

NOTES

OPPORTUNISTIC INFORMAL BANKRUPTCY: HOW BAPCPA MAY FAIL TO MAKE WEALTHY DEBTORS PAY UP

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Bankruptcy is not the most common recourse for individuals deeply in debt; it is merely the most well known. Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) in part to close state law exemption loopholes that allowed wealthy individuals, or “opportunistic debtors,” to declare bankruptcy and emerge with their debts discharged and their assets intact. Yet BAPCPA does not reach the more popular practice of informal bankruptcy, through which insolvent debtors avoid paying off their debts despite not filing for bankruptcy because creditors find it too costly to collect under state law. Although traditionally only poorer debtors used informal bankruptcy, BAPCPA will encourage opportunistic debtors to adopt this tactic as well, because the exemption loopholes the Act targets remain open under state law. Consequently, BAPCPA will fail to curb bankruptcy abuse. The Act might drive opportunistic debtors away from formal bankruptcy, but it cannot make them pay their debts. This Note proposes that courts close this informal bankruptcy loophole by relaxing the judicially created restrictions on involuntary bankruptcy, making it easier for creditors to force opportunistic debtors into formal bankruptcy.

INTRODUCTION

Everyone just assumed O.J. Simpson would file for bankruptcy.¹ Burdened by a huge civil judgment for the wrongful deaths of his ex-wife and Ronald Goldman,² Simpson moved to Florida, bought an expensive house, and dared the Goldmans to collect on their judgment.³ Most figured that Simpson would soon declare bankruptcy and use Florida’s un-

1. See, e.g., Howard Madris, Dismissing O.J.: Will a Court Allow Simpson to Go Bankrupt?, L.A. Daily J., Feb. 10, 1997, at 7 (“Bankruptcy court may likely be the next legal forum for O.J. Simpson.”).

2. See Associated Press, Appellate Court Rules Against O.J. Simpson, N.Y. Times, Jan. 27, 2001, at A9 (noting that Simpson faced \$33.5 million wrongful death judgment).

3. See Bankruptcy Reform: Hearing Before the S. Comm. on the Judiciary, 109th Cong. (2005) (statement of Elizabeth Warren, Professor of Law, Harvard Law School), at http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3996 (on file with the *Columbia Law Review*) (“After he lost a \$33 million dollar lawsuit in California, O.J. Simpson moved to Florida, explaining to a reporter that the unlimited exemption would permit him to protect a multimillion-dollar house.”).

limited homestead exemption⁴ to shield most of his assets from the Goldmans.⁵

As it turns out, federal bankruptcy law would have denied Simpson a discharge of his debts.⁶ Therefore, Simpson did not file for bankruptcy, which forced the Goldmans to attempt collection in Florida state court.⁷ Florida's generous homestead exemption, however, allows Simpson to protect any equity in his home from creditor reach, and the exemption applies even outside of bankruptcy.⁸ Simpson thus simply placed all of his assets in property exempted by Florida state law; to this day, the Goldman family has collected virtually nothing on their judgment.⁹ In the end, the Simpson saga has demonstrated that denying wealthy debtors an unlimited homestead exemption in bankruptcy proceedings does not always mean that creditors will get the house.

Concerned about perceived abuses of the bankruptcy system,¹⁰ and

4. Roughly speaking, an unlimited homestead exemption provides that unsecured creditors may not reach any equity a debtor has in her home, no matter how valuable the property. See, e.g., Fla. Const. art. X, § 4(a). Homestead exemptions are discussed in detail *infra* Part I.A.2.

5. See S.C. Gwynne & Elaine Lafferty, *Is O.J. Really Broke?*, Time, Feb. 3, 1997, at 44–45 (stating that if Simpson declares bankruptcy, “most of his \$3 million-plus net worth would be protected”); Todd Zywicki, *Bankrupt Criticisms*, National Review Online, Mar. 15, 2005, at <http://www.nationalreview.com/comment/zywicki200503150744.asp> (on file with the *Columbia Law Review*) [hereinafter Zywicki, *Bankrupt Criticisms*] (arguing that before 2005 bankruptcy reform act, see *infra* note 12 and accompanying text, O.J. Simpson could use Florida's unlimited homestead exemption and “thereby avoid seizure of his mansion”).

6. See 11 U.S.C.A. § 523(a)(6) (West 2007) (prohibiting discharge of debts created by “willful and malicious injury”). Bankruptcy also likely would not have rid Simpson of his obligation to pay the Goldmans punitive damages. See *Cohen v. De la Cruz*, 523 U.S. 213, 218 (1998) (holding that punitive damages, at least when awarded based on debtor's fraud, are not dischargeable through bankruptcy).

7. Cf. Dan Whitcomb, *Judge May Dismiss O.J. Simpson Book Lawsuit*, Reuters, Jan. 24, 2007, at http://news.yahoo.com/s/nm/20070124/people_nm/simpson_lawsuit_dc (on file with the *Columbia Law Review*) (reporting judge's probable dismissal of Goldman suit seeking collection of money paid to Simpson for his book *If I Did It* because “jurisdiction is in the state courts of Florida”).

8. See Fla. Const. art. X, § 4(a) (exempting homestead “from forced sale under process of *any* court” (emphasis added)).

9. See Melissa Jacoby, OJ, Rights of Publicity, and Debtor-Creditor Relationships, *Credit Slips: A Discussion on Credit and Bankruptcy*, Sept. 6, 2006, at <http://www.creditslips.org/creditslips/JacobyAuthor.html> (on file with the *Columbia Law Review*) (noting that Goldman family had asked for O.J.'s right to publicity in effort to collect from Simpson “because Simpson has never paid out on the multi-million dollar wrongful death claim”).

10. See, e.g., George W. Bush, *Remarks on Signing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 41 Weekly Comp. Pres. Doc. 641, 642 (Apr. 25, 2005) (“In recent years, too many people have abused the bankruptcy laws. They've walked away from debts even when they had the ability to repay them. This has made credit less affordable and less accessible The bill I sign today helps address this problem.”).

driven by intense lobbying from creditor groups,¹¹ Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).¹² BAPCPA was intended to close the loopholes that allowed wealthy individuals (or “opportunistic debtors”) to file for bankruptcy and emerge with their debts discharged and their assets intact—in short, it attempted to prevent future O.J. Simpsons from using bankruptcy to avoid paying their debts.¹³ Chief among these targeted loopholes were the large and sometimes unlimited exemptions on personal homesteads offered in several states; creditors cannot access or force the sale of exempt assets.¹⁴ In states with large or unlimited homestead exemptions, opportunistic debtors could place all their assets in a lavish home, placing them out of creditors’ reach.¹⁵ BAPCPA, however, has been almost universally criticized by academics,¹⁶ consumer bankruptcy attorneys,¹⁷ and

11. See, e.g., Charles J. Tabb, *Consumer Bankruptcy After the Fall: United States Law Under S. 256*, 43 *Can. Bus. L.J.* 28, 32–35 (2006) [hereinafter Tabb, *After the Fall*] (“[The credit] industry waged an almost ceaseless battle to reshape consumer bankruptcy . . . until achieving victory in April 2005.”).

12. Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.).

13. See, e.g., H.R. Rep. No. 109-31, pt. 1, at 15–16 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 102 (“[BAPCPA] also restricts the so-called ‘mansion loophole.’ Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. . . . [S]ome debtors actually relocate to these states just to take advantage of their ‘mansion loophole’ laws.”).

14. See Richard H.W. Maloy, “She’ll Be Able to Keep Her Home Won’t She?”—The Plight of a Homeowner in Bankruptcy, 2003 *Mich. St. L. Rev.* 315, 325–28 (explaining exemptions and noting that “exempted property may not be forcibly sold by creditors”).

15. See Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 *Wash. & Lee L. Rev.* 1071, 1087–88 (2005) (“Some cases involving homestead exemptions have been quite egregious, allowing debtors to pour massive amounts of wealth into a homestead exempt in bankruptcy, often on the eve of bankruptcy.”).

16. See, e.g., Jean Braucher, *A Fresh Start for Personal Bankruptcy Reform: The Need for Simplification and a Single Portal*, 55 *Am. U. L. Rev.* 1295, 1296 (2006) (“If it were possible to file for the bankruptcy of a legislative ‘reform,’ a leading candidate for the first case would be the 2005 bankruptcy legislation.”); Tabb, *After the Fall*, *supra* note 11, at 69 (“The well-funded creditor lobby won. Individual consumer debtors lost. . . . Now we may have the worst of both worlds—little social welfare, and weakened bankruptcy protection.”); Letter from Richard I. Aaron et al. to Sens. Arlen Specter & Patrick Leahy (Feb. 16, 2005), available at <http://www.abiworld.org/pdfs/LawProfsLetter.pdf> (on file with the *Columbia Law Review*) (letter signed by ninety-two bankruptcy and commercial law professors criticizing BAPCPA before its enactment).

17. See, e.g., Jennifer Emens-Butler, *Bankruptcy Reform: Gather ‘Round Children, Yes, the Sky IS Falling*, *Vt. B.J.*, Spring 2005, at 26, 26 (“[N]o established group of attorneys, including the American Bar Association, judges, law professors, bankruptcy practitioners, women, or consumer advocates supported the bill.” (footnote omitted)); Jennifer A. Smith, *Newly Enacted Bankruptcy Law: Bad News for Debtors, Good News for Creditors?*, *Nev. Law.*, June 2005, at 12, 12 (“Hailed by the banking and credit card industries, the Act will make it more difficult for individuals to discharge debt and easier for creditors to protect and pursue their rights. . . . The Act imposes onerous burdens on debtors’ lawyers . . .”).

even judges.¹⁸ Most of these critiques have alleged shoddy legislative drafting and harm to honest debtors, the latter under the belief that in an attempt to drive wealthy individuals away from bankruptcy, Congress has also closed bankruptcy relief to many individuals facing genuine financial hardship (or “nonopportunistic debtors”).¹⁹

Yet all these criticisms of BAPCPA overlook a striking weakness in the Act. Few experts have studied what might happen to opportunistic debtors²⁰ if they *don't* declare bankruptcy. In other words, the true goal of BAPCPA was not so much to deter wealthy individuals from bankruptcy, but instead to compel them to pay their debts.²¹ Consequently, BAPCPA might close every bankruptcy loophole and still fail in its ultimate purpose. Should that happen, O.J. Simpson's decision to avoid his creditors outside of bankruptcy would represent just one instance of what would become a widespread debtor strategy.

This Note argues that while BAPCPA may succeed in driving opportunistic debtors away from bankruptcy, it will have only minimal success in compelling them to pay their debts. Rather than close the “millionaire's loopholes,”²² BAPCPA's new exemption provisions merely move the loopholes outside the bankruptcy context; debtors who do not declare bankruptcy are not subject to BAPCPA's restrictions and may have larger exemptions available to them than if they did file. By creating a separate exemption scheme for debtors in and out of bankruptcy, BAPCPA has created an incentive for opportunistic debtors to fight off creditors outside the formal bankruptcy system, perhaps filing for bankruptcy once the time limitations on BAPCPA exemption restrictions lapse. The result is the same as pre-BAPCPA; opportunistic debtors will

18. See, e.g., *In re TCR of Denver, LLC*, 338 B.R. 494, 495–96 (Bankr. D. Colo. 2006) (“[T]he language of BAPCPA passed by Congress tends to defy logic and clash with common sense.”).

