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

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# BANKRUPT PROFITS:
# THE CREDIT INDUSTRY'S BUSINESS MODEL FOR POSTBANKRUPTCY LENDING

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

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## INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## I. THE MODERN CONSUMER CREDIT ECONOMY

### A. The Debtor Debate

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

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[8] Pub. L. No. 109-8, 119 Stat. 23 (codified as amended throughout 11 U.S.C.).

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

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

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

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

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

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

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

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

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

[14] REPORT OF THE NAT'L BANKRUPTCY REVIEW COMMISSION, ch. 5 (1997) (Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, at 2).

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

[16] NAT'L BANKRUPTCY COMMISSION REVIEW, ch. 5, *supra* note 14, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law at 11.

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

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

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

characterizations of debtors as strategic actors who reacted in immoral ways to undesirable incentives that bankruptcy law created for borrowers.[20]

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

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

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

[21] 145 CONG. REC. 2723-2724 (daily ed. May 5, 1999) (statement by Rep. Hyde on H2718).

[22] Dickerson, *supra* note 3, at 20.

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

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

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

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

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

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[26] Pub. L. No. 109-8, §§ 1301-1306; 19 Stat. 23, 204-213.

[27] Id. at § 1229; 19 Stat. 23, 200.

[28] Id.

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

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

[31] FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 3.

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

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

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[32] ID. at 26.

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

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

[35] Id.

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

### B. Models of Consumer Lending

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

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

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

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

[38] RONALD J. MANN, CHARGING AHEAD 61-62 (2006).

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

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

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

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

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

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

[42] FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 13.

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

[44] NAT'L BANKRUPTCY COMMISSION, ch 5, *supra* note 14, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law at 10-11.

[45] *See generally* Block-Lieb & Janger, *supra* note 2.

[46] *Id.* at 1486.

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

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

[47] *Id.* at 1488.

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

[49] *Id.* at 1500.

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

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

[52] *Id.* at 385.

[53] *Id.* at 386.

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

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

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

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

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

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[55] *Id.* at 392-97.

[56] *See, e.g.,* Pottow, *supra* note 6.

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

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

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

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

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

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

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

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

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

[64] Caroline Mayer, *Bankrupt and Swamped with Credit Offers*, WASH. POST., April 15, 2005, at A1.

[65] Timothy Egan, *Newly Bankrupt Raking in Piles of Credit Offers*, N.Y. TIMES, Dec. 11, 2005.

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

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

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[66] *Id.* (describing different approaches reported by Bank of America and Citibank)

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

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

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

[70] *Id.* at 537.

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

[72] *Id.* at 538.

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

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

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

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

[75] *Id.* at 538-9.

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

[77] *Id.* at 540.

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

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

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

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

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

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

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

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

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

[85] *Id.* at 735.

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

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

## II. CREDIT OPPORTUNITIES AFTER BANKRUPTCY

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

### A. Methodology

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

[86] *Id*. at 737 (estimating one extra card is obtained per four consumers in the tenth year postbankruptcy).
[87] I served as Project Director of CBP Phase III—2001 during its first six months of data collection. My responsibilities included pretesting the data instruments, overseeing the distribution and collection of the written questionnaires, and helping to design the court record coding protocols.

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

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

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

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

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

[91] *See* 11 U.S.C. § 341 (2005).

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

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

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

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

[93] *See infra* at notes 99-104 and accompanying text for analysis of issue of respondent bias.

economic characteristics of Chapter 13 respondents shows that these filers have higher incomes and more assets, and are more likely to be married, employed, or homeowners when they file bankruptcy than Chapter 7 filers.[94] These significant differences are a further reason for considering separately the experiences of Chapter 7 and Chapter 13 debtors.

The Chapter 7 sample used for this Article was narrowed from the 780 Chapter 7 cases in the core sample to include only those cases in which a first round telephone interview was completed. The longitudinal perspective of my analysis requires data on the postbankruptcy experiences of debtors, and the telephone interview was the instrument used to gather such data. Thus, the relevant sample (unless otherwise specified)[95] contains 359 Chapter 7 bankruptcy cases and captures 45.9 percent of the 780 Chapter 7 cases in the core sample.[96]

I compared the Chapter 7 telephone interview sample to the demographic finding of previous bankruptcy studies.[97] These studies measured common demographic and economic characteristics of debtors, such as age, marital status, occupational prestige score, homeownership, median annual income, and median unsecured debt. The respondents in this sample appear consistent with the profiles of Chapter 7 debtors in prior studies.[98] Primary petitioners in the Chapter 7 telephone interview sample averaged 43 years old. Approximately

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

[95] *See* Section E, *infra*, in which the sample consists of Chapter 13 debtors in the core sample who completed the first telephone interview.

[96] Some debtors could not be contacted at the contact information that they provided because the debtors had apparently moved or provided incorrect information. In anticipation of this problem, we asked debtors to provide us with two alternative contacts, which increased the response rate. Nevertheless, some debtors gave only their own information, and sometimes the alternative contacts could not be located. We were unable to complete interviews with these debtors. This non-participation may have skewed the data to overrepresent the economic stability of the postbankruptcy population. That is, those who could not be located for interview may be those facing the most severe financially distress, considering that they either moved and/or changed telephone numbers in the immediate aftermath of their bankruptcy.

[97] SULLIVAN ET AL., *supra* note 12; WARREN & TYAGI, *supra* note 3; Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1 (2004).

[98] Warren, *Financial Collapse and Class Status*, 41 OSGOODE HALL L.J. 115, 121 (2003) (concluding that 2001 bankruptcy debtors are middle class and similar to debtors who field in 1991).

one-third were married and living with a spouse, while another 7 percent were married but living separately. The median occupational prestige score was 36; occupations such as office clerk, bricklayer, teacher's assistant, and steel worker are represented by this score. Approximately 31 percent of the respondents reported that they owned their home at the time of filing. Families earned a wide range of incomes. Eight households, or just over two percent of the sample, said they received no income whatsoever. At the other end of the spectrum, one debtor reported annual earnings of just over $101,000. Overall, median annual income for households in the sample was $21,870, about half of the national average.[99] Median unsecured debt was $27,528. Like other researchers, I conclude that most bankruptcy debtors are demographically similar to middle-class Americans but earn much lower incomes at the time of their bankruptcies.[100]

Debtors who completed the telephone interviews were self-selected, introducing the possibility of respondent bias.[101] To test for this, Dr. Deborah Thorne,[102] the Project Director of the Consumer Bankruptcy Project when the interviews were conducted, compared interview participants and nonparticipants on several important demographic and economic variables. Demographically, the two groups were comparable on the variables of age, employment status, and homeownership. Interview participants were, however, significantly more likely to be single and white than those who did not complete interviews. Analysis of the economic variables did not reveal any statistically significant differences between the two groups. Debtors' court records revealed similar incomes, assets, and liabilities. Based on this analysis, the narrowed sample

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

[100] *See* SULLIVAN ET AL., *supra* note 12; Warren, *Financial Collapse, supra* note 98, at 155.

[101] EARL BABBIE, THE PRACTICE OF SOCIAL RESEARCH 187-90 (2004).

[102] Assistant Professor of Sociology, Ohio University; Project Director of CBP Phase III—2001.

appears to be generally representative of the 780 Chapter 7 cases that comprised the Consumer Bankruptcy Project's core sample.[103]

To increase the longitudinal perspective on postbankruptcy experiences, I also present data from the second round of telephone interviews completed in 2004. Of the 359 households in the sample used in this Article (Chapter 7 cases debtors who completed the first round telephone interview), 302 households completed a second interview approximately three years after each family's bankruptcy. This modest atrophy in the sample reflects the increased difficulty in locating debtors as years elapsed after their bankruptcies and their completion of the written questionnaire. I report the number of respondents with the relevant data and indicate whether the data come from the first or second interviews. A comparative analysis of demographic and economic differences between the first round interview respondents and second round interview respondents showed no significant differences between the groups.[104]

## B. Soliciting Credit Customers

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

Credit solicitation of recent bankruptcy debtors is rampant. Nearly all debtors stated that they had received offers for credit in the first months following their bankruptcy.[105] Figure 1

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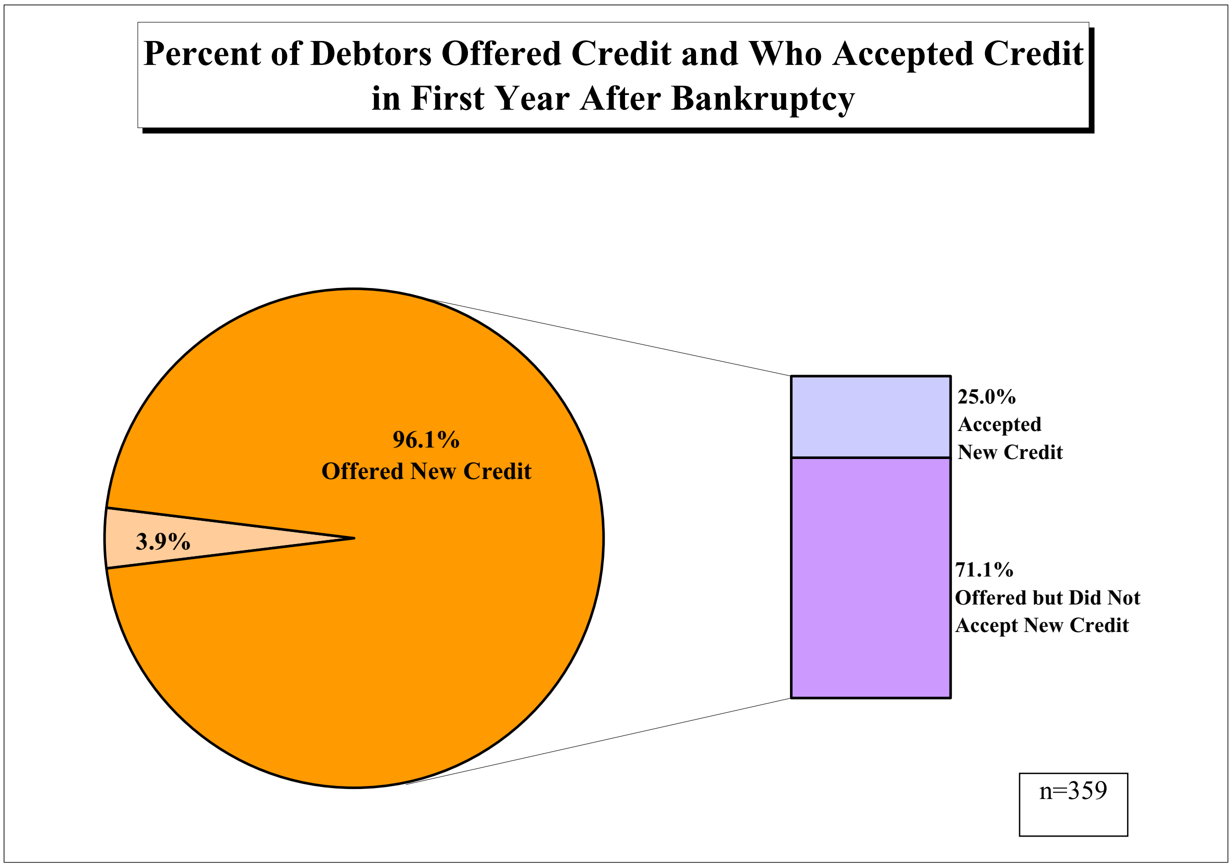
[103] Porter & Thorne, *supra* note 57, at 153 (reporting detailed respondent and nonrespondent data for subsample of 359 Chapter 7 bankruptcy cases from Consumer Bankruptcy Project Phase III 2001).

