BANKRUPTCY BY THE NUMBERS

BY: ED FLYNN **Executive Office for United States Trustees**[1]
& GORDON BERMANT **Burke, Virginia**

MEANS-TESTING: LESSONS LEARNED FROM A SINGLE CASE

As the bankruptcy community awaits the outcome of negotiations on H.R. 833 and S. 625, we continue to consider the issues arising under the legislation's consumer provisions, in particular the means-testing formulas. Here we begin with a brief background statement that puts some of the issues in broad perspective, then move to the lessons that can be learned from examining a single case in detail.

All of the consumer bankruptcy studies that have been published in the past two years have been criticized for their sampling techniques or extent of distribution: not enough districts, not enough cases, seasonal bias, large city bias, over-sampling, over-weighting, proprietary data, and so on.[2] Nevertheless, all of the studies paint quite similar pictures of chapter 7 debtors in respect to their assets, debts, incomes, and expenses as these are reported on the official schedules. Thus, despite the differences among the studies and the criticisms leveled against them, the studies have converged upon a stable portrait of the basic financial characteristics of chapter 7 debtors.

The studies diverge sharply, however, when their authors use the relatively stable basic numbers to calculate disposable income and the proportion of it that higher-income debtors would be able to repay to their unsecured creditors under various means testing proposals. This is because the terms of the means tests, based on standards promulgated by the IRS for their own purposes, are subject to legitimate differences of interpretation and need to be supplemented by judgment calls during the calculations. Moreover, because the data, though relatively stable, are not methodologically immaculate, everyone can claim that the conclusions reached by others arise in part or whole from flaws in the others' data rather than

---

[1] All views expressed in this article are those of the authors, and do not necessarily represent the views of the Executive Office for United States Trustees.

[2] 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)

from different judgments about how expenses should be calculated.

Given the enormous volume of work involved, means testing must rest on the ability of the system to separate chapter 7-eligible debtors from debtors who should be required to file in chapter 13 if they wish bankruptcy protection. Because the first prong of all the tests proposed so far measures gross income corrected for family size, and gross income and family size are *relatively* stable and accurate numbers in the schedules, this first prong of the test is relatively uncontroversial. All studies agree that at least 75% of all filers would be eligible for chapter 7 based on these calculations. However, problems may arise when the next prong of the test, estimating disposable income, is undertaken. Our opinion on this matter is based on a review of a cases from a set of 3,500 no-asset chapter 7 filings drawn from all 84 districts served by the United States Trustee Program during the past two years.

Consider the information contained in a single petition in our sample. (Although this petition is certainly not reflective of the "average" debtor, it does illustrate some of the common problems that are present in many chapter 7 cases now being filed.) The basic figures are as follows:

SEX:	**MALE**	
MARITAL STATUS:	**DIVORCED**	
GROSS MONTHLY INCOME:	**$4,587**	(*includes $400/month rent from roommate*)
DEPENDENTS:	**0**	*(The debtor lists 2 minor children on Schedule I, but he also lists $400 per month for child support on Schedule J and his food expenses are very low ($200 per month), so it is likely that the children do not reside with the debtor.)*
REAL PROPERTY C.M.V.	**$68,000**	(mortgage owed $102,806)
PERSONAL PROPERTY:	**$23,000**	($18,000 is for a 1996 pickup truck)
PRIORITY DEBT:	**$9,600**	(back child support)
UNSECURED DEBT:	**$106,000**[3]	
including:	$79,000	on 13 credit cards
	$12,000	in bank & credit union loans
	$13,000	legal fees and personal judgment
	$2,000	other unsecured debts

At first glance, this debtor appears to be a strong chapter 13 candidate--able to repay some or all of his unsecured debt. His gross monthly income is about $2,000 above the national median for one earner households ($2,481). In fact, his income is in the upper three

[3]Additionally, the debtor lists as "unknown" 24 medical debts, 3 accident claims, one insurance debt, and one debt for legal fees.

percent of all single debtors in the cases we have reviewed.

The second prong of means testing analyzes allowable expenses using the IRS Guidelines. Following is a listing of monthly expenses that would be allowable for this debtor under means testing:

ALLOWABLE MONTHLY EXPENSES

- CHILD SUPPORT PAYMENTS	**$400**
- TAXES & PAYROLL DEDUCTIONS	**$1,354**
- HOME MORTGAGE	**$1,928**[4]
- UTILITIES & HOME MAINTENANCE	**$300**
- CAR PAYMENT	**$492**
- CAR TAXES	**$50**
- IRS FOOD ALLOWANCE	**$761**[5]
- IRS TRANSPORTATION (OPERATING COSTS)	**$250**
- BACK CHILD SUPPORT ($9,600/60)	**$160**
TOTAL ALLOWABLE EXPENSES ------>	**$5,695**

The expense analysis reveals that this debtor would remain eligible for Chapter 7 under the means testing proposals in both H.R. 833 and S. 625. In fact, it wouldn’t even be a close call. Tithing by the debtor, private schools for his children, and other possible expenses could raise his allowable expense level to over $7,000 or $8,000 per month.

In contrast, a debtor with the same income who rented instead of owned, who drove an older vehicle or took public transportation, and who was current on his child support obligations, would have over $600 per month in available income to fund a chapter 13 plan.

Unfortunately, a few pieces of financial data do not provide a full picture of a debtor’s past, present, and likely future financial condition. For example, based on the information contained in his schedules and statement of affairs, our selected debtor also has a foreclosure suit pending on his home, is subject to pending criminal charges by the state, is in a custody battle with his ex-wife, and has a wrongful discharge suit pending against a former employer. He was in an auto accident in 1996 in which his children were injured; his

---

[4]The debtor lists a monthly mortgage of $1,928. This seems quite high for a mortgage of under $103,000 (and for which the underlying property has a market value of $68,000).

[5]If the debtor did not have a roommate paying $400/month rent, his monthly food allowance would fall from $761 to $612. The IRS food allowances are based on gross income, and the rental income puts this debtor into a higher food allowance category.

home was burglarized in 1997; and he reports that a tree fell through his roof in 1998. Additionally, his gross monthly income has fallen by about $1,000 since 1996.

Even after close review of this debtor's petition, it is not clear how much unsecured debt he owes, how many dependents he has, the true value of his home, or why his mortgage payment is so high relative to the market value of his home. Further, the debtor's financial future is quite uncertain, as the outcomes of the civil and criminal actions that he is a party to will all affect his income, expenses, and debts. Based on the information contained in his petition, we really don't know if this debtor is honest or dishonest, or whether he has been unlucky or reckless in his behavior.

Not all observers would agree on whether this debtor should be allowed to file under chapter 7. This case shows that applying the means testing criteria in individual cases will often be problematic, because debtors' financial affairs are not as transparent as one might wish they were.