19. See Letter to Sens. Arlen Specter & Patrick Leahy, *supra* note 16, at 3 (“The vast majority of individuals and families that file for bankruptcy are honest but unfortunate. The main effect [of various BAPCPA provisions] will be to deny them access to a bankruptcy discharge.”).

20. The term “opportunistic debtors” appears to be coined by Michelle White. See, e.g., Michelle J. White, *Bankruptcy Reform Gave Creditors Too Much*, *Washingtonpost.com*, Aug. 21, 2006, at <http://www.washingtonpost.com/wp-dyn/content/article/2006/08/19/AR2006081900413.html> (on file with the *Columbia Law Review*) [hereinafter White, *Too Much*]; cf. 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, 1484 (2006) (citing White in stating that “[t]he opportunistic debtor borrows with an eye on the Bankruptcy Code and files for bankruptcy when she has maximized her debt”).

21. See 146 *Cong. Rec.* S11621, S11639 (2000) (statement of Sen. Sessions) (advocating for earlier version of bankruptcy reform and arguing that for debtors with significant income, if “a judge finds you can pay some of your debts back, you ought to be able to pay that”).

22. See Patrick McGeehan, *In Florida, No Wolves at the Door*, *N.Y. Times*, Jan. 16, 2005, at 6 (stating that generous homestead exemptions are “often derided as a millionaire's loophole”).

not have to “pay up.” Finally, this Note proposes that courts tighten the informal bankruptcy loophole by relaxing the extensive, judicially created restrictions on involuntary bankruptcy, a rarely invoked process by which creditors can force a debtor into bankruptcy against the debtor’s wishes. Specifically, courts should apply their already existing “special circumstances exception,” which allows courts to bypass some judicially constructed restrictions on involuntary bankruptcy²³ whenever they detect wealthy, opportunistic debtors seeking to avoid BAPCPA’s reforms by bypassing formal bankruptcy.

Part I describes the consumer bankruptcy process prior to the enactment of BAPCPA and discusses some of BAPCPA’s most important changes. Part II highlights the increased attractiveness to opportunistic debtors of informal bankruptcy, whereby debtors simply refuse to pay their debts without filing for bankruptcy, daring their creditors to collect.²⁴ This Part argues that opportunistic debtors can avoid BAPCPA’s restrictions by warding off creditors outside the bankruptcy process and shows that this option has long been a favorite, effective option for truly indigent debtors. Part III concludes that the best way to keep opportunistic debtors from exploiting this nonbankruptcy option is for courts to order involuntary bankruptcy more frequently. This last Part also argues that courts can achieve this broadening without opening up involuntary bankruptcy to creditor abuse by adapting the special circumstances exception for use against opportunistic debtors.

I. CONSUMER BANKRUPTCY THROUGH BAPCPA

Congress has express constitutional authority to make bankruptcy law,²⁵ and the United States has been governed by some sort of federal bankruptcy scheme since 1898.²⁶ Yet state law plays a critical role in this largely federal process.²⁷ Part I.A provides an overview of consumer bankruptcy procedure prior to BAPCPA, focusing on the role played by

23. Roughly speaking, the special circumstances exception applies when 1) formal bankruptcy offers procedural remedies that are unavailable outside bankruptcy law; and 2) a debtor’s actions amount to some type of fraud. See *infra* Part III.A.3.

24. Dawsey and Ausubel claim to have first proposed the phrase “informal bankruptcy,” and this Note will use that term throughout. See Amanda E. Dawsey & Lawrence M. Ausubel, *Informal Bankruptcy 1* (Apr. 12, 2004) (unpublished manuscript, on file with the *Columbia Law Review*), available at www.ausubel.com/creditcard-papers/informal-bankruptcy.pdf (defining “informal bankruptcy”).

25. U.S. Const. art. I, § 8, cl. 4 (granting Congress power “[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States”).

26. Act of July 1, 1898, ch. 541, 30 Stat. 544, repealed by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1330 (2000 & Supp. V 2005)). This Act established the first permanent U.S. bankruptcy law. Previous attempts, dating back to 1800, were repealed within a few years. See generally David A. Skeel, Jr., *The Genius of the 1898 Bankruptcy Act*, 15 *Bankr. Dev. J.* 321 (1999) (explaining staying power of 1898 Act).

27. See Maloy, *supra* note 14, at 325–26 (detailing interplay between federal and state law in bankruptcy).

property exemptions. Part I.B details perceived abuses of the consumer bankruptcy process and its state-based exemption system, and Part I.C describes Congress's attempt to curb these abuses through BAPCPA.

A. An Overview of Consumer Bankruptcy

1. *Chapter 7 and the Fresh Start.* — Federal consumer bankruptcy law is a product of two competing interests: giving debtors a “fresh start” and recognizing debtors’ obligation to repay their debts.²⁸ The concept of a fresh start, offering debtors relief from a potential lifetime of crippling debt and giving them a new opportunity at success, dates back to biblical times.²⁹ Courts consistently reaffirm this principle in bankruptcy cases.³⁰ On the other hand, courts have stated that individuals should not be able to ignore their debts at will; if possible, they should fulfill their obligations to creditors.³¹ A policy urging repayment has the added benefit of keeping credit affordable and widely available, as creditors are less likely to make risky loans when they believe there is little chance of repayment.³²

Individuals declaring bankruptcy can elect to file under Chapter 7³³ or Chapter 13³⁴ of the U.S. Bankruptcy Code.³⁵ Chapter 13 is attractive

28. See Michelle J. White, *Personal Bankruptcy Law: Abuse Prevention Versus Debtor Protection 2* (Oct. 2006) (unpublished manuscript, on file with the *Columbia Law Review*), available at <http://weber.ucsd.edu/~miwhite/white-bapcpa.pdf> (noting “conflicting” bankruptcy objectives of “facilitat[ing] the operation of credit markets by providing a state-sponsored procedure for punishing default, determining defaulters’ ability-to-pay, and resolving debts” and “provid[ing] debtors with consumption insurance by forgiving some or all of their debt when their ability-to-pay is low”).

29. See Deuteronomy 15:1–2 (New Int’l ed.) (“At the end of every seven years you must cancel debts. This is how it is to be done: Every creditor shall cancel the loan he has made to his fellow Israelite. He shall not require payment from his fellow Israelite or brother . . .”).

30. See, e.g., *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (“[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy ‘a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.’” (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934))); *United States v. Sec. Indus. Bank*, 459 U.S. 70, 72 n.1 (1982) (“[Bankruptcy] exemptions were designed to permit individual debtors to retain exempt property so that they will be able to enjoy a ‘fresh start’ after bankruptcy.”); *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918) (“[A] main purpose of [bankruptcy] intends to aid the unfortunate debtor by giving him a fresh start in life . . .”).

31. See, e.g., *In re Adams*, 229 B.R. 312, 316 n.4 (Bankr. S.D.N.Y. 1999) (noting that “all debtors have a moral obligation to repay their debts”); *In re Whitelock*, 122 B.R. 582, 590 (Bankr. D. Utah 1990) (“[Debtor] asserts that he feels a strong moral obligation to repay the debt in full, as he rightfully should.”).

32. See White, *Too Much*, *supra* note 20.

33. 11 U.S.C.A. §§ 701–784 (West 2007).

34. *Id.* §§ 1301–1330.

35. Though rare, individual debtors can technically file under Chapter 11, a form of bankruptcy commonly associated with corporations. See Maloy, *supra* note 14, at 335–39 (describing Chapter 11 procedure for individual debtor). The most famous individual

to debtors who have significant income but cannot protect their assets with property exemptions, since it allows debtors to keep their home, car, and other physical property.³⁶ In practice, however, the vast majority of filers choose Chapter 7.³⁷ Chapter 7 is popular because it involves a fairly short process—individuals filing under Chapter 7 can receive their fresh start in a matter of months—and does not affect a debtor’s future income.³⁸ By contrast, Chapter 13 requires repayment to creditors from a debtor’s future income, a process that can span several years.³⁹ This Note primarily discusses Chapter 7 bankruptcies, as that Chapter’s focus on current assets is more relevant to property exemptions than is Chapter 13’s emphasis on future income.⁴⁰

Once an individual files for bankruptcy, the bankruptcy court places her assets into a bankruptcy “estate,” from which creditors can line up to collect on their debts.⁴¹ At the same time, the debtor receives an “automatic stay,” which stops creditors from all current and any further collection efforts, including wage garnishment.⁴² Bankruptcy ends when the debtor receives a discharge, by which all outstanding debts are forgiven, and the debtor does not need to apply future income or assets toward the

Chapter 11 debtor may be Mike Tyson. See Reuters, Tyson, Blaming Others, Files for Bankruptcy Protection, *N.Y. Times*, Aug. 4, 2003, at D4. BAPCPA, however, may increase the rate of individual Chapter 11 filings. Cf. Michael A. Fagone, Involuntary Individual Chapter 11 Post-BAPCPA as a Collection Device?, *Am. Bankr. Inst. J.*, Dec./Jan. 2007, at 28, 28 (stating that BAPCPA “essentially grafted the chapter 13 structure onto chapter 11 for individuals” and raising concern over involuntary Chapter 11 cases).

36. Maloy, *supra* note 14, at 339 (stating that Chapter 13 “does not provide for a liquidation of assets, as under Chapter 7”).

37. Richard M. Hynes, Why (Consumer) Bankruptcy?, 56 *Ala. L. Rev.* 121, 127 n.32 (2004) [hereinafter Hynes, *Consumer Bankruptcy*] (stating that more than seventy percent of individuals file under Chapter 7, and that this figure understates dominance of Chapter 7 filings).

38. See Michelle J. White, Why Don’t More Households File for Bankruptcy?, 14 *J.L. Econ. & Org.* 205, 205–06 (1998) [hereinafter White, *Households*] (describing aspects of Chapter 7 favorable to debtors).

39. See Maloy, *supra* note 14, at 339–40 (describing Chapter 13 bankruptcy).

40. In practice, however, the two forms of bankruptcy might not be that different. Debtors can choose between Chapter 7 and 13, and convert between the two even after filing. See 11 U.S.C. § 706(a) (2000 & Supp. V 2005). Consequently, a debtor filing under Chapter 13 will never agree to pay more (in present value) than she would stand to lose under Chapter 7. Some scholars, therefore, treat these two chapters identically. See Reint Groppe et al., Personal Bankruptcy and Credit Supply and Demand, 112 *Q.J. Econ.* 217, 222 (1997) (citing “close relationship between Chapter 7 and Chapter 13 bankruptcies” and thus choosing to “ignore the distinction between them”).