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

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

illustrates that just one year after bankruptcy, 96.1 percent of debtors were recipients of credit solicitations. Only 3.9 percent of families said they had not received credit offers. To the extent that the conventional wisdom says that debtors will not able to borrow immediately after a bankruptcy filing,[106] the adage is neither wise nor reflective of today's credit market.

**FIGURE 1**




Most debtors did not accept new credit, reporting that they were avoiding the credit industry entirely after bankruptcy. Debtors' use of credit bears directly on the rehabilitative goal of consumer bankruptcy and further research could consider how debtors use credit during the crucial "fresh start" period after bankruptcy.[107]

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[106] *See* Section II.B., *infra.*

[107] Additional research will present data on debtors' take-up of credit during the first three years after their bankruptcy. *See* Katherine Porter, *Borrowing After Bankruptcy* (forthcoming 2008). A modest fraction of families in addition to the 25 percent shown in Figure 1 may have access to credit after bankruptcy despite avoiding new

Debtors not only had the chance to borrow, they were inundated with solicitations urging them to borrow.[108] One year postbankruptcy, these families reported that creditors sent them an average of more than fourteen credit offers per month. In practical terms, this means that more often than not, each new day after bankruptcy presented these former bankrupts with a chance to borrow. Table 1 gives summary statistics on the frequency of credit offers. While the reported numbers ranged significantly, the typical (median) family said it got ten credit offers each month on average. On an annual basis, this corresponds to more than 100 invitations to borrow.

**TABLE 1**

| Frequency of Credit Offers Per Month in Year After Bankruptcy | |
|---|---|
| Average | 14.56 |
| Median | 10 |
| St. Dev. | 29.35 |
| Number of respondents | 339 |

Most debtors did not seem to expect these solicitations. Debtors' expectations about postbankruptcy credit were not a subject of the written survey that debtors completed shortly after their bankruptcy filing.[109] However, comments in the longitudinal interviews suggest that some families were shocked at the response of lenders to their bankruptcy. A married man in his early 30s from Texas expressed this reaction: "I was surprised at how fast they wanted to get you back into the credit game, [at] all of the offers of credit. It was incredible. They sent us lots and lots of offers for credit right after we filed. And I was told that it would improve my credit

postbankruptcy credit. These families may have a prebankruptcy credit line that was reaffirmed in their bankruptcy and remains available for their use after bankruptcy.

[108] Analysis of respondents' answers to the question asking them to report the number of credit offers that they get in a month revealed two suspicious responses of 300 offers per month (corresponding to 10 per day in a 30 day month). These two outliers were removed before these data were analyzed, and the findings on credit offers do not include these two individuals.

[109] Researchers interested in understanding how debtors chose between the two types of bankruptcy relief could fruitfully explore the role of credit expectation in the chapter choice decision.

history."[110] Debtors gave vivid and colorful descriptions of the numerous credit offers that they received after bankruptcy.[111] A middle-aged real estate developer likened himself to "fresh meat" out on the market, noting that it seemed like everyone was willing to help him get credit back.[112] Families generally felt inundated with what they described as an "unreal" number of credit solicitations.[113]

Indeed, families who have filed bankruptcy appear to be particularly desirable future borrowers. Bankruptcy debtors seem to receive more credit solicitations than the general American population. Industry researchers report that the average American gets six credit offers each month.[114] The average bankrupt receives sixteen, nearly three times the number directed to the non-bankrupt family. A carpenter in his mid-30s warned that "[o]nce you filed for bankruptcy, lenders come out of the woodwork. . . . They just really try to get you back in debt again. I still get lots of offers [three years after bankruptcy] and just toss them."[115] Many debtors noted a marked uptick in credit marketing after bankruptcy. An insurance claims worker described her perception that bankruptcy improved her credit access. "All these offers that I get for financing—Before I filed I bet I could not get a loan. The ironic thing is I'm sure, say within

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[110] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, TX-07-067.

[111] A Tennessean claimed that "[p]eople have been running over me to get me to buy a car." Consumer Bankruptcy project III, Respondent Interview One-Year Postbankruptcy, TN-07-062. Another debtor stated that he got frequent offers to refinance his mortgage and was mailed "live" checks. He told his interviewer, "If I don't get at least one or two in a week, it is not a good week." Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, PA-07-015.

[112] Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, TN-07-133.

[113] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, IL-07-038.

[114] S*ee* Frontline, *Secret History of the Credit Card* (2004) *available at* http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/battle.html (citing research conducted by Synovate a private research firm). The overall response rate on credit card solicitations is very low and has dropped significantly in recent years. *See* FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30 at 20, Tbl. 11 (showing that in 2004, the industry mailed 5.23 *billion* credit card solicitations that returned a 0.4 percent response rate.); David Enrich, *Card Firms Curb Mailings—a Bit*, WALL ST. J., July 26, 2006 at D3 (reporting that data from marketing firm Synovate show that more than six billion credit card offers sent in 2005 generated response rate of only 3 per 1,000 offers).

[115] Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, TN-07-041.

the six months before I filed, they would have laughed at me if I wanted to get a loan. Now they are saying 'let us give you money.'"[116]

The frequency and persistence of credit solicitations leaves many American families feeling overwhelmed.[117] Federal Reserve researchers found that 85 percent of consumers in a study believed that credit card solicitations caused other consumers take on too much debt.[118] In response to complaints about the deluge of credit industry mail, Congress passed legislation that allows families to opt-out of receiving prescreened credit offers.[119] This regulatory intervention enables families to intervene in the credit market by eliminating themselves as a potential customer for new credit. Opting out also can be a tool for financial discipline, reducing marketing pressure to borrowing and helping consumers to take affirmative control of their financial decisions.[120] Yet, few families take advantage of the opt-out law, with the result that credit solicitations are a reality of modern American life.[121]

Many debtors reported feeling frustrated, and even angered or scared, by the intensity of credit solicitations after bankruptcy. Indeed, these families' frustration with credit offers may be even sharper than the typical American. These families' downward spiral into bankruptcy was

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[116] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, PA-07-132.

[117] *See* Robert Berner, *Cap One's Credit Trap*, Business Week (Nov. 6, 2006) (quoting consumers with six Capital One credit cards thinking that company was "nuts" for being "willing to give me another card" when he "owe[d] these people that damn much money."); Bob Sullivan, *Deluged with Credit Card Mail? Help is Coming*, MSN Money Online (Aug. 8, 2005), http://www.msnbc.msn.com/id/8827007/ (documenting number of solicitations some families receive each month and describing law allowing consumers to opt-out of prescreened solicitations that responds to complaints about offers).

[118] FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 13.

[119] 15 U.S.C. § 1681b(e) (604 of Fair Credit Reporting Act); *see also* BD. OF GOVERNORS OF FED. RESERVE SYS., REPORT TO CONGRESS ON FURTHER RESTRICTIONS ON UNSOLICITED WRITTEN OFFERS OF CREDIT AND INSURANCE at 11-12 (Dec. 2004), *available at http://www.federalreserve.gov/boarddocs/rptcongress/UnsolicitedCreditOffers2004.pdf.*

[120] See Angela K. Littwin, *Beyond Usury: A Study of Credit Card Use and Preference Among Low-Income Consumers*, 32 Tex. L. Rev. ___ (forthcoming 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968330 (developing recommendations to improve opt-out law to provide users with more control over type of solicitations received).

[121] BOARD OF GOVERNORS OF FED. RESERVE SYS., REPORT TO CONGRESS ON FURTHER RESTRICTIONS ON UNSOLICITED WRITTEN OFFERS OF CREDIT AND INSURANCE 17 (Dec. 2004), http://www.federalreserve.gov/boarddocs/rptcongress/UnsolicitedCreditOffers2004.pdf (stating that only 6% of people with credit records choose to opt-out).

punctuated with efforts to borrow their way back to financial stability and increasing reliance on credit to make ends meet. The number of dollars of debt discharged in bankruptcy was a tangible and public signal of the depth of their financial collapse. Because credit was crucial (albeit unsuccessful) strategy that they used in efforts to avoid bankruptcy, they may associate credit with financial failure. Their financial collapse may heighten their consternation about credit marketing and explain why such offers made many consumers feel vulnerable. When asked if she had received credit offers, a Californian proclaimed, "Constantly! I've been pre-approved more times than you can count. I just throw them in the trash. I actually got a $2000 credit card; it suddenly arrived in the mail, a real, live credit card. I scissored it up into 17 pieces. You'd think I was Donald Trump, the way they would send me credit cards. When I got that credit card, I sat down and wrote them a blistering letter, but I doubt anyone ever read it."[122] This woman's disdain for credit solicitations seems to stem from her belief that she cannot afford $2000 in credit card charges. Her perception that lenders' credit offers threatened her financial recovery after bankruptcy was echoed by many families.

Generally debtors disapproved of the aggressive marketing to bankruptcy filers. A Californian said that getting credit cards after bankruptcy was "[n]ot as difficult as it should have been. It just seemed almost too easy. They just sent a piece of paper and said that I've been preapproved for $3000. It's yours, just return the application."[123] This woman's comments hint at some anxiety about the consequences of the widespread availability of postbankruptcy credit. A man in his mid-50s with some college education used the final open-ended question of the interview to share his frustrations. "The bottom-line profit mentality we have in the United States is one of the main issues here. I can't believe how many credit applications are coming in even

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[122] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, CA-07-187.
[123] Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, CA-07-149.

now."[124] This man's shock at being a target of credit marketing is mingled with disdain. He seems to think that lenders' willingness to profit from a postbankruptcy debtor should be a cause for policy concern.

These respondents' concerns reveal an important consequence of the "democratization of credit" that is rarely explored. Rather than seeing expansive credit as a benefit, families may desire restraints on credit marketing as an aid for improving their financial practices.[125] Optimal policy must balance these desires against the goal of credit rehabilitation that is encompassed by bankruptcy's fresh start theory.[126]

C. The Bankruptcy Beacon

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

One bank spokesperson has asserted that any credit card offers that it sends to people who have filed bankruptcy are inadvertent.[127] The data cast doubt on this denial. Major lenders deploy sophisticated analytical tools to identify future customers and their anticipated profitability. This strategy has been fundamental to the price and term differentiation that

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[124] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, TX-07-057.

[125] See Littwin, *supra* note 120, at ___ (finding that low-income women would like credit card companies should be required to give consumers the option to set their own credit card limits or require consumer approval before increasing credit limits.)

[126] *See* Porter & Thorne, *supra* note 57, at 74 (describing how bankruptcy's rehabilitative purpose includes enabling future borrowing); KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 99 (1999).

