filing total repayment of debt from available income over five years and from collateral on secured debt if all secured debt is reaffirmed (A+B)	$6,848	$14,891
D) Per filing repayment of unsecured debt from available income over 5 years if all secured debt is reaffirmed	$3,570	$6,885
E) Percent of filings with positive available income to repay unsecured debt if all secured debt is reaffirmed	31.6%	66.3%
F) Across filings with positive available income, percent of unsecured debt repaid from available income over 5 years if all secured debt is reaffirmed	31.4%	41.9%
G) Minimum amount of unsecured debt that a petitioner in the top 25% can repay from available income over five years if all secured debt is reaffirmed	$2,590	$8,134
H) Minimum amount of unsecured debt that a petitioner in the top 20% can repay from available income over five years if all secured debt is reaffirmed	$5,284	$10,601
I) Minimum amount of unsecured debt that a petitioner in the top 15% can repay from available income over five years if all secured debt is reaffirmed	$8,449	$13,408
J) Minimum amount of unsecured debt that a petitioner in the top 10% can repay from available income over five years if all secured debt is reaffirmed	$13,140	$19,460
K) Minimum amount of unsecured debt that a petitioner in the top 5% can repay from available income over five years if all secured debt is reaffirmed	$20,100	$29,460

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Table 4
By City Repayment Capacity For Chapter 7 Bankruptcy Petitioners

City	(1) *Amount of non-housing debt per filing*	(2) *Percent of filings with positive available income to repay non-housing debt over a five year horizon.*	(3) *Per filing repayment of debt from available income over five years if no secured debt is reaffirmed*	(4) *Per filing repayment of unsecured debt from available over 5 years if no secured debt is reaffirmed*	(5) *Percent of filings with positive available income to repay unsecured debt if no secured debt is reaffirmed*	(6) *Across filings with available income, percent of unsecured debt repaid over 5 years if no secured debt is reaffirmed*	(7) *Per filing repayment of debt from available income over five years if all secured debt is reaffirmed*	(8) *Per filing repayment of unsecured debt from available income over 5 years if all secured debt is reaffirmed*	(9) *Percent of filings with positive available income to repay unsecured debt if all secured debt is reaffirmed*	(10) *Across filings with available income, percent of unsecured debt repaid over 5 years if all secured debt is reaffirmed*
Atlanta	$77,058	52.7%	$6,880	$4,961	45.0%	36.1%	$7,943	$3,044	32.5%	28.4%
Chicago	30,938	50.2	6,090	4,956	44.0%	50.2%	6,914	3.372	36.7%	41.6%
Dallas	64,916	67.5	13,092	10,897	61.0%	46.8%	15.007	7.417	49.4%	38.6%
Hartford	47,740	52.8	9,627	9,009	52.3%	46.0%	10.611	7.963	48.1%	47.3%
Houston	56,795	60.2	12,349	10,920	58.2%	46.9%	14.040	7.424	49.0%	37.8%
Indianapolis	36,094	42.4	5,593	4,658	40.5%	37.7%	6.193	3.495	32.4%	31.6%
Kansas City (Mo.)	44,448	56.9	6,228	5,270	48.1%	26.1%	6.738	3.222	34.6%	19.2%
Los Angeles	59,407	31.5	4,618	4,200	30.6%	26.5%	5,068	3.100	24.2%	27.0%
Memphis	34,108	50.0	6,727	6,159	47.8%	51.0%	7.871	3.764	32.6%	40.6%
Phoenix	50,112	50.2	6,890	6,000	46.5%	40.4%	7.392	4,152	36.5%	34.2%
Pittsburgh	61,217	33.3	6,520	5,637	29.9%	41.4%	7.125	3.944	25.7%	31.8%
San Diego	60,377	31.7	5,086	4,155	29.6%	32.6%	5.542	2.336	24.1%	21.4%
Tampa	48,748	37.2	4,331	3,590	34.1%	35.1%	4,852	2,122	24.5%	28.2%
Overall (weighted)	*$50,105*	*43.3%*	*$6,144*	*$5,224*	*39.7%*	*36.9%*	*$6,848*	*$3,570*	*31.6%*	*31.4%*