41. Maloy, *supra* note 14, at 320–21. Maloy provides a concise and approachable overview of the Chapter 7 process from the point of view of an individual debtor. See *id.* at 317–35.

42. *Id.* at 322. For more on garnishment, see *infra* notes 113–118 and accompanying text.

discharged obligations after the bankruptcy process.⁴³ This discharge serves as the debtor's fresh start.

The discharge comes at a cost, however. Upon a bankruptcy filing, the court appoints a bankruptcy trustee, who can sell the debtor's assets to satisfy outstanding debts.⁴⁴ The debtor, however, can "exempt" certain assets from the estate, such as a homestead and certain personal property, up to a specific value.⁴⁵ Creditors can only reach assets ineligible for exemption or those with values exceeding exemption levels.⁴⁶ It follows, then, that Chapter 7 filers who can exempt all their assets receive a discharge from all debts while paying nothing at all.⁴⁷

Thus a debtor's main goal in Chapter 7 is to exempt as many assets as possible. While nonexempt assets will likely be liquidated to pay off creditors,⁴⁸ exempt assets are protected from creditors' reach.⁴⁹ This incentive to maximize exempt assets makes property exemptions critical in bankruptcy law.

2. *Enter the States: Property Exemptions in Detail.* — Exemptions have been a part of bankruptcy since the Bankruptcy Act of 1898.⁵⁰ Every state has enacted exemption laws—different states might exempt different as-

43. Not all debts are dischargeable. Nondischargeable debts include student loans, child support obligations, and debts incurred as a result of fraud conducted by the debtor. See 11 U.S.C.A. § 523(a) (West 2007) (cataloguing various nondischargeable debts).

44. See White, Households, *supra* note 38, at 209 ("The trustee sells the assets and uses the proceeds to pay creditors on a pro rata basis.").

45. See *id.* at 207 (discussing availability of homestead and property exemptions). Note that exemptions do not protect against creditors with secured loans, where the creditor holds some asset as collateral. Thus a mortgage on a home usually cannot be discharged, since the mortgage lender generally has a secured interest in the home. The creditor can either foreclose on the house, or the debtor can reaffirm the debt, by which she agrees to continue paying it off. See, e.g., Hynes, Consumer Bankruptcy, *supra* note 37, at 129–30.

46. See Maloy, *supra* note 14, at 324–26.

47. See Gropp et al., *supra* note 40, at 222 (stating that whenever Chapter 7 debtor's assets are less than exemption levels, debtor can "avoid repaying debt from either assets or future income"); Michelle J. White, Abuse or Protection? Economics of Bankruptcy Reform Under BAPCPA, 2007 U. Ill. L. Rev. 275, 284 [hereinafter White, Abuse or Protection] (noting that ninety-six percent of Chapter 7 filers pay nothing to unsecured creditors in bankruptcy).

48. See *supra* note 44 and accompanying text.

49. See *supra* notes 45–46 and accompanying text.

50. See David E. Skeel, Jr., Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship, 113 Harv. L. Rev. 1075, 1082 (2000) ("Then [under the 1898 Act], as now, individual debtors were not required to give up all of their assets, however. Under the laws of each state, certain kinds of property were exempt and thus unavailable to creditors . . ."). State exemption laws for use outside of bankruptcy had been in place several decades before the 1898 Act. See Eric A. Posner et al., The Political Economy of Property Exemption Laws 3–5 (U. Chi., Olin L. & Econ. Working Paper No. 136, Sept. 2001), available at http://www.law.uchicago.edu/Lawecon/WkngPprs_126-150/136.EAP.Property.pdf (on file with the *Columbia Law Review*) (giving history of exemption laws).

sets, and they may do so at different amounts.⁵¹ The current Bankruptcy Code provides its own federal exemptions,⁵² but states can “opt out” of these and either mandate their own exemptions or allow debtors to choose between the federal and state systems.⁵³ In fact, the vast majority of states have opted out, and only a few allow a debtor to choose between federal and state exemptions.⁵⁴

Importantly, state exemption laws apply to *any* money judgment, in or outside the bankruptcy context.⁵⁵ An individual uses the same exemptions when filing for bankruptcy as she would use to protect assets from a tort judgment or collection agency.⁵⁶ Bankruptcy, therefore, applies federal procedure to substantive state exemption laws. In other words, “the state furnishes only the type of exemption and its monetary limits. Federal law, mainly the [Bankruptcy] Code, governs the application of those exemptions.”⁵⁷ Thus two otherwise identical debtors living in different states might emerge from bankruptcy with drastically different assets if one state is more liberal in its exemption limits.⁵⁸ It is this exemption-setting role that injects states prominently into what constitutionally⁵⁹ appears to be the federal domain of bankruptcy.⁶⁰

51. See Ronel Elul & Narayanan Subramanian, *Forum-Shopping and Personal Bankruptcy*, 21 J. Fin. Services Res. 233, 233 (2002) (stating that, in practice, all states have set their own exemption levels).

52. See 11 U.S.C.A. § 522(d) (West 2007) (listing federal property exemptions).

53. See *id.* § 522(b) (describing the opt-out process, which BAPCPA did not appreciably alter).

54. See G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 Am. Bankr. L.J. 227, 248 (2000) (stating that, as of 1999, only thirty-five states forced debtors to use state-level exemptions).

55. See, e.g., Tex. Const. art. XVI, § 50(a) (declaring that homestead “is hereby protected from forced sale, for the payment of all debts” with some exceptions); N.Y. C.P.L.R. § 5206(a) (McKinney 1997 & Supp. 2007) (“Property . . . is exempt from application to the satisfaction of a money judgment”); see also Cole, *supra* note 54, at 228 (“State and federal nonbankruptcy courts generally apply state exemption law when an individual creditor seeks satisfaction of a debt from an individual debtor.”).

56. A few states have separate exemption laws for bankruptcy and nonbankruptcy contexts. The differences between the two exemptions systems, however, are negligible. See, e.g., Cal. Civ. Proc. Code § 703.140 (West 1987 & Supp. 2007) (outlining bankruptcy-specific exemptions that closely approximate federal bankruptcy exemptions); Ohio Rev. Code Ann. § 2329.66(A)(4)(a) (West 2004 & Supp. 2007) (exempting \$400 cash for bankruptcy proceedings only).

57. Maloy, *supra* note 14, at 326.

58. See Cole, *supra* note 54, at 248 (noting that differing state exemption labels encourage debtors to “jump jurisdictions to seek greener exemption pastures”).

59. See U.S. Const. art. I, § 8, cl. 4 (granting Congress power to make “uniform Laws on the subject of Bankruptcies”).

60. For an in-depth discussion of bankruptcy as a federalist system, see Cole, *supra* note 54, at 236–55.

Exemption laws cover both personal⁶¹ and real property.⁶² Since a home is the most valuable asset most people own,⁶³ the homestead protection is particularly important. Debtors can protect thousands or even millions of dollars in equity from the reach of creditors if that money is in home equity and state law supplies a substantial homestead exemption.⁶⁴ The value of homestead exemptions varies widely across states. Some states offer exemptions significantly less than the federal amount,⁶⁵ and until recently Delaware provided no homestead protection at all.⁶⁶ On the other hand, at least five states—Florida, Iowa, Kansas, South Dakota, and Texas—grant an unlimited homestead exemption.⁶⁷ Debtors in these states can declare bankruptcy while owning a multimillion-dollar home, and then keep the homestead and all associated equity after the discharge.⁶⁸ The unlimited homestead exemption is the key reason that bankruptcy is so much more attractive in some states—most famously⁶⁹

61. Personal property exemption statutes are often of ancient origin and have not changed much since, resulting in some unusual provisions. See, e.g., N.Y. C.P.L.R. § 5205 (McKinney 1997 & Supp. 2007) (exempting from monetary judgment, inter alia, “all stoves kept for use in the judgment debtor’s dwelling house and necessary fuel therefor[e] for sixty days; one sewing machine with its appurtenances,” and “the family bible”).

62. The most obvious “real property” exemption is the homestead exemption.

63. See, e.g., Abraham Bell & Gideon Parchomovsky, *Of Property and Federalism*, 115 *Yale L.J.* 72, 101 (2005) (“[H]omeowners’ most valuable asset is generally their homes.”); Steve H. Nickles, *Behavioral Effect of New Bankruptcy Law on Management and Lawyers: Collage of Recent Statutes and Cases Discouraging Chapter 11 Bankruptcy*, 59 *Ark. L. Rev.* 329, 406 (“Very often, the debtor’s most valuable exemption is her homestead.”).

64. For particularly egregious uses of the homestead exemption to protect assets, see *infra* notes 74–76 and accompanying text.

65. See Ryan P. Rivera, *State Homestead Exemptions and Their Effect on Federal Bankruptcy Laws*, 39 *Real Prop. Prob. & Tr. J.* 71, 73 (2004) (stating that twenty-two states have exemptions of fifteen thousand dollars or less). As of August 2007, the federal homestead exemption is \$20,200. 11 U.S.C.A. § 522(d) (West 2007) (providing federal exemption amount).

66. See 2005-2 *Del. Code. Ann. Adv. Legis. Serv.* 611 (LexisNexis) (establishing homestead exemption in Delaware). Before that law, Delaware had no homestead exemption. See Rivera, *supra* note 65, at 73.

67. See Fla. Const. art. X, § 4 (establishing unlimited homestead exemption); Kan. Const. art. XV, § 9 (same, except for city homesteads larger than one acre); Iowa Code Ann. § 561.16 (West 2007) (same); S.D. Codified Laws §§ 43-31-1 & 43-45-3 (2006) (same); Tex. Prop. Code Ann. § 41.001 (Vernon 2000) (same). At least one article claims that Arkansas also has an unlimited homestead exemption, although most scholars do not include Arkansas as an unlimited-exemption state. See Harry A. Light & Donald M. Warren, *The Arkansas Homestead Exemption Under the Revised Bankruptcy Code: A Crack in the Foundation?*, *Ark. Law.*, Spring 2006, available at http://www.arkbar.com/Ark_Lawyer_Mag/Articles/HomesteadExemptionSpring06.html (on file with the *Columbia Law Review*).

68. This tactic requires that the debtors own the home free and clear of any mortgages or other secured debts. See *supra* note 45.

69. See, e.g., Rivera, *supra* note 65, at 86 (highlighting Florida and Texas over other unlimited homestead exemption states “because of the pervasive exploitation of the homestead exemption that has occurred in those states”).

Florida and Texas—than others.⁷⁰ This potential loophole is not surprisingly the source of many complaints about pre-BAPCPA bankruptcy law; the next section examines these criticisms.