[127] Egan, *supra* note 65 (quoting Bank of America spokesman saying that it does not give credit cards to people who file bankruptcy but that a delay between the bankruptcy petition and credit reporting could cause a bank to still send an offer to someone who filed bankruptcy).

dominates the current lending environment.[128] During the same period in which the bankruptcy rate escalated,[129] technology improved the credit reporting and scoring systems. Simultaneously, marketing departments launched powerful incentives such as create "teaser" interest rates and affinity programs to attract customers.[130] Given this formidable marketing prowess,[131] accidental offers are probably rare. Most postbankruptcy credit offers could probably be prevented by the industry's technology, and the sheer numbers of offers that continue for years after bankruptcy strongly suggest that very few offers were processed before the credit report showed the bankruptcy.

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

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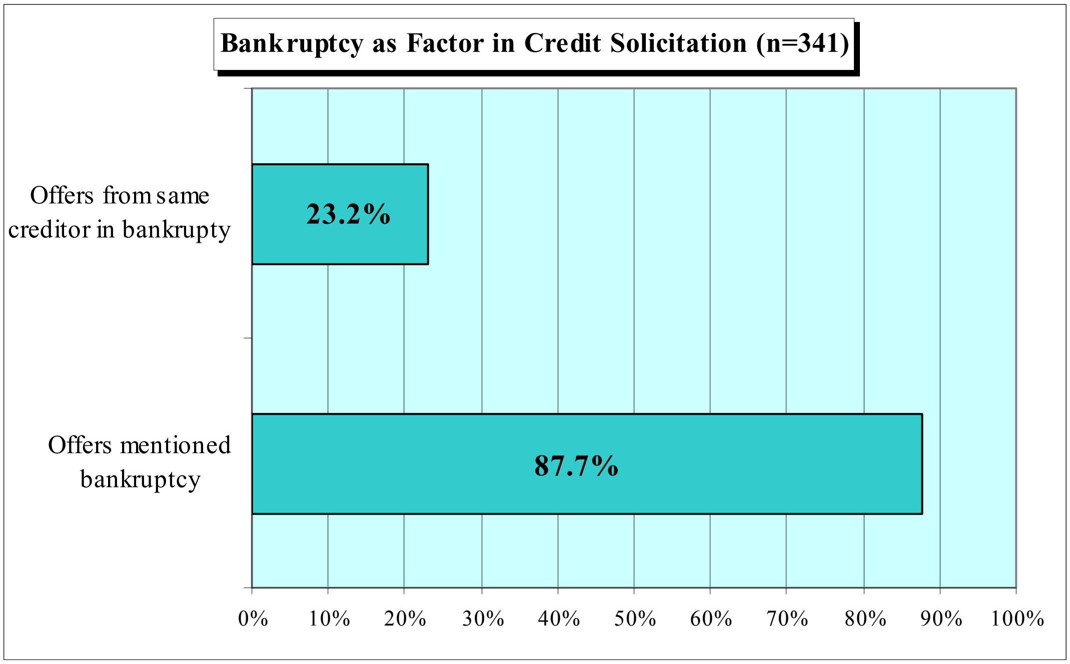
[128] *See* FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 19 (noting existence of "varied product offerings" that allow creditors "to tailor incentives and products to specific segments of the market and to price them in a way that reflects the underlying risk of each segment.")

[129] ADMINISTRATIVE OFFICE OF THE U.S. COURTS, BANKRUPTCY STATISTICS, http://www.uscourts.gov/bnkrpctystats/Bk2002_1990Calendar.pdf (number of filings per calendar year between 1990 and 2002).

[130] S*ee* Frontline, *supra* note 114.

[131] FED. RESERVE, REPORT ON SOLICITING AND EXTENDING CREDIT, *supra* note 30, at 19 ("Lender ratings of potential borrowers have become increasingly sophisticated and automated over the past decade. Lenders have extensive information on borrowers available from credit reporting agencies and from proprietary databases. This information is combined with new quantitative modeling techniques—which help lenders rank prospective borrowers on the basis of historical information about borrowers with similar quantifiable characteristics—to guide the determination of which prospective borrowers in each portfolio will be extended credit and the pricing of that credit.")

**FIGURE 2**




A vast majority of debtors had received credit solicitations that specifically mentioned their bankruptcy. Nearly 88 percent of debtors reported that lenders had referenced the debtor's bankruptcy in their credit marketing. The prevalence of these offers reflects that at least some creditors intentionally seek out recent bankruptcy debtors as future customers. When asked if she had received any offers that mentioned her bankruptcy, a woman in her mid-30s affirmed "almost all of them." She described their content, "We want to help, bankruptcy specialist, blah, blah, blah. It's awful."[132] Another woman read an interviewer a loan offer that she had received for a car. The solicitation explained, "Your name was obtained due to your recent bankruptcy filing—don't be alarmed. . . . We know that bad things happen to good people . . . We know that in the 12 months prior to bankruptcy people may experience considerable anxiety and stress.

[132] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, PA-07-062.

With our help you could be driving a new car the same day your bankruptcy is discharged."[133] As an accountant observed, "They seem to be looking for people who filed."[134]

Bankruptcy law facilitates these marketing efforts. Filing bankruptcy is a public act.[135] Individual creditors and the credit reporting bureaus search the records to obtain the names and contact information of bankruptcy debtors. Some companies specialize in trolling the court records and selling lenders lists of bankruptcy filers.[136] Lenders' access to this information for marketing purposes is probably an unintended consequence of the public nature of bankruptcy. Nevertheless, the effect deserves policy attention.[137] Amidst lamentations that the stigma of bankruptcy is declining,[138] lenders are capitalizing on bankruptcy records to market to debtors. Notwithstanding the public rhetoric, creditors' private message to these families is that far from being pariahs, they are welcome customers.

Research on Chapter 7 debtors' postbankruptcy experiences reveals the profit potential of former debtors. In the first year after filing, many families face financial difficulty and must cope with declining or stagnant incomes.[139] People in financial distress are more likely to have revolving accounts, to have exceeded their credit limit, and to use cash advances (which carry a higher interest rate), creating what some researchers have termed "attractive cash flows."[140] If families' face difficulty in making ends meet after bankruptcy, their profitability potential for

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[133] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, PA-07-108.

[134] Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, CA-07-016.

[135] 11 U.S.C. § 107(a).

[136] Two examples include Information Technologies Inc. (http://www.inft.net/) which provides a "Financial Hardship" database as an "excellent source for marketing leads" and Discreet Research (www.discreetresearch.com) which provides names and social security numbers for bankruptcy filers.

[137] *See infra*, Section III, A.

[138] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Hearing on S. 256 Before the Subcomm.on Administrative Oversight and the Courts of the S. Comm. on the Judiciary, 109th Cong. (statement by Todd J. Zywicki) (2005) (stating that increased bankruptcy filings were caused by a loss of "personal shame" and "social stigma" previously associated with filing for bankruptcy).

[139] Porter & Thorne, *supra* note 57, at 94-95.

[140] A. Charlene Sullivan & Debra Drecnik Worden, *Bankruptcy in a Bank Credit Card Portfolio*, 13 J. OF RETAIL BANKING 3, 36-37 (1991-92).

lenders is greater. Fee and interest income are a major component of credit card lenders' profits.[141] Other subprime lending products may also rely heavily on such revenue. These families exemplify the ideal customers for lenders' "sweatboxes."[142] These families may be slow to pay; they may make only small payments; they may incur huge fees; and their balances may negatively amortize. But they cannot seek bankruptcy relief. It is precisely this constellation of features that makes postbankruptcy families particularly profitable for lenders.[143] These families will generate more profit than card holders who frequently pay off their balance in full but the bankruptcy risk is mitigated. In effect, lenders escape anxiety about how long the borrower can sustain his unstable position before bankruptcy. Free from price regulation,[144] and staving off efforts to curb the substantive terms of their contracts,[145] the consumer credit industry can market to families who are vulnerable to financial distress at a price and on terms that maximizes their profit.

This profit potential explains perhaps the most remarkable fact about postbankruptcy credit offers. As shown in Figure 2, a substantial fraction of credit offers are made by the exact same entities that were creditors in these debtors' bankruptcy cases. Over one in five debtors reported receiving a credit solicitation from a lender that they could identify as a scheduled

[141] MANN, CHARGING AHEAD, *supra* note 38, at 23 tbl. 2.2. (Interest charges compose 65% of U.S. card issuer's revenue.)

[142] Mann, *Sweatbox*, *supra* note 1, at 391. Jay Westbrook apparently first coined the term "sweatbox" to describe the financial situation that maximizes credit card issuers' profits. *See* Pottow, *supra* note 6 at 416.

[143] *Id.* at 385 ("The successful card lender profits from the borrowers who become financially distressed.")

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

[145] Stop Unfair Practices in Credit Card Act, S.1396, 110th Cong. (2007); Universal Default Reform Act, H.2146, 110th Cong. (2007); Credit Card Accountability Responsibility and Disclosure Act of 2007, H.1461, 110th Cong. (2007).

creditor in their bankruptcy.[146] Given the incredible consolidation in the banking industry in the last decade,[147] this figure may substantially underreport the frequency with which prebankruptcy creditors seek to become postbankruptcy creditors. Debtors may not be able to accurately identify the bank extending credit in a particular offer. For example, a borrower may say that he has a "United Airlines credit card", without remembering that Chase Manhattan is the actual lender. When Chase Manhattan later sends him an offer to have a "Chase PerfectCard" card,[148] the consumer may not recognize that this offer emanates from the same bank that issued the United Airlines card.[149] Even taking the finding as is, however, the data show that some lenders are undeterred by a bankruptcy discharge.

Some debtors are shocked to discover that the very creditor who told them that filing bankruptcy would ruin their credit is now soliciting them as a customer.[150] "I am continually getting offers for credit cards. Even the cards that I listed on my bankruptcy still offer me more cards but the interest rates are higher" explained a California woman.[151] These families' disbelief

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[146] The qualitative interviews contain additional evidence of repeat lending activity. "The same company that I had at bankruptcy sent me an application without asking." Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, IL-07-053.

[147] Kenneth D. Jones & Tim Critchfield, *Consolidation in the U.S. Banking Industry: Is the "Long, Strange Trip" About to End?* FDIC Banking Review, *available at* http://www.fdic.gov/bank/analytical/banking/2006jan/ article2/index.html.

[148] This is actually the name of a real general purpose credit card issued by Chase Manhattan. *See* Chase PerfectCard Credit Card Offer at http://www.chase.com/ccp/index.jsp?pg_name=ccpmapp/card_acquisitions/unsolicited/page/PFSCreditCardDetails &sourcecode=64DY.

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

[150] S*ee* Frontline, *supra* note 114. A married man who filed bankruptcy told the Frontline reporter of his experience. "We gone one yesterday from a credit card company that told me I'd never have credit with them again. One of the last times I talked with them, told them what our situation was, they said, 'Well, we're canceling your card. And you are, in essence, blackballed with us for life. You'll never have a credit card from us ever again.' Yesterday, [we] received a solicitation from them, zero percent for life, with up to a $50,000 line of credit."