Table 5
Range of Values Across Thirteen Bankruptcy Courts

Chapter 7	*Overall (weighted)*	*Lowest City*	*Median City*	*Highest City*
Percent of filings with positive available income to repay non-housing debt over a five-year horizon	43.3%	31.5% LA	50.2% Chicago	67.5% Dallas
Percent of filings with positive available income to repay unsecured debt if no secured debt is reaffirmed	39.7%	29.6% San Diego	45.0% Atlanta	61.0% Dallas
Across filings with available income, percent of unsecured debt repaid over 5 years if no secured debt is reaffirmed	36.9%	26.1% Kansas City	40.4% Phoenix	51.0% Memphis
Percent of filings with positive available income to repay unsecured debt if all secured debt is reaffirmed	31.6%	24.1% San Diego	34.6% Kansas City	49.4% Dallas
Across filings with available income, percent of unsecured debt repaid over 5 years if all secured debt is reaffirmed	31.4%	19.2% Kansas City	31.8% Pittsburgh	47.3% Hartford

Table 6
Factors Underlying the Selection of Sampled Cities

City/Court	*% Chapter 7*	*% Change from Previous Year*	*Homestead Exemption*	*Unemployment Rate*
Los Angeles	82.2	15.7	$75,000	8.4
San Diego	74.1	23.1	$75,000	5.5
Phoenix	77.9	21.8	$100,000	4.1
Houston	48.9	25.9	Unlimited $	6.1
Dallas	50.2	19.5	Unlimited $	4.6
Kansas City	84.2	24.5	$8,000	4.4
Chicago	76.7	22.3	$7,500	5.3
Indianapolis	81.6	16.8	$15,000	3.3
Memphis	21.2	20.7	$7,500	5.1
Atlanta	33.7	14.8	$10,000	4.1
Tampa	82.0	21.9	Unlimited $	4.1
Pittsburgh	86.7	31.9	No exemption	4.9
Hartford	87.2	19.4	$75,000	6.3

Source: US Administrative Office of the Courts; National Bankruptcy Review Comission (memo by Elizabeth Warren and Melissa Jacoby, April 11, 1997); Bureau of Labor Statistics

The following are GAO's comments on specific issues included in the letter dated January 21, 1998, from Professor Michael Staten, on behalf of himself and his coauthor, Professor John Barron. Other issues discussed in the letter have been included in the report text.

GAO Comments

1. The authors agreed that there is a need to validate debtors' income, expenses, and debts in developing assumptions of future income and expenses but stated that a researcher currently has no recourse but to accept what the debtor advises the court under oath at the time the petition is filed. We understand that researchers must use the best available data and that, currently, verifiable data on debtors' income and expenses during bankruptcy have not been developed. However, our intent was to indicate that the Center report should have discussed how the use of data from debtors' initial schedules could affect the Center report's results and, thus, how those results should be used. In this case, it seems the researchers could have used more recent data, at least for some debtors, because debtors may amend their initial schedules at any time prior to the final disposition of their bankruptcy cases. Such amendments could alter the estimated income, estimated expenditures, and debts that debtors reported on their initial schedules. We recognize that obtaining these amended schedules would have required additional time and resources. However, we believe that the importance of these data to the overall conclusions in the Center's report would justify such an effort.

The authors also said that to the extent there is a bias in the debtors' initial schedules, it would be expected that the debtors would understate their capacity to repay debt. Although this may seem logical at first glance, it is important to note that there are no empirical data on the accuracy of the data reported in debtors' initial schedules. Nor is there any empirical basis for assuming that debtors would consistently attempt to understate their capacity to pay their debts. In fact, there is no empirical basis for assessing whether debtors generally overstate or understate their capacity to repay on their initial schedules or the general amount of the overstatement or understatement. There may be several reasons why some debtors would actually overstate their capacity to pay. For example, some people may simply not want to admit how serious their financial situation has become in order to protect certain assets. Also, mistakes could be made in the schedules used in the Center's analysis, which are not easily interpreted by debtors who might proceed without legal or financial assistance. For example, in Los Angeles, a location whose data contributed significantly to the Center's final weighted estimates, Center data showed that about

one-third of debtors reported they had no lawyer. Through mistakes in filling out the schedules, debtors could report information that would have the effect of either overstating or understating their capacity to pay their debts.