B. *Exemption Abuses Under Pre-BAPCPA Bankruptcy*

Bankruptcy filings have risen substantially since passage of the last major bankruptcy reform act in 1978.⁷¹ The number of consumers declaring bankruptcy has quintupled since 1980 and increased particularly rapidly since the mid-1990s.⁷² This rise in the number of bankruptcies is especially troubling because many of the new filers are not actually financially distressed. Instead, these opportunistic debtors utilize bankruptcy as a convenient means to rid themselves of their debts, while sheltering nearly all of their assets through exemptions.⁷³ The most blatant opportunistic bankruptcies use unlimited homestead exemption states to shield millions worth of assets in an expensive house before filing.⁷⁴ Several notable national figures, presumably quite wealthy, have taken advantage of liberal bankruptcy exemptions.⁷⁵ Even more troubling are instances of

70. In several more states, clever debtors can use the doctrine of tenancy by the entireties to gain what is in effect an unlimited homestead exemption. Many states have laws exempting from the bankruptcy estate property owned by the entireties, so long as a creditor is not a creditor of both spouses. In other words, ignoring fraudulent conveyance considerations, a debtor in such a state can accumulate significant debt, marry, then place an expensive home under entirety ownership. Creditors will not be able to reach the house. See, e.g., *In re Moreno*, 352 B.R. 455, 459 (Bankr. N.D. Ill. 2006) (exempting debtor's homestead in part because "unlike the Illinois homestead exemption statute, the tenancy by the entirety statute has no monetary limit"); Stephen G. Gilles, *The Judgment-Proof Society*, 63 Wash. & Lee L. Rev. 603, 632 (2006) ("[T]enancy by the entirety operates much like an unlimited homestead exemption."). Ironically, many of the states with small or nonexistent homestead exemptions have this strong "tenancy by the entirety" exception. See *id.*

71. Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (2000 & Supp. V 2005)); see also Robert J. Landry, III, *An Empirical Analysis of Consumer Bankruptcy: Will Bankruptcy Reform Really Change Anything?*, 3 Rutgers Bus. L.J. 2, 7 tbl.1 (2006) (listing bankruptcy filings rates since 1980).

72. See Landry, *supra* note 71, at 7-9 & tbl.1 (providing details on filings rates).

73. See Michelle J. White, *Abuse or Protection?*, Regulation, Fall 2006, at 28, 29 [hereinafter White, Regulation] ("[Opportunistic debtors] plan in advance to maximize their gains from bankruptcy. They often have high incomes and borrow as much as possible. They may have substantial assets, but they shelter the assets from the obligation to repay.")

74. For several examples of notable bankruptcy abuses, see H.R. Rep. No. 106-123, at 378-79 (1999) (stating additional dissenting views of several members discussing proposed 1999 bankruptcy reform act).

75. See, e.g., Larry Rohter, *Rich Debtors Finding Shelter Under a Populist Florida Law*, N.Y. Times, July 25, 1993, at 1 (describing debtors who have taken advantage of Florida's "broad and increasingly controversial network of legal exemptions from bankruptcy claims that have led [the state] to be dubbed 'the deadbeat's haven' and 'the debtor's paradise'"); Philip Shenon, *Home Exemptions Snag Bankruptcy Bill*, N.Y. Times, Apr. 6, 2001, at A1 ("[S]everal . . . celebrities have sought bankruptcy in Florida and Texas in recent years and held onto large homes."); Karen Hartline, *How Celebrities Go Bankrupt*, at http://www.legalzoom.com/articles/article_content/article13629.html (last

wealthy individuals successfully using bankruptcy to evade civil or even criminal sanctions.⁷⁶

Such asset protection tactics are not limited to the extremely wealthy; an entire field of “prebankruptcy planning” exists, with an aim to allow debtors to retain as many assets as possible through the bankruptcy process.⁷⁷ Prebankruptcy planning is understandable⁷⁸ when debtors declare bankruptcy due to genuine financial hardship.⁷⁹ It is less palatable when used by opportunistic debtors to avoid debts they could easily repay over time. A General Accounting Office study estimates that each year about 400 homeowners in Florida and Texas⁸⁰—all with over \$100,000 in home equity—use unlimited exemptions to shelter about \$120 million from creditors.⁸¹ One study estimates that about 4,500 households each year move to high-exemption states specifically for bankruptcy-related reasons.⁸² The problem is a national concern not confined to Florida, Texas, and the other unlimited exemption states—injured creditors, after all, can be located anywhere.⁸³

visited October 16, 2007) (on file with the *Columbia Law Review*) (noting that several public figures declared bankruptcy with millions in assets and still retained large homes).

76. For example, WorldCom founder John Porter purchased a \$17 million Florida home in 1998, despite owing more than \$25 million in back taxes, and filed bankruptcy to shield his home from creditors. See Light & Warren, *supra* note 67 (discussing Porter filing). Wall Street raider Paul Bilzerian declared bankruptcy twice, most recently in 2001, to keep his lucrative homestead and avoid hundreds of millions of dollars in debt and millions more in civil judgment liability. See *Corporate Raider Seeks Bankruptcy Again*, N.Y. Times, Jan. 6, 2001, at C2 (discussing Bilzerian filings).

77. See Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. Rev. 235, 265–68, 291–92 (1995) (examining judicial and academic views of prebankruptcy planning techniques).

78. See *id.* at 242 (“[T]he very existence of statutory exemptions reflects a deliberate policy choice to tolerate this type of ‘legal fraud’ in order to further even more important social interests.”).

79. Not all of this hardship is undeserved. Opportunistic debtors can also include individuals facing large tort judgments, or even people of modest means who purposely run up huge credit card debts without any intention of repaying them. Precise figures are difficult to come by, but it appears that the percentage of such opportunistic filers is “fairly small.” White, *Regulation*, *supra* note 73, at 31.

80. These individuals could have just as easily bought property in South Dakota, Iowa, or any other unlimited homestead state. See *supra* note 67.

81. 147 Cong. Rec. 3722 (2001) (statement of Sen. Kohl).

82. Elul & Subramanian, *supra* note 51, at 235 (stating that “slightly less than 1% of moves to states with higher exemption limits are found to be motivated by considerations of differences in bankruptcy laws”). But see 147 Cong. Rec. 3722 (citing unnamed Brown University study placing this figure at three percent).

83. See Zywicki, *Bankrupt Criticisms*, *supra* note 5 (stating that victims of opportunistic bankruptcy abuse “include every American who is forced to pay more for credit, goods, and services, because others file bankruptcy and walk away from debts they could pay but choose not to”).

C. Congress Responds with BAPCPA

A combination of increasing bankruptcy filings and rising reports of bankruptcy abuses led Congress to consider bankruptcy reform, beginning in 1998.⁸⁴ Unlimited homestead exemptions were at the forefront of congressional ire, since they were considered closely linked to the worst of bankruptcy abuses.⁸⁵ After several failed attempts, Congress finally passed BAPCPA in early 2005.⁸⁶ Presenting the bill to the President, former Senate Majority Leader Bill Frist remarked, “[b]ankruptcy is for those who need help, not those who want to shift costs to other hard-working Americans.”⁸⁷ In its purported attempt to make bankruptcy a system only for those who “need help,”⁸⁸ BAPCPA specifically targeted unlimited homestead exemptions through two provisions, limiting the exemptions based on both the time of bankruptcy filing and the character of debt.

1. *Exemption Limitations Based on Time of Filing.* — BAPCPA targeted opportunistic debtors who move to unlimited exemption states merely to purchase an expensive homestead and then file for bankruptcy.⁸⁹ The Act capped the homestead exemption for debtors who recently moved to a new state before filing bankruptcy.⁹⁰ The Bankruptcy Code now limits any state’s homestead exemption to about \$137,000⁹¹ for a debtor⁹² who

84. See Gary Neustadter, 2005: A Consumer Bankruptcy Odyssey, 39 Creighton L. Rev. 225, 226–32 & n.2 (2006) (detailing BAPCPA’s legislative history).

85. See, e.g., *In re Kaplan*, 331 B.R. 483, 487–88 (Bankr. S.D. Fla. 2005) (holding that Congress’s intent with BAPCPA was to limit homestead exemptions and stating that “it is common knowledge that Florida’s unlimited homestead was at the heart of the legislative debate”).

86. Both the Senate and then the House passed BAPCPA by comfortable margins. Almost all Republicans and several Democrats voted in favor of the law. See 151 Cong. Rec. H2076–77 (daily ed. Apr. 14, 2005) (Roll No. 108) (detailing 302–76 passage by House); 151 Cong. Rec. S2474 (daily ed. Mar. 10, 2005) (Rollcall Vote No. 44) (detailing 74–25 passage by Senate). President Bush signed the bill into law on April 20, 2005. See Bush, *supra* note 10, at 641–42.

87. Brian Debose, *House Passes Reform Measure*, Wash. Times, Apr. 15, 2005, at A1.

88. *Id.*

89. See, e.g., White, *Regulation*, *supra* note 73, at 29 (“BAPCPA was sold on the grounds that it would discourage opportunism . . .”).

90. The full relevant text of the Act provides that “a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate \$136,875 in value in [a homestead].” 11 U.S.C.A. § 522(p)(1) (West 2007). This restriction specifically applies to “real or personal property that a debtor or dependent of the debtor” either “uses as a residence” or “claims as a homestead.” *Id.*

91. BAPCPA set the homestead exemption limit at \$125,000, but the Judicial Conference of the United States raised this to \$136,875 as of April 1, 2007. 72 Fed. Reg. 7082–83 (Feb. 14, 2007); cf. 11 U.S.C. § 104 (2000 & Supp. V 2005) (granting Judicial Conference of the United States power to alter dollar amounts to account for inflation).

92. Debtors may be able to effectively double this \$137,000 limit through stacking, whereby a debtor and her spouse file jointly for bankruptcy, then each claim the \$137,000 exemption for a total homestead exemption of about \$274,000. BAPCPA is not clear on whether stacking is permitted under § 522(p), and courts are just beginning to grapple

acquires a home within three years and four months of filing for bankruptcy.⁹³ A longtime resident of a high-exemption state⁹⁴ who purchases an expensive homestead in that state will also have her exemption capped by § 522(p) for that forty month period.⁹⁵ On the other hand, residents who have owned a home for longer than three years and four months still enjoy the full protection of their state's homestead exemption.⁹⁶

2. *Exemption Limitations Based on Character of Debt.* — In certain situations, BAPCPA caps the total homestead exemption at about \$137,000 irrespective of the time between the homestead purchase date and the bankruptcy filing date.⁹⁷ These restrictions apply when the debtor is convicted of a felony that demonstrates that the filing was an abuse of the bankruptcy provisions, or when the debt arose through some form of fraud.⁹⁸ This provision appears to be a congressional effort to curb the

with the issue. In an apparent case of first impression under BAPCPA, a Florida court allowed stacking of the § 522(p) limits. See *In re Rasmussen*, 349 B.R. 747, 753–55 (Bankr. M.D. Fla. 2006). The court's reasoning was predicated on the fact that Florida state law allowed stacking of its exemptions. *Id.* at 755. Several states, however, do not allow stacking. *Id.* at 755 nn.3–4. Consequently, under the logic of *Rasmussen*, the applicable § 522(p) cap for joint filers will vary by state; in states where stacking is allowed, the cap will be twice as high as in states where stacking is prohibited.

