

# A look back and outlook ahead on the Chapter 7 landscape

By David Watkins, *Stretto*, and Heide Kurtz, *Chapter 7 Panel of Trustees*

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The Chapter 7 landscape has changed dramatically over the years, and it continues to transform in today's evolving economic and legal environment. As we look back at key milestones during the past few decades and at present trends, trustees, legal practitioners and their debtors can derive clues as to what's on the horizon for Chapter 7.

Before looking ahead, a look back at the origins of the Chapter 7 bankruptcy system accentuates how it has transformed to meet the changing needs of debtors, creditors and the court system — and how it has been dramatically influenced by economic cycles and financial events.

## BANKRUPTCY: A BRIEF HISTORY

Bankruptcy dates back to long before the U.S. federal bankruptcy system was created. The country's first bankruptcy provisions were outlined in the U.S. Constitution in Article 1, Section 8, which gave Congress the power to "establish ... uniform Laws on the subject of Bankruptcies throughout the United States."

While Congress did not immediately create such laws, many states established bankruptcy systems governing their own debtors. Those systems generally favored creditors and sometimes even allowed for debtor imprisonment.

During the 1800s, Congress passed several federal laws pertaining to bankruptcy. It began with the Bankruptcy Act of 1800, which was limited to allowing involuntary bankruptcies for merchant debtors. The law was repealed after complaints that the process it created was rife with favoritism and corruption.

The Bankruptcy Act of 1841 for the first time provided a way for debtors to file voluntary bankruptcies and discharge debt. Under this act, Abraham Lincoln handled 77 bankruptcy cases, and at the time his firm was among the largest in Illinois.<sup>1</sup> The law was later repealed due to concerns that it was too debtor-friendly.

Two decades later, Congress passed the Bankruptcy Act of 1867, which was the first to permit involuntary bankruptcies for any individual, rather than just merchants. It also failed, due to complaints similar to those raised regarding previous federal bankruptcy laws.

Finally, Congress passed a national bankruptcy law that prevailed: the Bankruptcy Act of 1898. While it has been amended and

reworked over the years, it has remained the foundation of today's U.S. bankruptcy system.

The Bankruptcy Reform Act of 1978 instituted broad changes to the U.S. bankruptcy system and created the "Bankruptcy Code." Among its changes, it increased the power of bankruptcy judges and led to the creation of the U.S. Trustee system. This was a pivotal moment for the Chapter 7 process as it required uniform and standardized reporting from trustees regarding debtors for the first time.

It also increased the scope of authority for bankruptcy judges and did away with the role of the bankruptcy referee, which previously was a federal office appointed by U.S. district courts to oversee and administer bankruptcy proceedings.

The Bankruptcy Reform Act of 1978 also created new reporting requirements that entailed potentially hundreds of pages of forms to be completed and submitted for a single case.

For trustees, this created a tremendous amount of work. Software providers applied technology to help trustees with new reporting requirements mandated by the U.S. Trustee and to manage the process of interviewing debtors at the required meeting of creditors, known as the 341 meeting.

For trustees and their clients, this greatly facilitated and alleviated these new burdens and the high volume of paperwork involved in each case.

## BAPCPA'S IMPACT ON CONSUMER BANKRUPTCY

Three decades later, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, or BAPCPA, was enacted with the goal of reforming the bankruptcy system. This was a pivotal moment for the consumer bankruptcy process.

Among other provisions, it created the means test to determine whether individual debtors should file Chapter 7 or Chapter 13 depending on their income and expenses. It also mandated credit counseling and debtor education for individuals filing bankruptcy.

These and other developments significantly expanded the responsibilities of trustees, requiring them to administer the new requirements on top of their existing responsibilities for the same fee of \$60 per case.



In addition, the 2005 act required trustees to collect past tax returns and even track down the ex-spouses of divorced debtors to notify them of their bankruptcy filings.

Perhaps the greatest immediate impact of BAPCPA could be seen in the filing trends prior to and following its enactment. Consumer bankruptcy filings skyrocketed just before its enactment, followed by a sharp drop-off in filings afterward. In anticipation of BAPCPA's enactment, debtors and their advisors rushed to file for bankruptcy to avoid the added burdens, costs and complexity of the process under BAPCPA.