[151] Consumer Bankruptcy Project III, Respondent Interview Three-Year Postbankruptcy, CA-07-011.

at receiving credit solicitations is probably tempered by some terms of the new credit offers. In some cases, an offer for postbankruptcy credit disguises an attempt to collect discharged debt. Ten percent of families whose prebankruptcy creditors solicited them after bankruptcy reported that some of those offers had asked them to make payments on prebankruptcy debts.[152] These future offers of credit were presumably conditioned on the debtor making a "voluntary" payment on debt discharged in bankruptcy. While these situations were relatively infrequent and were documented in only two percent of all Chapter 7 cases in the sample, they are nonetheless disturbing.[153] A request to pay debt that was discharged in bankruptcy is prohibited.[154] In some instances, postbankruptcy credit was a vehicle for enticing families to repay discharged debts. While a substantial minority of Chapter 7 debtors does, in fact, chose to repay a portion of their discharged debts,[155] the numerous credit offers that debtors received each month would seem to make such repayments truly "voluntary" and not motivated by a need to obtain future credit.[156] Nonetheless, any debtors who accept these offers reinforce creditors' incentives to violate the discharge injunction. Such fortunate creditors will get a double benefit. They will accrue the

[152] This question was posed only to the 79 debtors who said that they received credit offers from the same creditors that were listed on their bankruptcy schedules. Eight of the 79 debtors said these lenders asked them to repay their old debts in the new credit offers.

[153] The data in the text reflect the affirmative responses to the query on repaying old debts of 8 debtors among the group of 79 who had received credit offers from their prebankruptcy creditors. However, at another point in the interview, all debtors were asked if a prebankruptcy creditor had contacted them after bankruptcy. Nearly four in ten (39%) of debtors in the sample reported such contact. Apparently, creditors frequently violate the discharge injunction. However, the wording of this question did not make clear whether "old debt" referred only to debts that were discharged or included prebankruptcy debts that were reaffirmed or debts that were non-dischargeable. Thus, the data do not permit a conclusive determination of what amount of this postbankruptcy contact by creditors violated the discharge injunction.

[154] *See* 11 U.S.C. § 524(a)(2).

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

[156] Among the 62 families who made payments on at least one prebankruptcy debt, only three families cited "creditor required payment before agreeing to new credit" as one of the reasons for their voluntary repayment. This finding highlights the fact that debtors may repay discharged debts for reasons other than their own financial benefit. Understanding why one in five debtors makes a payment after bankruptcy would provide useful insights into debtors' attitudes about their prebankruptcy creditors.

superior profits from postbankruptcy borrowing, but also reduce their loss from the debt discharged in bankruptcy.

This complicated dynamic reveals the extent to which the credit industry is a repeat-player market. A substantial fraction of creditors will try to engage the very same debtors in new borrowing. Less than one year after receiving notice that these families were no longer obligated to pay their debt to them, the very same creditors actively seek to lend again to these families. Because a vast majority of Chapter 7 cases are no-asset cases in which unsecured creditors receive no distribution of payment,[157] these lenders are apparently quick to forget that their desired customers are the same "strategic" and "immoral" borrowers who purportedly game the credit system. This dichotomy between words and actions is stark. Profit opportunities appear to motivate lenders to abandon any effort to stigmatize bankruptcy filers by denying them credit. Instead, bankruptcy law facilitates postbankruptcy credit solicitation.

### D. Paradox of Secured Credit

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

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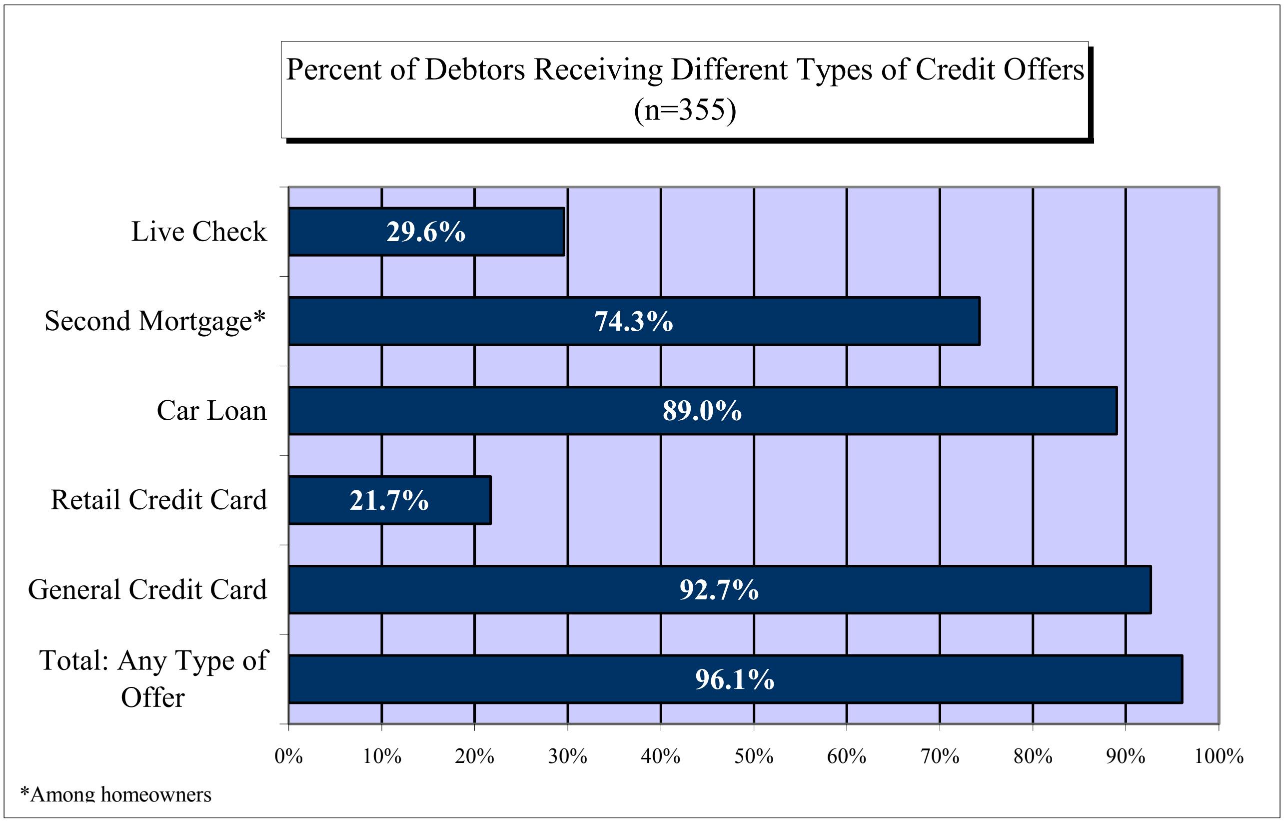
[157] *See* Ed Flynn, Gordon Bermant & Suzanne Hazard, *Bankruptcy by the Numbers: Chapter 7Asset Cases*, 21 AM. BANKR. INSTITUTE J. 22 (Dec. 2002/Jan. 2003) (reporting that 96 percent of all Chapter 7 cases (combined business and consumer total) were closed without any assets distributed); *see also* Susan D. Kovac, *Judgment-Proof Debtors in Bankruptcy,* 65 AM. BANKR. L.J. 675, 678 (1991) (concluding that a significant segment of the bankruptcy population is judgment-proof debtors who have no non-exempt assets and earn wages below garnishment limitations).

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

**FIGURE 3**




General purpose credit card offers were ubiquitous. Nearly 93 percent of postbankruptcy debtors reported receiving a credit card solicitation. Filing bankruptcy is plainly an ineffective technique for eliminating the phalanx of credit card offers that arrive in one's mail. Whether you pay your balance in full every month or declare yourself broke, the banking industry appears to have a credit card product that is suitable (and profitable) for your financial profile. This finding reinforces the segmentation of the card industry, and their efforts to reach customers who are vulnerable to financial problems.[158]

[158] MANN, CHARGING AHEAD, *supra* note 38, at 190.

Retail charge cards were less common. Only about one in five debtors were solicited to open these accounts. Debtors' experiences may not be unique. Pre-screened retail card offers may be less commonly sent to all consumers. The query about credit offers was not limited to mailed offers, but consumers may not have counted point-of-sale offers made in retail stores. Another possibility is that retail cards are less segmented than general cards. These products could be one-size-fits-all, marketed with a rate and fees that reflect the creditworthiness and risk of the entire borrower base. Recent bankruptcy filers may not meet retailers' lending criteria. The differential between general and retail credit card offers could suggest that many of the general credit cards offered to postbankruptcy families were subprime products. Some cards may have required collateral for the credit extension;[159] others may have charged unusually high interest rates or required consumers to pay unusually expensive annual fees.[160] Further evidence to support this hypothesis comes from debtors' experiences in trying to actually get companies to issue them credit cards. Three years after bankruptcy, 44 percent of debtors said they were denied at least once when applying for a credit card. The interviews did not ask for detail about these credit rejections. Given the large number of credit offers most debtors received each month, I hypothesize that these rejections perhaps resulted from the debtor applying directly for a credit card (such as when offered to them during a retail purchase), rather than responding to prescreened solicitations mailed to postbankruptcy families. The credit offers that bankruptcy debtors receive may be tailored to distressed borrowers and carry correspondingly high rates or unfavorable terms.

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[159] Secured credit cards require consumers to pay a deposit, usually a minimum of a few hundred dollars, as a condition of the card's issuance. The issuer holds this deposit, and the consumer makes monthly payments toward any accrued charges, fees, and interest. *See* Secured Cards Survey – November 2006 at http://www.cardweb.com/perl/cardlocator/survey/secured (describing secured cards as "ideal" for consumers with poor credit or no credit). For an example of the marketing and terms of a secured credit card, *see* Wells Fargo Credit Cards—Secured Visa Card *at* https://www.wellsfargo.com/credit_cards/select_card/secured/.

[160] *Id.* (reporting cards offering annual fees as high as $150 with interest rates as high as 23% APR.

A majority of families received solicitations for secured loans after bankruptcy, although these offers were somewhat less common than credit cards. Car loans are widely marketed to debtors. Many debtors were surprised to receive these offers, expressing concern that the substantial debt required to purchase a car would cause them financial trouble in the future. A young man from Pennsylvania told his interviewer that he had gotten car loans in the form of check, for up to $50,000 but that "[t]hey go right in the trash with the credit card offers."[161]

Comparable data for the general American population on the marketing of auto loans was not readily findable.[162] However, bankruptcy debtors may be particularly likely to respond to unsolicited offers for auto financing. Repossession of a car may have been the last straw that precipitated a decision to file bankruptcy. Other families may voluntarily surrender a car in bankruptcy or be unable to defend a lender's motion for relief from the automatic stay. The fact that families are lucrative targets for car purchases after bankruptcy reinforces the hardship that accompanies bankruptcy.[163] Characterizations of debtors as strategic financial actors flounder against such reality. Lenders' postbankruptcy marketing is tangible evidence of the financial rebuilding process that debtors must undergo after bankruptcy.

Families who retain their homes despite filing bankruptcy are targets for second mortgages or home equity loans. About three-quarters of homeowners reported that they received offers to use their home as collateral to borrow. These loans carry the potential for relatively large debts. The marketing of home loans to recent bankruptcy debtors offers is consistent with evidence on the penetration of the mortgage industry deep into the subprime

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[161] Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, PA-07-074.