93. While most of BAPCPA took effect 180 days after enactment, this section went into effect immediately after passage. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 1501, 119 Stat. 23, 216. This difference in effective dates is understandable, as otherwise there would be a rush of opportunistic debtors buying homes in unlimited exemption states and filing for bankruptcy during the period between BAPCPA's enactment and effective date.

94. Nothing in § 522(p) limits its reach to unlimited exemption states. Several states have homestead exemptions that exceed the BAPCPA limit; debtors in these states may also find their exemptions capped under this provision. See, e.g., *Ariz. Rev. Stat. Ann. § 33-1101* (2007) (setting homestead exemption of \$150,000); *Nev. Rev. Stat. § 15.010* (2005) (setting homestead exemption of \$350,000).

95. BAPCPA qualified this exemption limitation with a safe harbor rule, providing that § 522(p)(1) does not “include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.” 11 U.S.C.A. § 522(p)(2)(B). Importantly, this safe harbor only works if the previous and new homesteads are in the same state. Debtors cannot use this provision to sell their mansion and buy a new one in an unlimited-exemption state.

96. *Id.* § 522(b)(3).

97. *Id.* § 522(q).

98. The specific conditions are outlined by *id.* § 522(q)(1)(B). They include debts arising from a violation of federal or state securities laws, fraud in a fiduciary capacity or in connection with a securities transaction, a civil remedy under the Racketeer Influenced and Corrupt Organizations Act of 1970 (RICO), or any “criminal act, intentional tort, or willful or reckless misconduct” causing injury or death to another individual within five years of filing. *Id.*

worst of bankruptcy abuses,⁹⁹ filings by opportunistic debtors to avoid debts arising from civil or criminal sanctions.¹⁰⁰

Thus BAPCPA attempted to curb opportunistic uses of high homestead exemptions in the consumer bankruptcy process.¹⁰¹ BAPCPA's provisions seem designed to steer wealthy, opportunistic bankruptcy filers away from Chapter 7 bankruptcy. Less clear is whether this law, even if it achieves this goal, will actually compel debtors to pay their debts. Part II addresses that question by exploring nonbankruptcy options for opportunistic debtors and casts doubt on whether BAPCPA really has ended exemption law abuse.

II. THE INFORMAL BANKRUPTCY LOOPHOLE

Bankruptcy is not the most common recourse for individuals deeply in debt; it is merely the most well known.¹⁰² The more prevalent alternative is informal bankruptcy, where debtors simply refuse to pay off their debts despite not filing for bankruptcy, daring their creditors to collect.¹⁰³ The informal bankruptcy option poses substantial threats to the success of BAPCPA in curbing bankruptcy abuses because BAPCPA's provisions do not apply outside of formal bankruptcy. Therefore, opportunistic debtors can use informal bankruptcy to take advantage of potentially unlimited state property exemptions and thwart creditor collection efforts. Part II.A provides an overview of informal bankruptcy and notes its widespread use and effectiveness in warding off creditors. Part II.B argues that opportunistic debtors can use informal bankruptcy to avoid BAPCPA's reform provisions—in particular, they can circumvent the Act's restriction of large homestead exemptions because BAPCPA only applies when debtors file for formal bankruptcy. Finally, Part II.C examines portions of BAPCPA that may deter opportunistic informal bank-

99. Some language of this section, however, is quite broad, and it may reach well beyond the worst abusers. See *In re Larson*, 340 B.R. 444, 448–50 (Bankr. D. Mass. 2006) (holding that “criminal act” under § 522(q) did not require any level of culpability, or even actual conviction, and that debtor might be subject to 522(q) cap due to fatal automobile accident caused by her negligent conduct).

100. Commentators call this section the “Enron Clause,” as it was intended to prevent Kenneth Lay and others from using bankruptcy to shield their assets using an unlimited homestead exemption. See Margaret Howard, *Exemptions Under the 2005 Bankruptcy Amendments: A Tale of Opportunity Lost*, 79 *Am. Bankr. L.J.* 397, 407 n.51 (2005).

101. Other portions of BAPCPA that may deter opportunistic debtors include a longer statute of limitations for fraudulent transfers and a controversial means test for Chapter 7 filers. However, there is considerable doubt as to whether these provisions will have any practical effect on those who abuse the bankruptcy system. See *infra* Part II.C (analyzing possible obstacles to opportunistic informal bankruptcy).

102. See Richard M. Hynes, *Bankruptcy and State Collections: The Case of the Missing Garnishments*, 91 *Cornell L. Rev.* 603, 651 (2006) [hereinafter Hynes, *Missing Garnishments*] (“Despite bankruptcy’s dominance of the consumer finance literature, most consumers who do not pay their loans do not file for bankruptcy.”).

103. See Dawsey & Ausubel, *supra* note 24, at 1 (defining informal bankruptcy).

ruptcy, specifically the Act's fraud provision and means test, and concludes that these measures likely will be ineffective.

A. *The Appeal of Informal Bankruptcy*

1. *An Informal Bankruptcy Overview.* — Though Chapter 7 bankruptcy promises protection of future income and a discharge from all outstanding debts,¹⁰⁴ it also allows creditors to liquidate a debtor's nonexempt assets.¹⁰⁵ Debtors with large debts and little ability to exempt their assets, therefore, may wish to avoid Chapter 7. Additionally, those with few assets may find the filing costs of bankruptcy prohibitive, even if they are rather insignificant when compared to other legal fees.¹⁰⁶ Debtors who do not like these tradeoffs can decide instead not to file for bankruptcy at all. This alternative puts the burden of collection on creditors, who, without the procedural structure of the federal bankruptcy process, must rely on state law to govern collection. Informal bankruptcy debtors can impose significant costs on their creditors,¹⁰⁷ and creditors may decide to abandon their collection efforts, especially if the costs of collection rival the debts they could recover. Consequently, debtors choosing informal bankruptcy often avoid paying their creditors entirely.¹⁰⁸ When this scenario occurs, debtors effectively receive a discharge of their debts¹⁰⁹—since they no longer have to worry about payment—without having to endure the formal bankruptcy process. It is this possibility of a “free discharge” that makes informal bankruptcy so attractive; debtors can “obtain the benefits of bankruptcy without bearing the costs of filing.”¹¹⁰

104. See *supra* Part I.A.1 (providing overview of Chapter 7 bankruptcy).

105. See Dawsey & Ausubel, *supra* note 24, at 2 (describing costs of formal bankruptcy filing).

106. See *id.* (stating that “legal and court costs associated with a bankruptcy filing, though small relative to most other legal proceedings, are nonnegligible, especially for an insolvent debtor”). The individual Chapter 7 filing fee is \$130, and legal fees “range from \$250 to the thousands of dollars.” David A. Lander, *A Snapshot of Two Systems That Are Trying to Help People in Financial Trouble*, 7 *Am. Bankr. Inst. L. Rev.* 161, 171–72 (1999).

107. See Dawsey & Ausubel, *supra* note 24, at 1 (noting that informal bankruptcy debtor can ignore collection efforts and in general “can structure his affairs to make his income particularly difficult to garnish and his property particularly difficult to attach”). Federal law further limits the ability of creditors to collect outside bankruptcy. See 15 U.S.C. §§ 1692–1692f (2000) (prohibiting creditors from engaging in various “abusive practices”).

108. See Richard M. Hynes, *Broke but Not Bankrupt: Consumer Debt Collection in State Courts 59–62* (July 19, 2007) (unpublished manuscript, on file with the *Columbia Law Review*) [hereinafter Hynes, *Debt Collection*] (finding from Virginia statistics that most debtors facing civil judgments do not satisfy those judgments yet also do not file for bankruptcy).

109. See description of Chapter 7 bankruptcy, *supra* Part I.A.1.

110. White, *Households*, *supra* note 38, at 229.

Informal bankruptcy is not without its drawbacks for debtors.¹¹¹ While creditors may well write off their uncollected loans as costs of business, they still suffer an economic loss, one which they are likely to pass on to customers (including potential debtors) via higher interest rates.¹¹² The most powerful and widely used creditor weapon against informal debtors is wage garnishment, whereby, with judicial approval, creditors can seize part of a debtor's wages directly from her employer.¹¹³ Garnishment is not available in formal bankruptcy,¹¹⁴ but it could be a decisive weapon against informal bankruptcy were it not severely limited by federal and state law. Federal law limits garnishments to twenty-five percent of a debtor's income¹¹⁵ and permits states to set even more restrictive limitations.¹¹⁶ Some states have done so, and a few have prohibited wage garnishment entirely.¹¹⁷ It appears that informal bankruptcy rates are much higher in states with stricter restrictions on garnishments.¹¹⁸

2. *The Prevalence of Informal Bankruptcy.* — Until recently, legal and economic scholars had largely ignored informal bankruptcy.¹¹⁹ The evi-

111. See, e.g., White, Regulation, *supra* note 73, at 35 (arguing that informal bankruptcy hurts debtors because it "gives lenders longer to collect . . . high fees and interest charges").

112. Cf. Zywicki, Bankrupt Criticisms, *supra* note 5 (arguing that individuals who "walk away from debts they could pay but choose not to" impose significant costs on nondebtors). Though Zywicki is referring to formal bankruptcy abusers, the analysis applies equally well to those who avoid debt repayment via informal bankruptcy.

113. See, e.g., Hynes, Missing Garnishments, *supra* note 102, at 607 (stating that garnishment is "one of the most important collections tools afforded by state law"); Richard L. Peterson & Gregory D. Falls, Costs and Benefits of Restrictions on Creditors' Remedies 13 exhibit 6 (Credit Res. Ctr., Working Paper No. 41, 1981), available at <http://www.sbpn.gwu.edu/research/centers/fsrp/pdf/WP41.pdf> (on file with the *Columbia Law Review*) (showing that garnishment is most frequently used device by creditors seeking to collect).

114. See *supra* note 42 and accompanying text.

115. 15 U.S.C. § 1673 (2000). Alternatively, garnishment is limited to thirty times minimum wage, if that amount is less than the twenty-five percent limit. *Id.*

116. See *id.* § 1677 (allowing state to set laws "prohibiting garnishments or providing for more limited garnishment than are allowed under this subchapter").

117. Zero-garnishment states include North Carolina, New Hampshire, Pennsylvania, South Carolina, Texas, and Vermont. Several other states have restricted garnishment levels beyond the federal standards, but most states are content with the federal limitations. See Sumir Agarwal et al., Exemption Laws and Consumer Delinquency and Bankruptcy Behavior: An Empirical Analysis of Credit Card Data, 43 Q. Rev. Econ. & Fin. 273, 277 tbl.1 (2003).

118. See Dawsey & Ausubel, *supra* note 24, at 23 ("Strict garnishment has a positive and strongly significant impact on the probability of formal bankruptcy. Strict garnishment has an opposite and modestly significant impact on the probability of informal bankruptcy."). But see Agarwal et al., *supra* note 117, at 284 (claiming that, in contrast with Dawsey & Ausubel, "garnishment does not have [a] statistically significant effect [on] formal bankruptcy," but agreeing that garnishment does affect informal bankruptcy).