2. The Center stated that its calculations provided a benchmark of debtors' ability to pay that could easily accommodate whatever assumptions about possible income changes the reader wished to make. It also agreed with us that incorporating a cushion into a chapter 13 repayment plan to guard against income interruptions or unexpected expenses seemed to be a prudent step.

We agree that the Center report provided a baseline estimate of debtors' ability to pay that would change as the report's basic assumption—that debtors' income and expenses would remain unaltered for 5 years—changes. However, the Center provided no estimates based on alternative assumptions of repayment capacity, and without the Center's database, it is not possible for anyone to estimate the effect of such alternative assumptions on the Center report's estimates of debtors' potential repayment capacity. Since many economic factors can change in a debtor's financial situation during 5 years, it would seem prudent to base any policy decisions on a wider range of assumptions than the somewhat optimistic set of assumptions used in the Center study. For example, the assumption that debtors' reported income and expenditures would remain unchanged for 5 years had the effect of providing optimistic estimates of debtors' repayment capacity in two ways: (1) it did not allow for situations where the debtors' income decreases or expenses increase, thus discretionary income available to pay debt was assumed to remain unchanged for 5 years; and (2) 100 percent of this discretionary income was assumed to be used for 5 years to repay debt, when in fact a portion of the debtors' discretionary income would be used to pay the expenses of administering the debtors' repayment plans.

There is some additional evidence that the Center's assumption that debtors' income and expenses would remain unchanged for 5 years may be optimistic. For example, the AOUSC report discussed on page 8 of our report showed that only about 36 percent of chapter 13 debtors completed their repayment plans. The reasons for this low completion rate are unknown, but it illustrates the high level of discrepancy between the amount that debtors could potentially repay, based on the data and assumptions used in the Center report, and what has actually occurred over a 10-year period. In addition, in virtually all cases, creditors do not

receive 100 percent of debtors' payments under chapter 13 repayment plans. Fiscal year 1996 data from the Executive Office of U.S. Trustees showed that 14 percent of payments were used to pay the debtors' lawyers, the chapter 13 trustees' statutory operating expenses in administering the plans, and other administrative expenses.

3. The Center said that it believes it has clearly identified the universe of debts for which it estimated debtors' ability to pay as all "debts not secured by real estate, without drawing a distinction between secured vs. unsecured, priority vs. non-priority, or dischargeable vs. non-dischargeable." The Center commented that the distinction between dischargeable and nondischargeable debts is simply "an interesting side issue." The Center said that such distinctions between categories of debt were not necessary if the report's intent was to assess debtor's overall ability to meet their obligations. The Center also said that unsecured priority debt was not included in the base of total unsecured debt for many of the repayment calculations, because the report assumed that unsecured priority debt would be paid before unsecured nonpriority debt.

We do not agree that the distinction between dischargeable and nondischargeable debt is just an interesting side issue. The distinction is important if the Center's data are to be used for considering the need to alter existing bankruptcy statutes. It is the debtor's total eligible dischargeable debts that represent the potential loss to creditors if a debtor is granted a discharge of his or her eligible dischargeable debts. The Center did not attempt to identify this universe of debts in its analysis. Creditors are not at risk in the bankruptcy process for debts that are nondischargeable in bankruptcy or for eligible dischargeable debts that the debtor reaffirms. Total dischargeable debts are total debts less total nondischargeable debts. As discussed on pages 9 and 10 of our report, the Center report may not have fully identified all eligible dischargeable debts, because it excluded data on unexpired leases from Schedule G, such as automobile leases. Thus, the Center did not identify that universe of debts for which creditors are at risk in the bankruptcy process.

As we note on pages 9-10 of our report, to assume that all unsecured priority debts would be fully paid over 5 years but that no other class of nonhousing debts would be fully paid creates a disparity in the treatment of nonhousing debts that does not reflect actual bankruptcy practice. In chapter 13 repayment plans, secured debts would ordinarily be paid before or concurrently with unsecured priority debts. Consequently, the Center report's calculations did not provide an estimate of the amount of

unsecured nonpriority debt that could be repaid. If the Center report's purpose was simply to identify debtors' overall ability to pay nonhousing debts from net income after reported expenses, then the report should have included unsecured priority debt with all other nonhousing debts—secured and unsecured—and calculated debtors' ability to pay the resulting total nonhousing debt.