In retrospect, industry analysts have mixed views of the value of BAPCPA. Based on available data, it seems clear that BAPCPA has decreased the number of consumer bankruptcy filings. That may or may not be a favorable outcome, depending on the point of view.

Some feel that BAPCPA made Chapter 7 bankruptcy protection inaccessible for millions of deserving debtors who could have benefited from the process, as it inherently directed many debtors toward Chapter 13 bankruptcy protection instead of Chapter 7.

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Many professionals assert that Chapter 7 is often more appropriate, despite the fact that is a liquidation proceeding, because it offers debtors a better outcome given the higher failure rate of Chapter 13 bankruptcies. Others feel that the lower number of consumer bankruptcy filings overall is evidence that the reform achieved its goal of reducing abuse of the system.

Regardless of the point of view, one thing is clear: Chapter 7 bankruptcy has never been quite the same following BAPCPA's enactment, and its changes created new challenges.

As debtors, trustees and their involved professionals and parties adapt, new technology solutions and service providers have emerged to ease the burdens of the process.

### THE ROLE OF TECHNOLOGY

The growing requirements imposed on debtors, trustees and other parties engaged in the Chapter 7 process have given rise to the emergence and growth of software and technology solutions to help manage and comply with them.

The prospect of filling out hundreds of pages of petitions and schedules, preparing and filing reports for each debtor, and then managing all the associated data on an ongoing basis is daunting. However, software providers have devised systems that enable trustees to manage the debtors' forms, reporting, data and other administrative matters all from one

dashboard, making onerous tasks less burdensome for all involved.

As electronic case filing emerged with Case Management/Electronic Case Files, or CM/ECF, followed by the introduction of the Public Access to Court Electronic Records, or PACER, bankruptcy technology providers came to the rescue once again.

Prior to the early 2000s, trustees were provided with paper copies of the petitions and schedules. A trustee with, for example, a 50-case meeting of creditors would have 50 documents of perhaps hundreds of pages to review and take to the meeting. As the internet evolved, these documents were stored on the court's website and PACER was created to grant access to these documents and eliminate the need for paper.

This system provided numerous benefits to bankruptcy professionals, but the task of retrieving documents one at a time proved extremely burdensome to the trustees now required to get their documents electronically. Hours per week were added to the trustees' administrative burden.

To address these challenges, bankruptcy technology partners created a national system that explored each bankruptcy court via PACER, retrieved appropriate bankruptcy documents and provided them to the trustees.

Today, technology remains foundational to the Chapter 7 bankruptcy community, particularly for trustees. Without it, they would not be able to fulfill their responsibilities.

There are four key areas in which technology has become integral to the process: portability, security, access to information and automation.

The need for portability has been a major driver for technology solutions to support the Chapter 7 process. With the fluctuation of bankruptcy filings, law offices increasingly have outsourced administrative work to teams working outside the office who need remote access to the information.

With greater portability comes the potential for data exposure. For this reason, keeping debtor and trustee information confidential and secure has become another top priority.

As bankruptcy trustees are appointed and overseen by the court, their data systems must comply with the Federal Risk and Authorization Management Program, or FedRAMP, a government program providing a standardized approach to security assessment, authorization and monitoring for cloud-based services and products. Bankruptcy software providers are able to safeguard data using the latest technology available and maintain compliance with these government and judicial regulations.

With the increased burdens on trustees, the need for access to real-time information also has become more important than ever.

This is reflected in the features available through certain bankruptcy software providers. For example, trustees can get a real-time appraisal of the debtor's property through integrated software platforms that give them access to online data sources, such as Zillow and others, in the same dashboard where they manage other debtor information.

Technology has also enabled the automation of time-consuming procedures and tasks associated with the bankruptcy process.

Looking ahead, automation and the emergence of artificial intelligence hold tremendous promise for future advances in how bankruptcy trustees can access and manage necessary data in their cases. Leading software providers are applying artificial intelligence in new ways that can lead to greater efficiencies in how trustees identify, collect and process information. This software can also offer predictive insights into the profile of new cases.

In doing so, trustees and their teams will be able to focus more attention on substantive matters rather than the mundane task of reviewing documents and collecting data from them.

## CHAPTER 7 FILING TRENDS

Chapter 7 has been regarded as a "fresh start" bankruptcy and most often used by cash-strapped debtors to resolve their debt obligations.