119. See, e.g., Hynes, Missing Garnishments, *supra* note 102, at 652 ("[T]he use of collections proceedings has not been systematically studied by scholars in a generation."); Dawsey & Ausubel, *supra* note 24, at 3 ("[T]here appear to be no papers in the economic

dence that does exist indicates that debtors have known about and widely utilized this option for years.¹²⁰ Visa U.S.A., for example, claims that two-thirds of its credit card loans “charged off”¹²¹ in 1999 were deemed uncollectible for reasons other than bankruptcy.¹²² Moreover, garnishment, in theory creditors’ most effective weapon against informal bankruptcy, appears to be a rather ineffective means of debt collection.¹²³ Using statistics from the early 1990s, Professor White has calculated that at least 15% of households would benefit by filing for bankruptcy, even though only about 1% of households actually filed during that period.¹²⁴ White claims that informal bankruptcy accounts for much of this discrepancy; debtors do not file for bankruptcy even though they would benefit because they can achieve the same gains by simply not filing and not paying.¹²⁵ Though aggregate numbers for informal bankruptcy are difficult to find,¹²⁶ White’s study suggests that a significant fraction of the 15% of households that would gain from bankruptcy have chosen informal bankruptcy instead.

Dawsey and Ausubel have concluded that formal and informal bankruptcy are economic substitutes.¹²⁷ As the price for one option increases, rational debtors—or at least rational lower income debtors¹²⁸—are more

(or non-economic) literature that document the prevalence of informal bankruptcy, explain the factors affecting its incidence, or explore its wider implications.”).

120. See Hynes, *Consumer Bankruptcy*, supra note 37, at 122 n.4 (reporting that “approximately seventy percent of all bank consumer credit losses occur outside of bankruptcy” (citing Am. Banker’s Ass’n, 1997 Installment Credit Survey Report 109 (9th ed. 1997))).

121. Lenders “charge off” a loan when they write the loan off as a loss for regulatory purposes. Dawsey & Ausubel, supra note 24, at 1 & n.4 (noting that “the loan may still be collectable unless the account was charged off for bankruptcy discharge, death, or fraud”).

122. *Id.* at 1–2. But see Hynes, *Consumer Bankruptcy*, supra note 37, at 122 n.4 (stating that some of Visa’s uncollected credit card loans “may be discharged in a bankruptcy proceeding after they are charged off as uncollectible”). Hynes, however, further claims that the percentage of debtors who choose formal bankruptcy is even lower than studies indicate. See *id.*

123. See White, *Households*, supra note 38, at 212 (“One study reported that only 30% of all attempts by creditors to garnish wages actually succeed in collecting anything.” (citation omitted)).

124. *Id.* at 206, 215.

125. *Id.* at 206. White’s other explanation for the discrepancy is that individuals delay filing because they value the option to declare bankruptcy at some future point. See *id.*

126. See Dawsey & Ausubel, supra note 24, at 5 (“[U]seful information on defaults (and, hence, informal bankruptcies) is extremely difficult to come by.”).

127. See *id.* at 4 (“[F]ormal bankruptcy and informal bankruptcy are usefully viewed as economic *substitutes*: increasing the price of one causes substitution into the other.”).

128. Professor Hynes used Virginia bankruptcy and civil judgment statistics to conclude that middle class debtors are far more likely to choose formal bankruptcy, while lower income debtors tend toward informal bankruptcy. Hynes’s findings imply that at least one of these income groups does not consider formal and informal bankruptcies to be perfect economic substitutes. See Hynes, *Debt Collection*, supra note 108, at 5–6, 17–22.

likely to choose the alternative.¹²⁹ Moreover, informal bankruptcy should be just as sensitive to the costs of formal bankruptcy as it is to its own costs. If BAPCPA has significantly reduced the appeal of formal bankruptcy, then, this Note argues, we should expect to see bankruptcy filings decrease, not because people now pay their debts, but because they are more frequently electing informal bankruptcy. Informal bankruptcy studies thus far have focused only on those facing true financial hardship. Opportunistic debtors, however, should be equally, and perhaps more, eager to make the switch to informal bankruptcy if the economic price is right.¹³⁰

B. *Opportunistic Debtors Discover Informal Bankruptcy*

This Note's chief criticism of BAPCPA is that even if the Act successfully steers opportunistic debtors away from formal bankruptcy, it will merely push them toward informal bankruptcy and thus fail to compel them to pay their debts. Part II.B.1 argues that, since BAPCPA does not affect state law exemptions outside of informal bankruptcy, the Act has made informal bankruptcy a cheaper option for opportunistic debtors than its economic substitute, formal bankruptcy. Part II.B.2 presents specific plans opportunistic debtors can follow to circumvent BAPCPA's exemption restrictions, and Part II.B.3 shows the feasibility of informal bankruptcy for opportunistic debtors.

1. *Exemptions and Informal Bankruptcy.* — Though much scholarship exists on the relationship between exemption levels and formal bankruptcy filings,¹³¹ these studies have largely dismissed the impact of state exemptions on the decision to pursue informal bankruptcy.¹³² Because the vast majority of states opt out of federal bankruptcy exemptions in favor of their own state law exemptions, debtors are normally subject to the same exemption laws regardless of whether they file bankruptcy.¹³³ In economic terms, "higher exemptions imply lower prices for *both* infor-

129. See Dawsey & Ausubel, *supra* note 24, at 4.

130. See, e.g., Jay Adkisson & Chris Riser, *Bankruptcy Act Impact on Life Insurance and Domestic Asset Protection Trusts*, Leimberg Info. Servs., May 3, 2005 (on file with the *Columbia Law Review*) [hereinafter Adkisson & Riser, *Bankruptcy Act Impact*] (stating that individuals with significant assets should, in prebankruptcy planning, try "to avoid [formal] bankruptcy altogether").

131. See, e.g., Landry, *supra* note 71, at 45 (finding via statistical analysis "positive relationship . . . between homestead exemption and percentage of total filings under Chapter 7"); Michelle J. White, *Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change*, 65 U. Chi. L. Rev. 685, 690 (1998) ("[T]he incentive to file for bankruptcy is stronger for debtors who live in states that have more generous property exemptions."). But see Lawrence A. Weiss et al., *An Analysis of State-Wide Variation in Bankruptcy Rates in the United States*, 17 Bankr. Dev. J. 407, 416–18 (2001) (finding no correlation between exemption levels and filing rates).

132. See, e.g., Agarwal et al., *supra* note 117, at 283 ("[H]omestead exemption levels are insignificant for the informal bankruptcy decision.").

133. See *supra* notes 55–56 and accompanying text.

mal and formal bankruptcy.”¹³⁴ Before BAPCPA, therefore, exemption levels were largely irrelevant to an informal bankruptcy analysis.

BAPCPA aimed to curb bankruptcy abuses by capping applicable exemption levels in certain circumstances.¹³⁵ The Act, however, does not in any way modify state exemption law; it merely preempts it in a formal bankruptcy context.¹³⁶ State exemptions, therefore, are no longer uniform between formal and informal bankruptcy. Instead, BAPCPA’s exemption cutoff becomes a cost of formal bankruptcy, just as wage garnishment is a cost of informal bankruptcy.¹³⁷ Higher state exemptions, when preempted by BAPCPA, now lower costs for informal bankruptcy only. Since the two forms of bankruptcy are substitutes,¹³⁸ it seems likely that opportunistic debtors seeking high exemptions will more frequently make the now economically rational decision to choose informal bankruptcy.

2. *Exemption-Preserving Tactics for Opportunistic Debtors.* — Bankruptcy practitioners have already noticed that the best option for their wealthy debtor-clients may be informal bankruptcy.¹³⁹ One option for such opportunistic debtors may be to use informal bankruptcy as a delaying tactic.¹⁴⁰ Opportunistic debtors could still move to a state with a generous or unlimited homestead exemption. Once they purchase a homestead in that state, these individuals are subject to BAPCPA’s cap if they file for bankruptcy.¹⁴¹ However, BAPCPA’s restrictions only last for 1,215 days after a homestead is purchased.¹⁴² Opportunistic debtors, therefore, can simply “wait out” BAPCPA by warding off creditors outside of bankruptcy for forty months, after which the BAPCPA cap expires.¹⁴³

134. Dawsey & Ausubel, *supra* note 24, at 23.

135. See 11 U.S.C.A. § 522(p)–(q) (West 2007); *supra* Part I.C.

136. See Barry A. Nelson, How Does the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Affect Florida Homesteads? Many Unanswered Questions, Fla. B.J., Nov. 2005, at 22, 24 (stating that “since all of [BAPCPA’s] new limitations are based upon federal bankruptcy law,” state exemption law still applies “outside the bankruptcy arena”).

137. See *supra* notes 113–118 and accompanying text.

138. See *supra* note 127 and accompanying text.

139. See, e.g., Adkisson & Riser, Bankruptcy Act Impact, *supra* note 130 (“New asset protection plans should be designed to avoid bankruptcy altogether”); Alan S. Gassman & Justin Taylor Pikramenos, How the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act Affects Planning for Physicians and Physician Practices, ABA Health eSource, Feb. 2006, at <http://www.abanet.org/health/esource/vol2no6/gassman.html> (on file with the *Columbia Law Review*) (“Because of the stricter bankruptcy rules now applicable, more clients with large judgments against them will become insolvent, yet will attempt to avoid or delay bankruptcy while maintaining their creditor-exempt assets.”).

140. Cf. Gassman & Pikramenos, *supra* note 139 (stating that wealthy debtors facing large judgments will “avoid or delay bankruptcy”).

141. 11 U.S.C.A. § 522(p) (West 2007).

142. *Id.*; see also *supra* Part I.C.1.

143. This type of delayed bankruptcy is in some respects like a system Professor Hynes proposes as a replacement for the current formal bankruptcy process. Hynes argues that the country would be better off with a uniform bankruptcy system, not the informal/

Opportunistic debtors can even use informal bankruptcy to circumvent BAPCPA's \$137,000 limit on property exemptions when debts are acquired via fraudulent or criminal acts.¹⁴⁴ Unlike the general § 522(p) homestead restriction discussed above, the fraud restriction on exemption levels never lapses.¹⁴⁵ Fraudulent opportunistic debtors in high-exemption states can avoid this provision through informal bankruptcy, though in this case they would have to avoid filing indefinitely.¹⁴⁶ Through informal bankruptcy, these individuals may escape their obligation to pay their debts, "leaving their creditors to years of collection actions under state law."¹⁴⁷

3. *Feasibility of Opportunistic Informal Bankruptcy.* — Given the general success of insolvent debtors in using informal bankruptcy to avoid repayment of debts,¹⁴⁸ it seems likely that opportunistic debtors, holding more resources with which to fight creditors, would be equally if not more successful with informal bankruptcy. There is some precedent for this opportunistic informal bankruptcy; O.J. Simpson, to this day, has neither filed for bankruptcy nor paid much of anything to his wrongful death creditors.¹⁴⁹

To be sure, there is some reason to believe that opportunistic debtors may face higher costs with informal bankruptcy than do those facing true financial hardship; in particular, they may be more vulnerable to wage garnishment.¹⁵⁰ However, opportunistic debtors can mitigate the

formal bankruptcy regime that exists now. He proposes modifying the informal bankruptcy system by adopting a short statute of limitations for most debts, after which the debts would be uncollectible and effectively "discharged." See Hynes, *Consumer Bankruptcy*, supra note 37, at 134–44.

