

## BANKRUPTCY BY THE NUMBERS

### ESTIMATING MEANS-TESTED CHAPTER 13 CASE YIELDS FROM CURRENT CHAPTER 13 PERFORMANCE

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Some researchers have estimated that current chapter 7 debtors could contribute from \$3 billion to \$5.1 billion annually in payment of unsecured debt if required to file chapter 13. (We will call such debtors "means-tested chapter 13 debtors") These estimates became controversial when other researchers estimated the available annual yield to be under \$1 billion.<sup>2/</sup>

Numbers in the billions are hard for most of us to work with, so it helps to have some simple yardsticks. Basically, any estimate of the potential yield to unsecured creditors comes down to the product of two numbers-- the number of debtors who would be means tested into chapter 13, and the average amount they would pay to their unsecured creditors. The product of these two numbers must equal \$3 billion to reach the lower range of the estimates in the higher yield studies, whether this means that the system has 3,000 debtors each paying an average of \$1 million, or 1 million debtors each paying \$3,000, or something in between these extremes.

In last month's column we reported that during the 12 months ending September 30, 1998, chapter 13 estates returned approximately \$540 million to unsecured creditors.<sup>3/</sup> More than five times this amount would be needed from the means-tested cases to raise \$3 billion per year. In this column we use this information and a few key

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<sup>1/</sup>The opinions expressed here are those of the authors and do not necessarily reflect the positions of the U.S. Trustees or the Department of Justice.

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See for example General Accounting Office, Personal Bankruptcy: Analysis of Four Reports on Chapter 7 Debtors' Ability to Pay. GAO/GGD-99-103 (June, 1999), & Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay. Michael Staten & John Barron, Credit Research Center, (Oct. 1997).

<sup>3/</sup>This amount does not include contributions from Alabama and North Carolina, which are not served by the U.S. Trustee Program. Both of these states have very active chapter 13 practices, however, which presumably make substantial contributions back to unsecured creditors.

assumptions to answer the following question: is there any conceivable scenario that would generate the return to unsecured creditors that has been promised by some advocates of means testing? We conclude that there is not.

**AVERAGE PAYMENT PER CASE:** As noted above, during FY 1998 approximately 1 million chapter 13 debtors repaid \$540 million in unsecured debt: thus the average yield per debtor was about \$540. This number represents the average paid through any chapter 13 case that was open during the year. Our estimate of the average payment to unsecured creditors over the life of a chapter 13 case is \$1,618.<sup>4/</sup> If we assume that means-tested chapter 13 debtors would provide the same average yield, it would require approximately 1.85 million debtors per year to return \$3 billion. This is approximately twice the number of chapter 7 cases that are now filed nationwide per year.

However, we know that, in general, the debt profiles of chapter 7 debtors are more highly loaded with unsecured debt, and that a lower percentage of chapter 7 debtors have secured and priority debts listed in their schedules.<sup>5/</sup> We might reasonably relax the first assumption, therefore, and let the payments to unsecured creditors by means-tested chapter 13 debtors hypothetically increase to 2, 3, or even 5 times the yield from current chapter 13 debtors. If we assume (rather optimistically) that the return will be 5 times as high, the average yield to unsecured creditors will be approximately \$8,090 per case. To raise \$3 billion per year would require about 370,000 cases per year, about 40% of current chapter 7 filings.

**NUMBER OF MEANS TESTED DEBTORS:** No one has suggested that 40% of current chapter 7 debtors would be forced into chapter 13 under means testing. The estimates have ranged between 3.6% and 15%, assuming no pre-bankruptcy planning by debtors. Less than 20% of current chapter 7 debtors exceed the various income thresholds in H.R. 833 and S. 625. A high proportion of these debtors would remain eligible for chapter 7 after an expense analysis. Based on our research, we can see no scenario in which even 10% of debtors would be means-tested into chapter 13. In fact, we feel that even an estimate of 5% of current chapter 7 debtors being means-tested into chapter 13 would be optimistic.

If we assume that 10% of present chapter 7 debtors are forced into chapter 13, the average payment to unsecured creditors per case would have to be \$32,360 to raise \$3 billion—20 times the current chapter 13 per case average. This figure increases to 40 times the chapter 13

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<sup>4/</sup> We make this rough estimate by dividing total payments to unsecured creditors in 1998 by average annual filings between 1995 and 1999. Both figures in this equation do not include cases or receipts for chapter 13 cases in Alabama and North Carolina.

<sup>5/</sup>Staten & Barron, *supra* n.2.

case average if the number of means-tested cases is assumed to be 5%.

Clearly, there is something wrong here. It is rather unrealistic to posit that any bankruptcy system is going to generate enough debtors paying enough money to unsecured creditors to generate \$3 billion per year. Whatever may be the virtues of means-testing and essentially mandatory chapter 13 cases, there is little hope that they will generate several billion dollars or more per year in payments to unsecured creditors.