4. The Center agrees with us that its calculations of debtors' ability to repay their nonhousing debts did not consider the payments required to pay the nonhousing debts that debtors stated it was their intent to reaffirm (repay). The Center notes that the February 1997 testimony of law professors Marianne Culhane and Michaela White before the National Bankruptcy Review Commission stated that about 50 percent to 60 percent of intended reaffirmations (the data used in the Center report) actually result in signed reaffirmation agreements in which debtors reaffirmed their debts. Thus, they noted it is possible that the number of final reaffirmations could be less than that reported in debtors' statements of intent.

We agree that the number and dollar value of debts that debtors ultimately reaffirm could be more or less than those found in debtors' statements of intent. We believe that this further supports our overall conclusion that the results in the Center's report should be viewed with caution. In September 1997, professors Culhane and White reported updated results of their study, which were based on debtor reaffirmations in only 7 of the 90 bankruptcy districts, and thus must be considered illustrative, not conclusive. Nevertheless, the reaffirmation report's findings provide additional evidence that one should be cautious in interpreting conclusions based solely on debtors' initial schedules, such as schedules of income and expenses as well as reaffirmations. For example, the reaffirmation report found that debtors filed fewer reaffirmations than indicated in their statements of intent and that the debts that debtors ultimately reaffirmed were often quite different from those that debtors stated it was their intention to reaffirm. The reaffirmation report and the Center's data indicated that debtors rarely stated their intention to reaffirm unsecured debts. However, the reaffirmation report found that debtors in fact ultimately reaffirmed unsecured debts as well as debts that were not listed in their initial schedules at all. The reaffirmation report also noted that court records provide an incomplete picture of reaffirmations, because debtors may also sign reaffirmations with creditors that the creditors fail to file with the court, as required.

In addition, the reaffirmation report reinforces our concern that local court bankruptcy practice and rules may affect the data that debtors report on their initial schedules and in the data found in debtors' court files generally. For example, the reaffirmation study found that the number of final reaffirmation agreements filed with the bankruptcy court in each district appeared to be affected by governing court decisions for the districts studied. In two districts, the debtor could keep property, such as a car, by simply maintaining ongoing contractual payments on the property. Thus, it was not necessary for the debtor to file a reaffirmation agreement with the court in order to keep the property. In two other districts, court decisions required the debtor to file a reaffirmation agreement or surrender or redeem the property. The number of final reaffirmation agreements was lower in those districts that did not require a reaffirmation agreement in order for the debtor to keep the property. However, the report said that the data did not permit an empirical evaluation of the extent to which such controlling court decisions affected the number and type of reaffirmations that debtors in the report ultimately filed with the bankruptcy courts.

5. The Center comments included data and analyses, not previously provided, that the Center said address the impact of reaffirmations on debtors' ability to pay their nonhousing debts. These new analyses are based on weighted data for the 13 locations included in the Center's study. We cannot assess the accuracy of the data in the tables because we do not have the database used to develop these tables and, therefore, cannot replicate how the new estimates were derived. However, we do have some overall observations on these new data.

First, the weighted data are based on the same weighting methodology used for the Center report's other estimates and, therefore, are subject to the same limitations of that weighting methodology that we noted in our report. The weights are heavily influenced by filings in two locations—Chicago and Los Angeles—which accounted for about 41 percent of all bankruptcy filings in the 13 locations.

Second, the tables presented in the comments need clarification in their presentation. For example, table 1 of the comments does not indicate that all dollar amounts in the table are averages, which they are. The table also does not clearly indicate that the amount of nonhousing debt shown is the total amount of nonhousing debt—secured and unsecured—less unsecured priority debt.