[162] Specialized marketing exists for car loans for the general nonbankrupt population, *see* CUNA Mutual Group, *Compete in the auto loan market and win*, *at* http://www.cunamutual.com/cmg/freeFormDetail/0,1248,4458,00.html but data on the quantity of loans was not available.

[163] I am conducting further research to examine how many debtors accept these loans and to document the price and terms of these loans. *See* Porter, *Borrowing After Bankruptcy*, *supra* note 107.

credit market.[164] While a Congressman lamented the morality of a debtor who would buy a house and then file bankruptcy,[165] the lending industry was actively soliciting families to risk their homes after bankruptcy by loading up on new debt.

Another way to measure creditors' willingness to lend to debtors is to study debtors' perceived difficulty of obtaining credit.

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

Figure 4 shows how families' experiences in trying to obtain three types of credit after bankruptcy. The overall trend was that families with financial problems may have greater access to unsecured credit in the form of credit cards than to secured credit. Credit cards were particularly easy to obtain. Three years after discharging any prior credit card debts in bankruptcy, 60 percent of families had at least one new postbankruptcy credit card.[166] Approximately 24 percent of these new credit card holders believed that their bankruptcy had made it difficult for them to get these new cards. More than three in four families reported that bankruptcy did not cause them to be turned down for credit cards.

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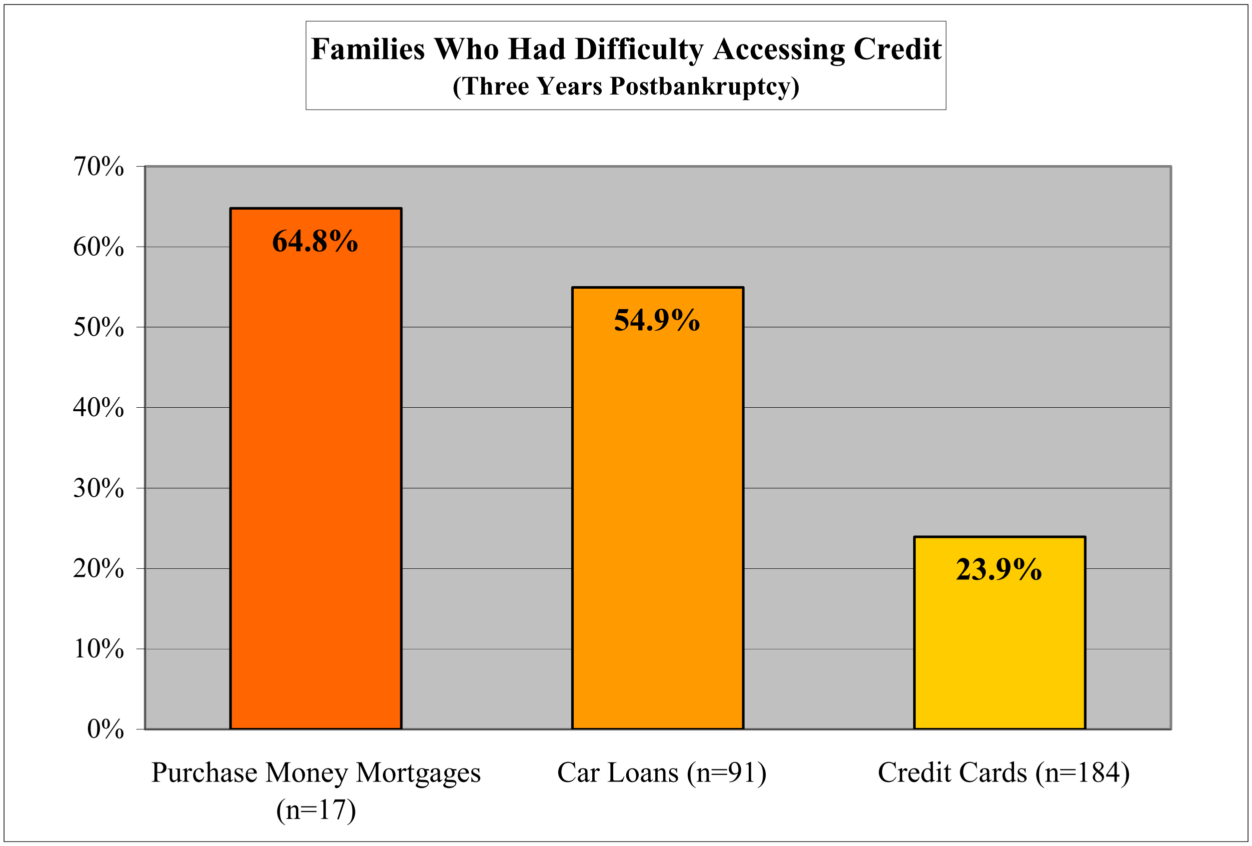
[164] *See* Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets Revisited*, 82 TEX. L. REV. 439 (2003); HARVARD JT. CENTER FOR HOUSING STUDIES, *supra* note 80, tbl. 20.

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

[166] A forthcoming paper presents more detailed data on families' use of credit after bankruptcy. *See* Porter, *Borrowing after Bankruptcy*, *supra* note 107.

**FIGURE 4**




Paradoxically, families found lenders more reluctant to lend to them on a secured basis than to issue them credit cards, which are frequently, although not always, unsecured lines of credit. Approximately 55 percent of those who financed a car purchase in the first three years after bankruptcy reported having difficulty obtaining a car loan.[167] Figure 4 illustrates that families were twice as likely to find it difficult to get a car loan as to obtain a credit card. About one in three families who obtained a home loan after bankruptcy said that their bankruptcy caused them trouble in borrowing or caused their credit application to be refused.

The presence of collateral should reduce a loan's risk, both directly by increasing the lender's ability to obtain repayment by foreclosing on the collateral and indirectly by enhancing

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

the borrower's incentives to pay.[168] Thus, secured credit should facilitate borrowing to less creditworthy consumers. In the commercial context, the most financially sound companies avoid secured credit.[169] In the consumer context, however, vulnerable borrowers like bankruptcy debtors are more likely to struggle to obtain secured credit than unsecured credit. This differential may reflect the greater experience of the credit card industry with subprime borrowers, a trend that has arrived more recently in the mortgage and auto lending industries.[170] Perhaps in the consumer context, lenders cannot attract postbankruptcy debtors to secured lending products that fully reflect the expense of enforcing a security interest or monitoring collateral. Former bankruptcy debtors may have a harder time qualifying for the available secured credit products. Families may instead turn to credit cards to finance a car purchase through a cash advance or to serve the purpose of a home equity loan such as funding a home improvement project or paying unexpected medical bills. At least in the market for distressed consumers, unsecured credit that excuses borrowers from risking collateral is more widely available to risky customers than secured credit.

Lenders repeatedly solicit families who file Chapter 7 bankruptcy. Bankruptcy creates obstacles for some credit transactions, but simultaneously guarantees a virtual flood of credit solicitations marketed specifically to postbankruptcy families. The widespread availability of credit starkly contrasts with assertions of bankruptcy debtors as immoral or strategic actors and highlights lenders' interest in these families as a source of profit.

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

[169] *Id.* at 634.

[170] Cherie Berkley, *Interest Rates Shake Up Subprime Lending Market*, DEBT COLLECTION AND RISK 35 (Oct. 2006).

E. Chapter 13 Twist

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

In the vast majority of Chapter 7 cases, individuals receive a discharge of eligible debts two or three months after they filed their bankruptcy case.[171] The discharge effectively ends the bankruptcy process for Chapter 7 debtors. No trustee or bankruptcy court supervises the credit activities of debtors after discharge. The prior statement is equally true in Chapter 13, but the discharge in Chapter 13 cases does not enter until the debtor has completed all required payments, which occurs between three and five years after plan confirmation.[172] Chapter 13 imposes obstacles to obtaining new credit. While making plan payments, debtors are required to get authorization before obtaining new credit.[173] Many trustees emphasize this requirement to debtors,[174] although in fact trustees may liberally grant such requests.[175] Research on actual borrowing by Chapter 13 debtors could illuminate the extent to which this credit restraint

[171] ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY (15 ed. Revised) §§ 700.04 – 700.05.

[172] ID. at § 1328.01.

[173] 11 U.S.C. §§ 1305(c), 1306(a)(2) and (b) and 549(a)(2)(B) (2006).

[174] *See, e.g.,* Office of the Chapter 13 Trustee, Thomas P. King, http://www.ch13oshkosh.com/profile.html#newcredit; *see also* The Administrative Office of the U.S. Courts includes the limitation on new credit in its public information about Chapter 13 Bankruptcy. *See* Admin. Office of U.S. Courts, Chapter 13 Bankruptcy Basics, http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.htm/.

[175] *See* Braucher, *One Code, supra* note 68, at 539 & n. 130 (1993) (stating that trustees are receptive to new credit requests).

operates to curb the desires of lenders and bankruptcy debtors for borrowing during Chapter 13 cases.[176]

A brief analysis of credit marketing to Chapter 13 families powerfully illustrates how bankruptcy law shapes the incentives of the lending industry. Most families who file Chapter 13 bankruptcy receive credit solicitations.[177] More than three-quarters of families (76.7 percent) said that lenders had sent them credit offers in the first year after their bankruptcy filing. However, Chapter 13 families are significantly less likely to receive credit offers than Chapter 7 families.[178] The reported rate for Chapter 13 families is significantly lower than the fraction of Chapter 7 debtors (96.1 percent) who receive credit offers after filing bankruptcy. At least in the short-term, Chapter 13 seems to be a modest deterrent to the credit industry's efforts to turn bankrupt families into customers.

Figure 5 shows the frequency with which Chapter 13 filers reported being offered different types of credit during the first postbankruptcy year and illustrates the comparative difference with Chapter 7 debtors. The differences were significant for all credit offers except retail cards. [179] Lenders' preference for Chapter 7 bankruptcy debtors is most pronounced with regard to secured credit loans, as general credit cards were the only type of unsecured credit that

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

[177] These data come from the Chapter 13 cases collected in the core sample in which a first round telephone interview was completed. The same method was used for the Chapter 7 sample considered in Parts II A-D. First round interviews were completed by 243 families who filed Chapter 13; this figure represents 51.5 percent of the 470 total Chapter 13 cases in the core sample. Note that these data reflect all families who *filed* Chapter 13 bankruptcy, but that some portion of these families may have dismissed their Chapter 13 cases before the interview at one year postbankruptcy filing. Indeed, the completion rate for Chapter 13 is notoriously low. *See* Scott Norberg, *Debtor Discharge and Creditor Repayment in Chapter 13,* 39 CREIGHTON L. REV. 473, 476 (2006) (67% of chapter 13 filings were either dismissed or converted before completion.); Jean Braucher, *An Empirical Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown*, 9 AM. BANKR. L. REV. 557, 571-74 (2001) (summarizing variations in Chapter 13 completion rate in various studies). I do not exclude cases that were dismissed or converted to Chapter 7 bankruptcy because I am focused on creditor reaction to a debtor's bankruptcy choice, rather than how debtors use credit during the postbankruptcy period.

[178] $P \leq .001$.