The number of consumer bankruptcy filings has fluctuated over the years but has generally remained high even in more economically prosperous times. However, over the past decade, consumer filings have been dropping.

According to a recent report from Chief Justice John Roberts, bankruptcy filings are at a 10-year low.<sup>2</sup> Bankruptcy experts attribute this downward trend to a range of factors.

Some ascribe the gradual decline to BAPCPA's more restrictive provisions and resulting higher costs for consumer filings. With the additional burdens upon lawyers to fulfill BAPCPA's requirements, they are forced to charge more to debtors, who do not have access to the funds needed to undergo the bankruptcy process.

Others attribute the drop in filings to a strong stock market and the more limited ability of Americans to obtain credit.

However, others observe that bankruptcy filings do not necessarily correlate with the health of the economy. For example, during the 1990s when the economy was strong, filings were on the rise.

Instead, some see bankruptcy filings as being linked to an individual consumer's debt-to-income ratio. As many households today are able to more easily pay off their debt than they were during the recession, filings have dropped.

Another factor driving down bankruptcy filings, according to some experts, is the student loan crisis. While it is estimated

that Americans owe \$1.5 trillion in student loan debt, they are not able to discharge this debt under bankruptcy because it is challenging to prove repayment would cause "undue hardship" under the BAPCPA's provisions and requirements. As a result, they are not filing bankruptcy to resolve these debt obligations.

However, new legislation is on the table that may change this. The Student Borrower Bankruptcy Relief Act of 2019, S. 1414, recently introduced into Congress, would, if passed, amend the Bankruptcy Code to provide bankruptcy relief for student borrowers.<sup>3</sup>

The housing crisis that resulted from the Great Recession also changed the profile of Chapter 7 filings from the trustee perspective.

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When the housing market crashed and revealed that homeowners were underwater with their mortgages, trustees faced new challenges in trying to recover value from homes as an asset. While housing exemptions for debtors vary from state to state, more debtors were likely to be able to hold on to their homes, leaving fewer assets for the trustee to recover for the estate.

While the housing market has recovered, the number of Chapter 7 cases with homes as eligible assets has remained lower than it was prior to the market crash. Furthermore, many states have increased the amount that debtors may claim as property exemptions, often making their homes ineligible as assets that can be recovered by trustees.

## WHAT'S ON THE HORIZON FOR CHAPTER 7?

Economic indicators signal that a recession may be likely in the coming years, which may lead to an increase not only in consumer Chapter 7 filings, but also in corporate Chapter 7 liquidations. And with the potential for new legislation allowing student loan debtors to shed their debt obligations under bankruptcy, there may also be a future uptick in filings among the 45 million student borrowers in the U.S. today.<sup>4</sup>

But while legal practitioners engaged in Chapter 7 proceedings have encountered challenges and changes over the years, there are signs showing some promise that trustees and other professionals can make the process less onerous.

As trustees who transitioned from paper-laden processes to bankruptcy software systems retire, a new generation

of trustees — one with a solid grasp on the emerging technology tools and resources that can make the job easier — is emerging. As leading software providers continue to introduce advances in artificial intelligence, technology will play an increasing role in helping to ease administrative burdens.

While the Chapter 7 process will undoubtedly continue to evolve, it maintains its position as a safety net for millions of individual and corporate debtors to manage and resolve their debt obligations — and will prevail as long as there are debtors in need of a fresh start.

### NOTES

<sup>1</sup> “Who Are Bankruptcy Judges and How Did They Become Federal Judges?” <https://bit.ly/2m5peBW>.

<sup>2</sup> “Bankruptcy filings are at a 10-year low, but not for the reasons you might think,” <https://on.mktw.net/2sgrBz>.

<sup>3</sup> “Warren Bill to Forgive Student Loan Debt Coming Soon,” <https://bit.ly/2m5SLLI>.

<sup>4</sup> *Id.*

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### ABOUT THE AUTHORS



**David Watkins** (L) is vice chairman emeritus of **Stretto** (formerly Bankruptcy Management Solutions/BMS) in Irvine, California, which serves

the consumer bankruptcy and corporate restructuring industries. **Heide Kurtz** (R) has served as a bankruptcy trustee since 1995 on the **Chapter 7 Panel of Trustees** in San Pedro, California, covering the Central District of California.

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