Third, the assumptions underlying the data in table 2 are not explained. For example, line “D” of table 2 is supposed to represent the amount of unsecured nonpriority debt that could be paid over 5 years from future income after liquidating all of the debtor’s nonexempt property, if any. The calculation appears to assume that (1) when surrendered and liquidated, the collateral would bring 100 percent of the value of the collateral, as listed in the debtor’s initial schedules; and (2) 100 percent of the proceeds realized from the liquidation would be used for repaying the debt secured by the collateral. We found no basis for either of these assumptions. For example, when a debtor’s nonexempt assets are liquidated to pay creditors, the asset may bring more or less than the value of the collateral as listed in the debtor’s schedules. Moreover, there are usually expenses associated with liquidating a debtor’s nonexempt assets, such as statutory bankruptcy trustees’ commissions and appraiser or auctioneer fees. Such expenses would reduce the amount paid to creditors because these costs would be paid before any remaining proceeds were distributed to creditors.

The data in the new tables are subject to the same limitations as other estimates of debtors’ ability to pay included in the report. The tables are based on the assumptions, used throughout the report, that debtors’ income and expenses would remain unchanged over a 5-year period and that 100 percent of a debtor’s discretionary net income will be used for debt repayment. As previously discussed, both logic and available evidence would suggest that these are not realistic assumptions. For example, the Center provided us data, not included in its report, which showed that the majority of nonhousing secured debt was vehicle debt. The data in the new tables 2 and 4 provided with the Center’s comments assumed that the debtor’s automobile would be sold, and no replacement obtained. The absence of an automobile could very well affect a debtor’s employment and, thus, a debtor’s future stream of income.

6. The Center’s comments noted that it would be difficult to estimate with precision debtors’ ability to pay their nonhousing debts in any location other than the 13 locations included in the Center report. On the other hand, the Center concluded that debtors’ data in all 13 locations showed a substantial repayment capacity, despite the great diversity in the characteristics of the 13 locations, such as unemployment rates and the percent of total personal bankruptcy cases that were chapter 7 cases. The Center stated that this showed that substantial repayment capacity is a widespread phenomenon, whether or not the report’s findings are applicable to other locations.

We agree that the Center's data show that some debtors who file for bankruptcy under chapter 7 may have some capacity to repay their debts. But, from a policymaking standpoint, the more relevant questions are whether the Center report's findings provide a reasonable estimate of that repayment capacity and whether the Center's defined universe of debtors and debts used to estimate repayment capacity was appropriate for assessing the need for a change in current bankruptcy laws. As previously discussed, we believe the Center's universe of both debts and debtors may not be the appropriate ones for assessing whether current bankruptcy statutes should be changed. In answering these questions, it is also important to note that the data used for the Center report were based on information debtors provided at a single point in time—the time they filed for bankruptcy—regardless of whether or not they completed the bankruptcy process and received all or part of the relief they sought in filing for bankruptcy. Thus, the report included data from debtors who may have withdrawn their petitions voluntarily, had their petitions dismissed by the court, or who received bankruptcy court discharges of all or part of their eligible dischargeable debts. For example, in Los Angeles, of those chapter 7 petitions filed on the same days of May and June 1996 as those petitions used in the Center sample, about 5 percent had been dismissed by September 30, 1996. For chapter 13 petitions, more than 30 percent had been dismissed during the same period. In contrast, not more than about 4 percent of chapter 7 and 13 petitions in San Diego had been dismissed within 90 days. Because the report's findings include debtors who did and did not receive a discharge of their eligible debts, the report's findings cannot be used to reach conclusions about the most relevant public policy question—the potential ability to pay of debtors who received a discharge of all or part of their eligible dischargeable debts.

7. The Center agreed with our general conclusion that scientific, random sample methods were not used to select the bankruptcy petitions used in the Center's analysis. However, the Center said that the lack of a scientific, random sample did not necessarily diminish the usefulness of the Center report's findings. The Center commented that it did not intend to obtain a nationally representative probability sample and agrees that it did not use a scientific random sampling methodology to select the 13 bankruptcy locations or the bankruptcy petitions used in the analysis. The Center also states that most social science research is conducted with samples that are not nationally representative probability samples and concludes that much useful information comes from samples that are technically less ambitious than the standard that we applied.

Our evaluation assumed that the Center report may be used for important policymaking on a national scale. As a result, we believe that it is appropriate to inform the Committee that the Center report's data do not meet scientific standards for estimating the characteristics of bankruptcy debtors for the United States as a whole or for all bankruptcy debtors in each of the 13 locations.