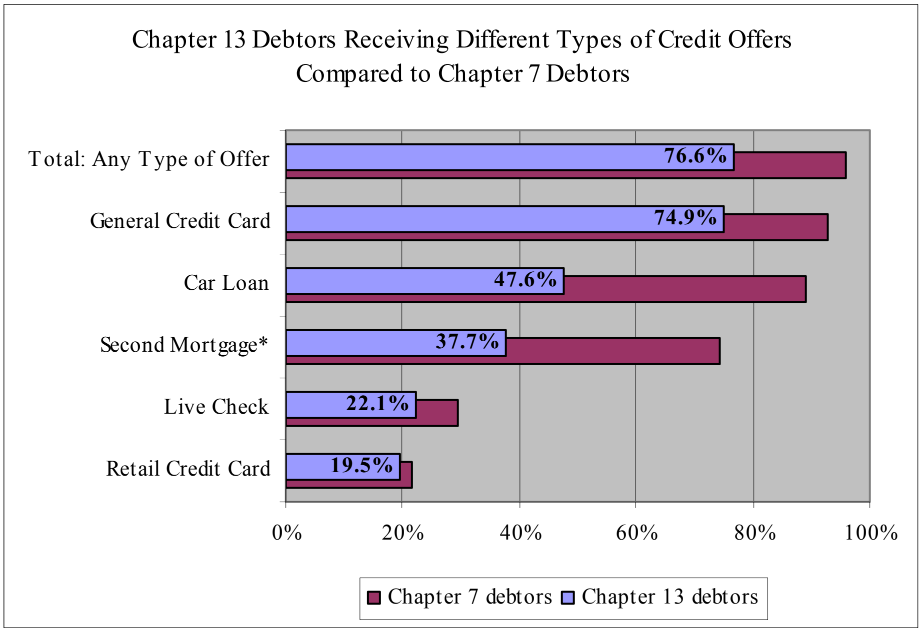
[179] $P \leq .05$.

showed a significant difference by chapter. Both car loans and second mortgages are significantly less available to families who filed Chapter 13 than families who filed Chapter 7. Perhaps the need to obtain permission for post-filing credit in Chapter 13 deters lenders; this requirement theoretically adds expense and hassle to the loan transaction costs. Alternatively (and to my mind, more plausibly), this difference may reflect the practical needs of Chapter 7 and Chapter 13 bankruptcy debtors. Families who file Chapter 13 may retain non-exempt assets such as a car or home and continue making payments on the debt through their Chapter 13 plan, curing any default that existed at the time of the bankruptcy.[180] In contrast, Chapter 7 debtors may surrender these assets in bankruptcy or be less likely to own them.[181] Thus, lenders may exert less effort marketing secured loans to Chapter 13 families because these families may be less responsive to such offers.

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

[181] SULLIVAN ET AL., *supra* note 12, at 205 n.27.

**FIGURE 5**




Even if Chapter 7 and Chapter 13 debtors have identical postbankruptcy borrowing preferences,[182] the law creates different lending risks to debtors based on the type of bankruptcy filed. Because consumers can convert their bankruptcies from Chapter 13 to Chapter 7,[183] unsecured credit extended to a Chapter 13 debtor after their initial filing would be subject to discharge if the case were converted to Chapter 7.[184] This effect may constrain the availability of credit cards to Chapter 13 debtors while they are paying into their plans. Data on the number of credit offers could help test this hypothesis. Chapter 13 filers said they received an average of 8.65 credit offers per month; Figure 2, *supra*, shows Chapter 7 filers' average was 14.56 offers

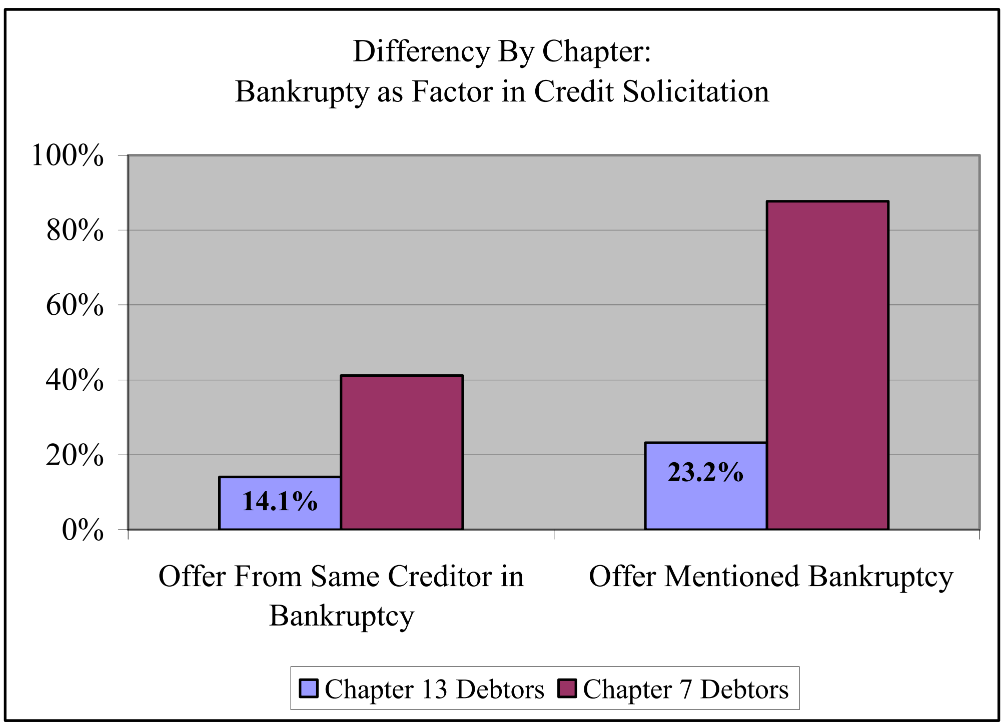
[182] I do not make any assumption that families who chose Chapter 7 and Chapter 13 would, in fact, have the same desire for or beliefs about the availability of postbankruptcy credit. Scholars have expended considerable effort to explain why debtors chose the chapter of relief that they do, *see, e.g.,* Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, "The Persistence of Local Legal Culture: Twenty Years of Experience From the Federal Bankruptcy Courts." 17 HARVARD J. OF LAW & PUBLIC POLICY 801, 814-15 (1994); but no study has extensively considered the role of this factor in shaping a debtor's decision. Jean Braucher's research on lawyers' role in debtors' filing decisions may be the best effort to date. *See* Braucher, *One Code, supra* note 68.

[183] *See* 11 U.S.C. § 1307(a).

[184] *See* Braucher, *One Code, supra* note 68, at 538.

per month.[185] A similar margin existed at the median, with the typical Chapter 13 debtor receiving half (five per month) the number of offers of the typical Chapter 7 debtor (ten per month.) The data do not permit a complete understanding of the reasons for Chapter 7 and Chapter 13 credit marketing. The less frequent credit solicitations to Chapter 13 families may reflect the fact that some lenders simply avoid Chapter 13 debtors entirely. Marketers, in turns may have more success selling data on Chapter 7 filers, who lenders prefer as customers. Chapter 13 families were substantially less likely to report credit offers that mentioned their bankruptcy or were received from a prebankruptcy creditor. Figure 6 shows these findings and comparative data from Chapter 7 debtors.

**FIGURE 6**




Overall, lenders exhibit a customer preference for Chapter 7 filers over Chapter 13 filers. This preference does not square with the credit industry's backing of bankruptcy reform that

[185] $P \leq .001$.

allegedly would screen more families into Chapter 13 bankruptcy. Despite their rhetoric championing Chapter 13 as the "honorable" path for families in serious financial trouble, the lending industry is more likely to cast away a family who chooses Chapter 13. Congressional representatives repeatedly emphasized the policy importance of partial debt repayment in Chapter 13.[186] However, lenders are less likely to reward families who chose Chapter 13 by offering them additional credit. This differential treatment by creditors has implications for the design of bankruptcy law.

Despite debtors' trepidations and creditors' warnings before bankruptcy, borrowing after bankruptcy is not only possible after bankruptcy, such activity is actively encouraged by the credit industry. These data suggest that creditors' threats to refuse credit after bankruptcy are hollow. The credit industry may tell consumers that they will not lend after bankruptcy and that paying the debt is the only option to maintain their credit access, but such statements are largely untrue. Rather than resulting from a marketing mistake, the widespread availability of postbankruptcy credit more likely reflects a careful calculus about the profits of lending to customers vulnerable to financial distress. The bankruptcy system shapes creditors' ability to profit from former bankrupts, and law can play a critical role in defining the appropriate boundaries of credit solicitation.

## III. IMPLICATIONS

### A. Unraveling the "Strategic" Story

The findings about postbankruptcy credit solicitation do not legitimate the strategic debtor model as a serious concern for lenders. Advocates of bankruptcy reform often conflated

[186] *See* 145 CONG. REC. 8509, 8580 (1999) (statement of Rep. Delay) ("Mr. Chairman, the bankruptcy bill under consideration today is based on the premise that those debtors who can afford to repay their debt should do so, rather than have it forgiven. To accomplish this seemingly simple goal, an income-based means test is employed to determine if a debtor could do one of three things: have debt forgiven; reorganize and enter into a repayment plan; or refrain from filing bankruptcy at all.")

prodigality with immorality, making it difficult to unravel the exact behavior by debtors (other than the act of filing bankruptcy) that was undesirable. Some policymakers conjectured that the stigma of bankruptcy had declined and suggested that families lacked the moral fiber to honor their obligations.[187] This view of bankrupt families suggests that debtors have serious character flaws. Lenders' rampant solicitation of bankruptcy debtors refutes this characterization of bankruptcy filers as profligate and untrustworthy. If lenders believed that bankruptcy files were inherent promise-breakers, they would not pursue them as customers. Positioned with public knowledge of the bankruptcy and impressive technology for assessing risk, the credit industry chooses to target bankruptcy debtors with credit solicitations. These efforts are inconsistent with characterizations of bankruptcy filers as people who do not indent to or try to honor their obligations.

The obvious response to this critique is to emphasize concerns that the prior bankruptcy laws permitted consumers to engage in strategic borrowing before bankruptcy. This view does not necessarily rely on immutable or chronic character traits. Instead, bankruptcy debtors are portrayed as brutally rational actors, who ratchet up debt with the intent to use bankruptcy law to escape repayment.[188] This economic incentive analysis of consumer default emphasizes the moral hazard of the bankruptcy discharge.[189] This theory of consumer borrowing would not expect families to default immediately after their bankruptcy because the law prohibits repeated bankruptcy discharges in close proximity.[190] Thus, creditors can market safely to these families because the law assures them that bankruptcy will not be an immediate consequence of the

[187] *See, e.g.,* 146 CONG. REC. S50 (daily ed. JAN. 26, 2000) (statement of Sen. Hatch) ("Not long ago in our Nation's past, there was an expectation that people should repay what they have borrowed. Hand in hand with this expectation was a stigma that attached to those who filed bankruptcy."); *see also* Warren & Lawless, *The Myth of the Disappearing Business Bankruptcy*, 93 CALIF. L. REV. 743, 784 (2005).

[188] *See* Block-Lieb & Janger, *supra* note 2, at 1483-85.

[189] *Id.* at 1491.