Hynes acknowledges that this proposal requires more research into informal bankruptcy, see *id.* at 179, but the BAPCPA exemption-cap loophole illustrates a potential abuse of his proposed system. Effectively, BAPCPA places a short, forty month statute of limitations on the debts of opportunistic debtors with large homesteads. After that period, creditors of such debtors are generally out of luck because most of the debtors' assets are locked up in untouchable exempt assets. In short, though Hynes claims that the law could grant consumers equally effective relief from debts outside a formal bankruptcy system, see *id.* at 135, the real threat is that informal bankruptcy grants debtors *too much* relief.

144. See 11 U.S.C.A. § 522(q); supra Part I.C.2.

145. Compare 11 U.S.C.A. § 522(p) (limiting exemption restrictions to "1215-day period" after debtors buy new homestead), with *id.* § 522(q) (providing no such time limit).

146. See Janet M. Moringiello, *Has Congress Slimmed down the Hogs?: A Look at the BAPCPA Approach to Pre-bankruptcy Planning*, 15 *Widener L.J.* 615, 638–39 (2006) (stating that BAPCPA may result in fewer bankruptcy filings by individuals who "can afford to move to another state to escape their creditors" because "[t]hose individuals can always move, purchase exempt homesteads, and not file for bankruptcy").

147. *Id.* at 639.

148. See supra Part II.A.2.

149. See supra notes 1–9 and accompanying text.

150. See Dawsey & Ausubel, supra note 24, at 1 & n.1 (noting that informal bankruptcy debtor can avoid wage garnishment by "eschew[ing] relationships with banking institutions and . . . tak[ing] employment where he is paid in cash"). Wealthy opportunistic debtors are likely less willing or able to adopt such measures.

dangers of wage garnishment through their greater ability to ward off creditors. Nonopportunistic debtors often navigate informal bankruptcy on their own; opportunistic debtors can hire specialist attorneys to assist them.¹⁵¹ Additionally, federal law limits garnishment to thirty times the minimum wage (and prohibits states from increasing this limit),¹⁵² and opportunistic debtors may be happy to forfeit a few thousand dollars a year in wages if their potentially dischargeable debts well exceed that annual figure.

Allowable wage garnishment levels vary by state, and states with strict restrictions on garnishments have more informal bankruptcies.¹⁵³ Opportunistic debtors, therefore, may choose to fight their creditors in states that curtail or fully prohibit garnishment.¹⁵⁴ Consequently, “zero-garnishment” may join “unlimited-homestead exemption” as a criterion for the ideal opportunistic safe haven. Interestingly, both Texas¹⁵⁵ and Florida,¹⁵⁶ the most notorious nesting places for opportunistic debtors,¹⁵⁷ also effectively prohibit wage garnishment.

C. Potential Obstacles to Opportunistic Informal Bankruptcy

1. *The Expanded Fraud Provision.* — BAPCPA restricts the extent to which opportunistic debtors can convert assets from nonexempt to exempt form on the eve of a formal bankruptcy filing. Before these limitations, debtors anticipating bankruptcy could liquidate their personal

151. Asset protection and prebankruptcy planning already exist as legal fields; the aim of both is to shield assets from the potential reach of creditors, although asset protection is more likely to happen on a “clear day.” For a detailed discussion of this area, see generally Jay Adkisson & Christopher M. Riser, *Asset Protection: Concepts & Strategies for Protecting Your Wealth* (2004).

152. See supra note 115.

153. See supra notes 114–118 and accompanying text (analyzing connection between informal bankruptcy and garnishment limits).

154. See supra note 150 and accompanying text (suggesting that wage garnishment may be chief deterrent to opportunistic informal bankruptcy).

155. Tex. Const. art. XVI, § 28 (prohibiting wage garnishment with family law exceptions). Note, however, that an outside state’s exemption laws may control if that state has a dominant interest in their application. See *Bergman v. Bergman*, 888 S.W.2d 580, 585 (Tex. App. 1994) (applying Connecticut exemption law in case before Texas court). There is Texas case law, old but still successfully cited by creditors, that supports using an outside state’s wage garnishment rules when debtors are paid from an out-of-state location. See *Baumgardner v. S. Pac. Co.*, 177 S.W.2d 317, 319–20 (Tex. App. 1943) (noting that out-of-state exemption “is allowed by our courts if it is in conformity with the general policy of this State”); Wage Garnishment and Attachment Rules by State, Fair-Debt-Collection.com, at <http://www.fair-debt-collection.com/state-wage-garnishments.html#44> (last visited Oct. 16, 2007) (on file with the *Columbia Law Review*) (stating that creditors have had success under *Bergman*).

156. See Fla. Stat. Ann. § 222.11 (West 1998) (stating that heads of households are immune from wage garnishment). Though Florida law provides an exception for heads of households making more than \$500 a week, this applies only if the individual agrees in writing to a waiver. *Id.* It is unclear if individuals ever knowingly waive this restriction.

157. See supra note 69.

property and transfer the proceeds into home equity.¹⁵⁸ States have long had restrictions on such fraudulent transactions.¹⁵⁹ BAPCPA, however, extended the statute of limitations on such transfers from one to ten years.¹⁶⁰ This provision potentially could prevent opportunistic debtors from acquiring expensive homesteads within ten years of a bankruptcy filing, greatly extending the forty month period prescribed by § 522(p), if a court finds that the debtors did so with the intent to one day declare bankruptcy.¹⁶¹

BAPCPA's new fraud provision, however, is unlikely to have any additional deterrent effect on opportunistic debtors. Though BAPCPA increased the statute of limitations for fraudulent transfers, it did not significantly alter the definition of fraud, which creditors have long had difficulty proving.¹⁶² Prebankruptcy shifting of nonexempt assets to exempt form, for example, has long been held not to constitute a fraudulent transfer.¹⁶³ Professor Moringiello analyzed BAPCPA's new fraud provision and concluded that "fraud will likely be just as hard to prove under the new law as it was pre-BAPCPA."¹⁶⁴

In fact, BAPCPA's fraud provision may well steer more debtors toward informal bankruptcy. Debtors who do not file for bankruptcy are subject only to state law interpretations of fraud.¹⁶⁵ Though courts have been somewhat inconsistent in ruling whether prebankruptcy planning

158. See 11 U.S.C.A. § 522(o) (West 2007) (stating that homestead exemption "shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor").

159. See, e.g., *In re Sholdan*, 218 B.R. 475, 484–85 (Bankr. D. Minn. 1998) (denying homestead exemption to debtor who converted eighty-three percent of liquid net worth into exempt homestead form on eve of bankruptcy); *In re Wilbur*, 206 B.R. 1002, 1007–08 (Bankr. M.D. Fla. 1997) (finding Florida law may disallow homestead exemption if used as instrument of fraud). But see *Havoco of Am., Ltd. v. Hill*, 790 So. 2d 1018, 1028 (Fla. 2001) (holding that Florida's homestead exemption generally makes no exception for fraud).

160. See 11 U.S.C.A. § 522(o) (setting statute of limitations at ten years); Moringiello, *supra* note 146, at 620 ("[U]nder the pre-BAPCPA Code, there was a one-year statute of limitations for fraudulent transfers.").

161. Cf. *In re Maronde*, 332 B.R. 593, 600 (Bankr. D. Minn. 2005) (applying 11 U.S.C.A. § 522(o) to reduce debtor's homestead exemption because debtor tried to "thwart his creditors rather than mak[e] an honest attempt to repay them").

162. See Moringiello, *supra* note 146, at 625–29 (detailing courts' struggles with defining fraud).

163. See, e.g., *Hanson v. First Nat'l Bank in Brookings*, 848 F.2d 866, 868 (8th Cir. 1988) ("It is well established that under the Code, a debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption . . .").

164. Moringiello, *supra* note 146, at 637.

165. See Nelson, *supra* note 136, at 26 (stating that BAPCPA fraud provisions "apply only if the debtor files for bankruptcy and would not apply in a . . . state court action").

constitutes fraud,¹⁶⁶ they have often allowed debtors to retain their property exemptions even in the face of clear attempts to thwart creditor collection efforts.¹⁶⁷ For example, an Arizona bankruptcy court made it almost impossible for a creditor to prove fraud without some type of deception, concealment, or fraudulent conveyance, and it emphasized that fraud is especially difficult to prove when the validity of the homestead exemption is contested.¹⁶⁸ Florida's Supreme Court ruled that there is no fraud exception at all to the state's homestead exemption, so long as the funds used to obtain or improve the homestead were not themselves obtained fraudulently.¹⁶⁹ If BAPCPA's fraud provision does indeed have teeth, then opportunistic debtors in states such as those discussed above will simply opt for informal bankruptcy, where they can take advantage of state courts more receptive to attempts to hinder creditors.

2. *Means Testing.* — Perhaps the most controversial part¹⁷⁰ of BAPCPA is its means test, which debtors must pass before they can obtain a Chapter 7 discharge.¹⁷¹ Under this complicated provision,¹⁷² debtors cannot file under Chapter 7 if, roughly, their incomes are above a level based on the median family income in their state, and they are able to pay a significant fraction of their qualified expenses.¹⁷³ Courts must presume that debtors who do not pass the means test have abused Chapter

166. Cf. Moringiello, *supra* note 146, at 625–29 (discussing divergent rulings on matter and noting that “[c]ourts have struggled with these badges of fraud”).

167. See *In re McGinnis*, 306 B.R. 279, 284–87 (Bankr. W.D. Mo. 2004) (upholding joint debtor's claimed exemption even after debtor sold nonexempt property out of state for cash, then carried cash in paper bag to Kansas, where she purchased an exempt homestead); Ponoroff & Knippenberg, *supra* note 77, at 256 (“It has been widely recognized that the conversion of nonexempt property to exempt property in contemplation of bankruptcy is not itself actionable as a fraudulent conveyance.”).

168. See *Murphey v. Crater* (*In re Crater*), 286 B.R. 756, 772 (Bankr. D. Ariz. 2002) (stating that “unless the creditor shows a deception or concealment, an insider transaction, a fraudulent conveyance, a secretly retained possession or benefit, or debtor explanations that lack credibility,” fraud cannot be proven “even if all of the debtor's nonexempt assets were converted into exempt assets just after being sued and just before filing bankruptcy”).