8. The Center discussed our observations on its methods of selection for each of the three steps at which petition selections were made without probability selection methods.

The Center agrees with us that the 13 locations were not selected using probability selection techniques and, thus, may or may not be representative of the remaining courts in the United States. The Center commented that nonprobability samples have been used in some previous studies of bankruptcies, including a study by GAO, and that the purpose of the Center study was to form and test hypotheses about potential causal factors. The Center also stated that the study has potential value for policymakers because the large sample from a varied cross-section of courts identifies significant numbers of petitioners with some capacity to repay debts and because there was a finding of substantial repayment capacity in every city in the study despite the great diversity in city/court characteristics.

We agree that this diverse set of 13 locations demonstrates that based on the data and assumptions the Center used, the Center's indicators of debtors' ability to repay debts are found at greater than negligible rates at all locations. However, we also concluded that users of the Center data should consider the variation among locations and the lack of a national estimate as limitations. The important variations between the studied cities might be of importance for some policy purposes. In addition, we cannot confirm the Center's conclusion that there is a "substantial" repayment capacity in every city, because we do not have a basis for determining how much repayment capacity should be considered to be substantial and because, as explained above, we can not conclude that petitioners' reports of income on bankruptcy petitions can be accepted as an accurate estimate of income for the following 5 years.

9. The second sampling issue on which the Center commented was what the Center referred to as seasonality—the fact that the Center's petitions were filed in the spring and summer months and might not be representative of petitions filed at other times of the year. The Center

stated that ample evidence from previous researchers and supplemental testing in the Center study suggest that the potential bias from focusing only on cases filed in the spring and summer months is negligible. The Center cited as evidence the findings from two previous studies and the Center's analysis of Indianapolis petitions from its current study.

The Center and we agree that the study petitions were drawn from a limited part of the year. We did not have a sufficiently strong basis to conclude that seasonality factors could or could not have possibly affected the Center report's estimates of the debtors' repayment capacity. The two previous studies cited in the Center's comments do not address the effect of season on the debtors' ability to repay debts but only examined the number of chapter 7 and chapter 13 bankruptcy filings by season. The results of the Center's analysis do show that season of the year did not affect estimates of the ability to pay in one city, Indianapolis. We agree that we do not have a strong theoretical reason for expecting a seasonal effect. However, in the absence of evidence from more than one location, and in view of the fact that the present study is strongly concentrated by season, we continue to believe that the season in which the petitions were selected should be considered a limitation in interpreting the results from the study.

10. The third sampling issue addressed in the Center comments was the time of the month from which the Center's petitions were drawn. The Center agrees that the bankruptcy petitions used in the study were generally drawn from days early in the month. The Center explains that the petitions were drawn from the beginning of the month to maintain tight control over the petition selection procedure and to minimize uncertainty about the characteristics of cases that were not studied. The Center maintains that Texas is the only one of the 13 locations where there is evidence or reason to believe that cases early in the month might differ from those late in the month. In Texas there were a disproportionate number of past-due home mortgage chapter 13 petitions early in the month, and the Center said it was now drawing additional cases in Texas. In addition the Center notes that although chapter 13 petitions might differ by time of month in Texas, it is not clear why the characteristics of the chapter 7 cases would differ over the month. The Center also notes that the study did not find differences in the values of variables that measure ability to pay at the one location, Indianapolis, that could be tested with the data from the Center study.

We believe that the differences among petitions at different times of month in Texas should be considered. Those debtors who file for chapter 13 early in the month to prevent a mortgage foreclosure may have different financial characteristics from chapter 13 debtors filing later in the month. The only clear evidence of the absence of a time-of-month effect comes from a single court in Indianapolis. We are concerned that there may be other court-specific factors of which we are unaware. For example, working with the Federal Judicial Center, we learned that mortgage foreclosures early in the month also could affect the type of filings early in the month in Atlanta. Although the Atlanta filings for this study did not happen to be concentrated at the beginning of the month, the Atlanta example indicates that it is difficult to exclude time-of-month effects. Thus, we believe that the lack of representativeness by time of month should be considered in evaluating the study.

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