[190] *See* 11 U.S.C. § 727(a)(8). At the time these data were gathered from 2001 through 2004, the ban on subsequent filings was six years. *See* 11 U.S.C. § 727(a)(8) (2000).

borrowing. Without doubt, the ban on subsequent bankruptcy discharges has some effect on credit marketing.[191] But it alone may be insufficient to explain the desirability of postbankruptcy families as customers. The basic economics of default and Chapter 7 support this point. Most consumers default without filing bankruptcy and do so before bankruptcy; the amount of charged-off debt significantly exceeds the amount of debt discharged in bankruptcy.[192] The simple truth is that creditors can go unpaid with or without a bankruptcy discharge. Over 96 percent of Chapter 7 filings are no-asset cases, suggesting that many families may be judgment-proof or nearly so.[193] This reality means that lenders do not necessarily recover less because a family chooses bankruptcy instead of "informal" bankruptcy—sustained nonpayment backed by applicable non-bankruptcy law's limits on debt collection.[194] Similarly, after Chapter 7 bankruptcy, a majority of families could likely evade repaying any postbankruptcy borrowing because they will continue to be judgment-proof. Future research could examine whether lenders continue to offer credit as the time after bankruptcy elapses. To the extent that they do so, it suggests that the ability to discharge debt in bankruptcy is not a major consideration in driving lenders' evaluations of a family's desirability as a customer.

The findings on postbankruptcy credit marketing are inconsistent with the immorality or strategic theories of bankruptcy debtors. To the extent that lenders believe bankruptcy indicates poor character, the public act of bankruptcy guarantees that lenders can identify these families and refuse them new credit. In this way, bankruptcy solves the information asymmetry problem

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

[192] Ausubel, *supra* note 40, at 253 & fig. 1.

[193] *See supra* sources cited at note 156; *see also* WARREN & WESTBROOK, *supra* note 180, at 350-51.

[194] *See* Amanda E. Dawsey & Lawrence M. Ausubel, *Informal Bankruptcy* 1 (Twelfth Annual Utah Winter Finance Conference, Working Paper 58, Feb. 2002) (stating that 50.7% of credit card loans were charged off for reasons other than bankruptcy.); Michelle J. White, *Why Don't More Households File for Bankruptcy?* J. L. ECON. & ORG. 205 (1998) (exploring reasons why many debtors default but do not file bankruptcy).

by flagging for lenders these families who are willing to file bankruptcy.[195] More pointedly, if lenders are seriously worried about the stigma of bankruptcy declining, they are in an ideal position to deter such an effect. If creditors refused to lend to families after bankruptcy, families who are considering bankruptcy may be more inclined to continue to struggle to repay their debts. In this way, lenders did not necessarily need bankruptcy reform to address stigma "problem;" they themselves could have sharpened consequences of bankruptcy. Instead, lenders engaged in behavior contrary to their professed beliefs about the need for bankruptcy reform. The postbankruptcy credit findings show lenders engaging in "strategic" decisions of their own. During the very same years in which the credit industry pushed policymakers to enact bankruptcy reform,[196] creditors were hard at work trying to lure bankruptcy debtors as new customers.

The extent of postbankruptcy credit solicitation is suggestive of lenders' actual beliefs about the causes of bankruptcy. Efforts to lend to postbankruptcy families are more consistent with an adverse events model of bankruptcy than the "deadbeat" debtor model.[197] The data are not conclusive on this point; a bankruptcy filing clearly changes the ability of a consumer to engage in strategic borrowing. However, lenders' intense solicitation of postbankruptcy families is consistent with an understanding of the consumer bankruptcy system as a refuge for decent, honest families reacting to adverse events such as job loss or illness.[198] These events are

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

[196] Bankruptcy cases in this sample were filed in 2001 and the first and second longitudinal interviews conducted in 2002 and 2004 respectively. Bankruptcy reform bills were introduced into each Congress during this period. *See* Mann, *Sweatbox*, *supra* note 1, at 384 tbl. 1.

[197] I put this term in quotes because in reality credit card issuers call people who pay off their balances in full each month "deadbeats." Those who accumulate balances and make minimal payments are termed "revolvers," a group that the top lobbyist for the American Bankers Association called the "sweet spot" of lending. *See* Frontline, *Secret History of the Credit Card*, *supra* note 114 (interview with Edward Yingling) ("I think it is generally understood that those that use the revolving part of the credit card are kind of the sweet spot.")

[198] See sources cited *supra* note 13.

exogenous to a consumer's desire or intent to repay. If bankruptcy were endogenous in origin and primarily reflected a family's willingness to engage in ruthless default, lenders should avoid these families after bankruptcy for fear of future non-payment.

Creditors' actions speak louder than their words.[199] Despite public protests about declining stigma and strategic debtors, creditors want to count these families among their customers. Bankruptcy reform's focus on debtors largely missed this insight.[200] Lenders' behavior toward postbankruptcy families highlights the need for policymakers to consider how credit policy facilitates strategic *lending* and ways in which law could reduce undesirable consequences of such behavior. [201]

B. Bankruptcy Incentives

The debtor focus of the bankruptcy reform debate hindered careful study of how bankruptcy law shapes the behavior of creditors. In this section, I identify three ways in which this Article's findings on postbankruptcy credit opportunity could be useful in crafting bankruptcy policy. Efforts to alter creditors' legal incentives capitalize on creditors' rationality as a tool for improving the bankruptcy system.

Widespread postbankruptcy credit marketing is not an inevitable absolute, but is a product of existing bankruptcy law. Bankruptcy discharges are not unlimited goods.[202] The law's

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[199] *See* Frontline, Secret History of the Credit Card, *supra* note 114 (interview with Edward Yingling), *at* http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/synopsis.html.

[200] There were exceptions, of course, including some who publicly decried the hypocrisy of creditors' support of the bankruptcy bill. *See* Frontline, *supra* note 114 (untelevised interview with Sen. Christopher Dodd), *available at* http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/battle.html. ("The problem is that the credit card companies want it both ways. . . . On one hand, they want unfettered access to new customers, irrespective of whether these new customers are financially literate, or have the ability to repay the debts they incur. At the same time, they want to be protected when they overextend credit to these very same customers.")

[201] *See* Block-Lieb & Janger, *supra* note 2, at 1565 ("To the extent that rationality and opportunism exist in consumer credit transactions, they both appear to exist on the lender, not the borrower side of the equation. Those who would seek to reduce the bankruptcy filing rate should focus there as well.") *See* Pottow, *supra* note 6, at 429 (noting that it takes "two to tango" with bankruptcy-causing debt and suggesting that bankruptcy lawmaking could have usefully considered ways to change creditor behavior).

[202] *See* 11 U.S.C. § 727(a).

prohibition on repeat filings facilitates creditors' ability to profit from lending to recent bankruptcy debtors. Eliminating a bankruptcy discharges removes one barrier to collecting the debt and frees the creditor to continue collecting, during which time interest and fees accumulate. The ban on repeat filing helps to insulate lenders from the risk of ultimate nonpayment (but does guarantee repayment). In this way, the discharge limitation increases postbankruptcy credit marketing.

Current law permits a Chapter 7 discharge only if a debtor has not received a discharge in the prior eight years.[203] This time period was lengthened as part of BAPCPA,[204] a change that should increase postbankruptcy credit marketing. Policymakers advocated this reform as necessary to reduce debtors' incentives to file bankruptcy as a financial planning strategy. However, the sharpest effect of a discharge limitation may be on creditors, not debtors. The repeat filing rate for Chapter 7 bankruptcies was already very low before BAPCPA.[205] However, lenders can exploit the extended prohibition on discharge to maximize profits from postbankruptcy lending. Because many families continue to struggle to make ends meet after bankruptcy,[206] postbankruptcy families are ideal revenue sources for fee and interest income.

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

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[203] 11 U.S.C. § 727(a)(8).

[204] *See* Pub. L. No. 109-8, § 312; 119 Stat. 23, 87. The bankruptcy cases in this Article's sample were filed in 2001 when the ban on repeat Chapter 7 discharges was six years.

[205] SULLIVAN ET AL., AS WE FORGIVE DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 192 (1989) (stating that of the 1502 petitions in their sample only 8% were repeat filers).

[206] Porter & Thorne, *supra* note 57.

An exclusive focus on debtors has impoverished prior policymaking on the optimal scope of the bankruptcy discharge. The discharge does not just affect prebankruptcy debts; it has powerful consequences for debtors' fresh start after bankruptcy because it changes the context for future borrowing. Acknowledging how creditors' respond to bankruptcy enriches our ability to evaluate the ideal boundaries of discharge. The postbankruptcy borrowing findings presented here do not conclusively point to a particular reform, which should be supported by research on how debtors use postbankruptcy credit. The data do suggest some immediate recommendations for bankruptcy's new financial education requirement.[207] Education providers need to be responsive to the reality of postbankruptcy credit solicitation in their curricula.[208] The debtors' reactions of frustration, anger, and fear about postbankruptcy credit marketing emphasize the need to educate families about their ability to use existing law to opt-out of prescreened credit offers. This modest recommendation integrates existing consumer law into BAPCPA's financial education requirement to aid families in capitalizing on their fresh start after bankruptcy. Debtors could chose to eliminate solicitations for credit and wrestle affirmative control of credit marketing from lenders.

The second implication for bankruptcy law derives from the findings on the relative differences between postbankruptcy availability of secured and unsecured credit. The data suggest a declining spectrum of credit availability from general credit cards to car loans to mortgage loans. This pattern may be opposite of the ideal for facilitating debtors' financial recovery. Purchasing or refinancing a home is lauded as a wealth-building strategy,[209] yet after

[207] 11 U.S.C. § 727(a)(11).

[208] *See* Deborah Thorne & Katherine Porter, *Financial Education of Families in Bankruptcy*, __ J. of Consumer Ed. ___ (forthcoming 2007) (articulating how education needs of bankrupt families may differ from general population for financial education).

[209] Edward M. Gramlich, Governor of Federal reserve, Remarks at Home Ownership Summit of the Local Initiatives Support Corporation (Nov. 8, 2001), *available at*

bankruptcy this may be the most difficult credit transaction to complete. On the other hand, new empirical research suggests that credit cards, which are widely available after bankruptcy, may stimulate financial distress.[210] Current law does not attempt to influence these outcomes, perhaps due to a lack of prior research. The law could treat certain types of postbankruptcy debt differently in the event that a family experiences future hardship. While home mortgage debt already gets favorable treatment in Chapter 13 bankruptcy,[211] the law could create further distinctions. For example, credit card loans made in the immediate aftermath of prior bankruptcy could be subordinated to the obligations or barred from using wage garnishment as a collection tool. Alternatively, the law could prohibit credit solicitations for a cooling-off period after bankruptcy,[212] or give debtors a defense of suitability for loans made after bankruptcy without evidence that the debtor is likely to repay.[213] This Article's findings are alone insufficient, at least in my mind, to justify such reforms. Credit availability after bankruptcy could, in fact, be a powerful tool for helping families achieve financial well-being after bankruptcy.[214] These data may highlight the need for further longitudinal bankruptcy research.

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

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http://www.federalreserve.gov/boardDocs/speeches/2001/200111082/default.htm ("For a family, a home is generally its most significant asset and serves as its primary wealth-building vehicle.")

[210] *See* Mann, CHARGING AHEAD, *supra* 38, at 46-47; *cf.* Katherine Porter, *The Debt Dilemma,* __ MICH. L. REV. ___ (forthcoming 2008) (reviewing *Charging Ahead* and offering empirical data identifying complexity of relationship between cards and financial well-being).

[211] *See* 11 U.S.C. 1322(b)(2).

[212] Enzer et al., *supra* note 62, at 90 (reporting that the only suggestion specifically directed at the issue of postbankruptcy credit was a six-month prohibition on credit and that this was found to be "very undesirable" with problems of "feasibility" and "interference" with debtors' lives raised).

[213] *Cf.* Kathleen C. Engle & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1317-1366 (May 2002) (discussing government imposition of a suitability standard as a possible solution to the problem of predatory lending.)

[214] *Cf.* Pottow, *supra* note 6, at 418 (calling for careful development of policy prescriptions to focus specifically on "bad" credit rather than reduce the overall amount of credit).

Chapter 13 bankruptcy and attempt to repay some of their debts.[215] The postbankruptcy data reinforce the improbability that creditors' purpose in lobbying for bankruptcy reform was increasing Chapter 13 filings as a proportion of bankruptcy cases.[216] Creditors' own actions give over indebted consumers the opposite incentive—to choose Chapter 7 because it will afford them greater access to credit after bankruptcy. At least during the first years after filing, Chapter 13 debtors seem to have less credit access than Chapter 7 debtors and face legal obstacles to using credit. Additional research could illuminate whether Chapter 13 debtors do, in fact, have access to more affordable credit after completion of their Chapter 13 plans than Chapter 7 debtors. These findings could have important implications for bankruptcy professionals who counsel potential debtors based on unsupported perceptions about difference in credit availability by chapter. This Article's data suggest that families may be misled in thinking that Chapter 13 will improve their credit access, at least in the short term.[217] Policy efforts to encourage Chapter 13 need to consider postbankruptcy borrowing and how law could shift lenders' incentives to enhance the attractiveness of Chapter 13. Collectively, the findings reinforce the conclusion of Susan Block-Lieb and Edward Janger that "[i]t is senseless to look at consumers' incentives to borrow without also considering lenders' incentives to extend credit. Thus, consumer bankruptcy

[215] *See* 151 CONG. REC. H1993, H2053 (daily ed. Apr. 15, 2005) (statement of Rep. Goodlatte) ("The means test applies clear and well-defined standards to determine whether a debtor has the financial capability to pay his or her debts. The application of such objective standards will help ensure that the fresh start provisions of Chapter VII will be granted to those who need them, while debtors who can afford to repay some of their debts are steered toward filing Chapter 13 bankruptcies.")

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

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

law, and indeed all consumer law, should be crafted with an understanding of both sides of a consumer finance transaction."[218]

C. The Expense of Profit

The story of postbankruptcy credit has implications beyond bankruptcy. Recent bankruptcy debtors are an exemplar of financially vulnerable Americans. Confronting lenders' marketing to these families provokes consideration of the appropriate scope of lending to financial distressed individuals. Such transactions may generate profits for creditors but impose unacceptable costs on society and consumers.

Recent scholarship has posited that lending models no longer require full and timely repayment for profitability. John Pottow has observed that this profit model "turns the conventional paradigm of credit risk assessment on its head" and suggested some of these loans may be "reckless."[219] Families who do not repay quickly or in full are the most profitable customers for some lending products.[220] These creditors rely for profit principally on income from late fees, over the limit fees, and accumulating interest.[221] Ronald Mann has detailed this profit model in the context of debt-based credit card issuers.[222] Subprime mortgages and car loans may rely similarly on faltering repayment efforts to maximize profits; more research on these transactions is needed. Certainly, products targeted specifically at financially-strapped borrowers such as payday loans and auto-title loans rely heavily on fee revenue.[223] Ultimate

[218] *See* Block-Lieb & Janger, *supra* note 2, at 1556-57.

[219] Pottow, *supra* note 6, at 414.

[220] *Id.* at 414-17 (collecting research on profitability of possible or likely defaulting borrowers).

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

[222] Mann, *Sweat Box, supra* note 1.

[223] *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 U.C.L.A. L. REV. 855, 862 (2007) (noting that economics of payday lending revolves around standard fee per loan); Jean Ann Fox & Elizabeth Guy, *Driven into Debt*: *CFA Car Title Loan Store and Online Survey* (Nov. 2005) (describing fees for auto title loans); *see also*

repayment may not be necessary for a highly profitable transaction. Block-Lieb and Janger have observed that this profit model explains why rational lenders would have continued to expand consumer credit and reduce their lending standards even as bankruptcy filings increased.[224] Lost profit from charge-offs or bankruptcy discharges can be offset by delinquency-derived revenues. In this economic model, the higher bankruptcy rate is merely a consequence of different lending criterion.[225]

Postbankruptcy debtors are even better candidates for the debt "sweatbox" or "reckless loans" than prebankruptcy debtors. While the American Bankers Association's president has minimized credit card issuers' interest in having financially distressed customers,[226] a lending industry publication has described the "trick" in subprime lending as finding consumers who have "bottomed out" but is "looking to rebuild his life."[227] The reasons are easiest to understand in the context of credit cards but could apply equally to other loan products. These families have previously relied on cards (and on debt financing generally) so borrowing is part of the family's financial routine.[228] They likely have few to no cards (and perhaps have other cancelled loans) when marketing begins after bankruptcy so that postbankruptcy lenders increase

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*Berkley*, supra note 170, at 2 ("Most subprime lenders are relying on fees as a countermeasure" to consumers with "less than stellar credit").

[224] Block-Lieb & Janger, *supra* note 2, at 1488.

[225] *Id.*

[226] Frontline, *supra* note 114 (untelevised interview with Edward Yingling) *available at* http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/battle.html. ("You just can't build a long-term financial relationship with someone who mismanages their personal finances.") This statement is intriguing. First, it suggests that lenders may be seeking to maximize short-term profits from customers, dumping them if they fail to generate profits or generate significant losses. Second, the reference to mismanagement of personal finances is telling. If Mr. Yingling is correct, then the industry's interest in bankruptcy debtors must suggest that lenders do not see bankruptcy as evidence of a family's financial mismanagement but rather as the result of exogenous adverse financial events.

[227] Berkley, *supra* note 170, at 2. (quoting Alan Weinberg, "They said the trick in all this is to find the guy who has bottomed out and is looking to rebuild his life, to rebuild his credit and is on the way back. You don't want to be lending money to the guy who is still sliding down. . . . So in essence they said that they go to the people who are in the worst situations but yet have procured a job—they have now been gainfully employed for some period of time and have the wherewithal to stabilize their situation to be able to pay."

[228] Porter, *Debt Dilemma*, *supra* note 209, at ___ (providing data from 2001 Consumer Bankruptcy Project showing 91.44% of all debtors had at least one credit card debt when they filed bankruptcy).

the chances that their card gets used frequently rather than stored in a drawer with dozens of others.[229] Consumers may be particularly reluctant to switch lenders by transferring a balance (or refinancing a secured loans) for fears of adverse activity on their credit report. These families' desperation to rebuild credit after bankruptcy helps lenders avoid the "switching" consequence of raising fees.[230] Families may also believe that postbankruptcy credit options are uniformly expensive and fail to shop.[231] Thus, unlike with nonbankrupt consumers a "great new rate of 18%" may actually lure in customers.[232] Finally, postbankruptcy families cannot discharge their debts in bankruptcy for a period of years, reducing one source of loss for lenders.

With the exception of the latter limitation on bankruptcy discharge, former bankrupts face financial circumstances similar to those of other populations who have attracted concern about undesirable credit marketing. Several researchers have advocated for restrictions on credit solicitations aimed at college students.[233] Like postbankruptcy debtors,[234] college students earn low incomes but are anticipating higher incomes and improved financial circumstances in the future. Thus, they may be attracted to borrowing to smooth consumption in anticipation of a better future. Yet, many people will overestimate their future prospects and ability to service

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

[230] This response of an elderly woman from Texas to her experience with credit cards after bankruptcy is illustrative of how debtors deal with cards after bankruptcy. "I accepted one credit card to re-establish my credit. I've been offered a number of offers, but I'm leery of credit; I have been for a long, long time." Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, TX-07-101. A married man in his 30s said that his family had accepted one new credit card from Capital One after bankruptcy. He explained his reasoning as follows: "It has a low limit—only $300. I got it to re-establish myself. I'm trying to pay as much as I can [on the balance] and make sure it's on time." Consumer Bankruptcy Project III, Respondent Interview One-Year Postbankruptcy, TX-07-100.

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

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

[233] MANN, CHARGING AHEAD, *supra* note 38, at 158.

[234] Porter & Thorne, *supra* note 57, at 95-96.

debt.[235] Similarly to postbankruptcy debtors, college students also have few existing credit obligations compared to typical Americans, allowing an early lender to enjoy a sustained period of profitability. College students and postbankruptcy debtors both face difficulty in meeting bills without borrowing. The credit industry's intense marketing to postbankruptcy families parallels their efforts to lure other vulnerable borrowers into lending relationships. Because bankruptcy is a public process, recent bankruptcy debtors offer a useful group to study to understand creditors' strategies for profiting from financially vulnerable consumers.

If lenders' intense solicitation of such customers indeed is drive by these families' propensity to pay late, go over the limit, and revolve large balances, society may wish to prohibit or constrain such lending.[236] Lending strategies that profit from financial distress may be suboptimal because they force society to bear the costs of such distress.[237] As Ronald Mann has observed in another context, "lender's incentives differ from the ideal incentives just as much as the borrower's incentives do."[238] Concern about the externalities of financial distress could motivate policymaking designed to deter lending opportunism by shifting these costs to creditors.

## CONCLUSION

Consumer credit policies and bankruptcy law affect the well-being of millions of American families. In the face of assumptions, theories, and lobbying rhetoric, empirical research reveals the real world consequences of policymaking. This Article's findings on

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

[236] Pottow, *supra* note 6, at 455 ("Much hand wringing occurred in Congress regarding the death of personal responsibility that practically made bankruptcy reform a moral imperative . . . there was no concomitant call for personal responsibility of lenders.") (internal citations omitted).

[237] *Id.* at 412-13 (summarizing likely externalities but noting that evidence is more "intuitive than empirical at this juncture.")

[238] Mann, *Secured Credit, supra* note 1, at 683, n. 89.

postbankruptcy credit highlight the shortcomings of debtor-oriented debate about consumer credit and bankruptcy. Efforts to lure recent bankruptcy debtors to borrow after bankruptcy belie creditors' characterizations of these families as immoral strategic actors. Rather than eschewing them as profligates, the lending industry treats families who seek bankruptcy relief as a lucrative source for profits. The widespread marketing to families after bankruptcy provides a powerful example of the credit industry's willingness and ability to profit from financially distressed and vulnerable consumers. The law shapes creditors' marketing and lending decisions to recently bankrupt families, but this effect was hidden during the past decade of bankruptcy reform. Understanding lenders' incentives in the current credit market yields useful ideas on how bankruptcy and other consumer law can improve credit policy and reduce the collective harms of financial distress.