169. See *Havoco of Am., Ltd. v. Hill*, 790 So. 2d 1018, 1028 (Fla. 2001) (“The transfer of nonexempt assets into an exempt homestead with the intent to hinder, delay, or defraud creditors is not one of the three exceptions to the [Florida] homestead exemption . . .”).

170. See Neustadter, *supra* note 84, at 233 (stating that means testing has “commanded the lion's share of debate, overshadowing other significant components of the reform”); Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 *Am. Bankr. L.J.* 231, 231 (2005) (“Perhaps the best-known and most discussed feature of [BAPCPA] is its means test.”).

171. See 11 U.S.C. § 707(b) (2000 & Supp. V 2005).

172. See, e.g., I Rosemary E. Williams, *Bankruptcy Practice Handbook* § 5:78 (2d ed. 2005) (stating that means test is “most complex aspect of a bankruptcy case,” followed by exemption planning).

173. For an extensive analysis of the means test, see Neustadter, *supra* note 84, at 271–311.

7,¹⁷⁴ and such debtors must then file under Chapter 13,¹⁷⁵ which forces them to use some future income to pay creditors.¹⁷⁶ If successful, the means test and accompanying threat of Chapter 13 may deter opportunistic debtors from filing for bankruptcy, since they might have to dip into their potentially substantial income to repay debts. Supporters of the means test frequently cite this potential to curb abusive filings as a primary reason for its inclusion within BAPCPA.¹⁷⁷

As with the fraud provisions in § 522(o),¹⁷⁸ however, there is considerable doubt over whether the means test will have any practical effect in deterring opportunistic debtors from bankruptcy.¹⁷⁹ The means test only applies to “primarily consumer debts,”¹⁸⁰ so opportunistic debtors can run up business debts and still receive a Chapter 7 discharge.¹⁸¹ Additionally, the means test only deters opportunistic debtors who were planning to file for bankruptcy either immediately or after waiting out the forty month homestead restriction.¹⁸² It is no deterrent to informal bankruptcy, and, as with BAPCPA’s fraud provision, effective means testing would only encourage informal bankruptcy.

Thus BAPCPA has made informal bankruptcy more attractive to opportunistic debtors. Because BAPCPA applies only to debtors who declare formal bankruptcy, opportunistic debtors can simply ward off creditors outside the formal bankruptcy system, and in doing so enjoy the full, unrestricted protection of generous or unlimited state property exemptions. Though BAPCPA contains other anti-abuse provisions, ultimately none of its reforms can ever force opportunistic debtors to pay their debts because none can force these debtors to declare formal bank-

174. See *id.* at 273 (noting that BAPCPA has eliminated requirement of “substantial” abuse of Chapter 7).

175. Chapter 7 filers who fail the means test will have their bankruptcies dismissed or converted to Chapter 11 or (more likely) Chapter 13. See 11 U.S.C. § 707(b)(1).

176. See *supra* note 39 and accompanying text (noting Chapter 13 effects on debtor’s future income).

177. See, e.g., 151 Cong. Rec. S2219 (daily ed. Mar. 8, 2005) (statement of Sen. Sessions) (“[T]here is nothing wrong with the means test. People who make high incomes . . . and file bankruptcy, wiping out all their debts, who don’t care who got hurt by their failure to pay . . . this will crack down on those people who are abusing this system.”).

178. See *supra* Part II.C.1.

179. Cf. White, *Too Much*, *supra* note 20 (“Opportunistic debtors can also pass the means test and qualify for Chapter 7 even if they have high incomes, by spending more on categories that increase their consumption allowances.”).

180. 11 U.S.C. § 707(b)(1).

181. See White, *Abuse or Protection*, *supra* note 47, at 293. Acquiring business debt (or perhaps converting personal debt into business debt) should not be a problem for most opportunistic debtors. Doctors, for example, are likely to seek bankruptcy protection after a malpractice suit. See, e.g., Edith H. Jones, *The Bankruptcy Galaxy*, 50 S.C. L. Rev. 269, 273 (1999) (“[D]octors who commit malpractice . . . may discharge in bankruptcy the judgments for injury they caused others.”).

182. See *supra* note 136–137 and accompanying text (noting that BAPCPA does not apply to debtors who do not declare formal bankruptcy).

ruptcy. In short, the drafters of BAPCPA never realized that opportunistic debtors might simply bypass the system altogether.

III. MAKING INVOLUNTARY BANKRUPTCY A USABLE DEVICE FOR CREDITORS

Because BAPCPA does not apply to debtors who choose informal bankruptcy, one effective way to give BAPCPA its intended strength is to force such debtors under the Act's scope by compelling them to declare formal bankruptcy. Such a procedure, known as involuntary bankruptcy, could largely eliminate the abuses caused by opportunistic informal bankruptcy that BAPCPA has either left open or even exacerbated. Practitioners have already begun to notice the potentially increased importance of involuntary bankruptcy post-BAPCPA.¹⁸³ At this point, however, opportunistic debtors can all but ignore involuntary bankruptcy because the procedure is virtually impossible for creditors to invoke—one article calls it “the world’s worst debt collection device.”¹⁸⁴

This Part argues that bankruptcy courts should extend the “special circumstances” exception of involuntary bankruptcy to allow creditors to more easily bring the procedure against opportunistic debtors. Though they should still adhere to statutory restrictions on involuntary bankruptcy, courts should disregard judicially created hurdles to the process when confronted with opportunistic debtors using informal bankruptcy. Specifically, courts should be open to involuntary bankruptcy when a debtor, by not filing bankruptcy, can enjoy higher exemptions than if she did file, and her debt well exceeds the BAPCPA-imposed exemption levels. Part III.A examines the statute- and court-imposed hurdles to involuntary bankruptcy and describes the judicially created “special circumstances exception” to one of these hurdles in its currently limited form. Part III.B outlines how courts can interpret the special circumstances exception to apply against informal bankruptcy abusers while ensuring that only judicially created hurdles are bypassed, and Part III.C analyzes potential challenges to this proposal and concludes that expanding involuntary bankruptcy is worthwhile despite these objections.

183. See, e.g., Nelson, *supra* note 136, at 28 (“[D]efensive homestead planning may suggest that a debtor plan to avoid being involuntarily put into bankruptcy.”); Adkisson & Riser, *Bankruptcy Act Impact*, *supra* note 130 (stating that because of BAPCPA “creditors likely will threaten to force a debtor into bankruptcy so that the debtor’s assets can be picked clean”); Patricia A. Redmond & Jessica D. Gabel, *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Summary of Certain Critical Consumer and Exemption Provisions 25, 37* (2005), at Westlaw, SL068 ALI-ABA (on file with the *Columbia Law Review*) (“One of the real consequences that could stem from these modified homestead provisions is a rise in involuntary bankruptcy proceedings.”).

184. Brad R. Godshall & Peter M. Gilhuly, *The Involuntary Bankruptcy Petition: The World’s Worst Debt Collection Device?*, 53 *Bus. Law.* 1315, 1316 (1998) (arguing that involuntary bankruptcy is ineffective as debt collection tool).

A. *The Difficulties of Forcing Involuntary Bankruptcy*

1. *Statutory Hurdles.* — Congress has made it quite difficult for creditors to bring a successful involuntary bankruptcy petition. Whenever a debtor has twelve or more creditors, three such creditors need to cooperate and jointly seek involuntary bankruptcy.¹⁸⁵ Creditors must also show that none of these debts is in “bona fide dispute,”¹⁸⁶ and they must establish that the debtor is “generally not paying such debtor’s debts as such debts become due.”¹⁸⁷ Furthermore, Congress has allowed harsh penalties for a failed involuntary bankruptcy petition; courts rejecting involuntary bankruptcy can impose attorneys’ fees, costs, and even punitive damages on the petitioning creditors.¹⁸⁸

Though widely viewed as a creditor-friendly law,¹⁸⁹ BAPCPA modified involuntary bankruptcy procedures to the benefit of debtors.¹⁹⁰ BAPCPA amended § 303(b) to clarify that creditors can defeat a petition by demonstrating a bona fide dispute as to either the liability or amount of a debt.¹⁹¹ Creditors are also now open to criminal liability if a court deems their petition fraudulent.¹⁹²

2. *Judicial Hostility.* — Courts have been quite reluctant to grant involuntary bankruptcy petitions, interpreting the already strict statutory requirements of involuntary bankruptcy “in a manner which vastly complicates creditors’ difficulties of proof and, therefore, increases the costs and risks associated with seeking bankruptcy relief.”¹⁹³ For example, courts have developed a virtual per se rule against involuntary bankruptcies

185. See 11 U.S.C.A. § 303(b)(1) (West 2007). The creditors must also hold in aggregate \$13,475 in claims. *Id.* Though a single creditor can force involuntary bankruptcy if there are fewer than twelve creditors, this scenario rarely occurs. See Godshall & Giluhy, *supra* note 184, at 1321 (“Few alleged debtors will have less than twelve creditors.”).

186. 11 U.S.C.A. § 303(b)(1).

187. *Id.* § 303(h)(1).

188. See *id.* § 303(i).

189. See *supra* notes 16–19 (detailing opposition to BAPCPA, mainly on grounds that Act was heavily influenced by creditor lobby).

190. See Richard J. Reynolds, *Involuntary Bankruptcies as a Creditor Strategy* (Dev. in Asset Protection and Wealth Preservation), May 2005, at http://www.assetprotectionbook.com/Dev_May2005.htm (on file with the *Columbia Law Review*) (calling BAPCPA’s changes to involuntary bankruptcy “pro-debtor provision[s]”).

A BAPCPA drafting error may have inadvertently made involuntary bankruptcy impossible. Targets of an involuntary bankruptcy petition may claim that they are not “debtors,” and thus not eligible for involuntary bankruptcy, because they have not received BAPCPA’s required credit counseling. See Maria Ann Milano, *Involuntary Bankruptcy: The End Has Come*, *Bus. L. Today*, Jan./Feb. 2007, at 8, 8.

191. See 11 U.S.C.A. § 303(b)(1) (adding phrase “as to liability or amount” concerning bona fide dispute).

192. See 18 U.S.C. § 157(1) (2000) (allowing criminal penalties for “a fraudulent involuntary bankruptcy petition”).

193. Lawrence Ponoroff, *Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute*, 65 *Ind. L.J.* 315, 351 (1990).

when sought by only a single creditor.¹⁹⁴ Courts also are quite sympathetic to a debtor's claims that her debts are subject to some type of bona fide dispute.¹⁹⁵ Congress merely permits attorneys' fees awards upon dismissal of an involuntary bankruptcy petition,¹⁹⁶ but bankruptcy courts appear to award costs and fees, if not punitive damages, "as a matter of course" if the petition does not meet the technical requirements set by § 303.¹⁹⁷ Several particularly hostile courts have held that involuntary bankruptcy cannot be used as a debt collection device at all.¹⁹⁸ Such decisions have made involuntary bankruptcy virtually useless to creditors seeking to collect from opportunistic debtors.¹⁹⁹

3. *The Special Circumstances Exception.* — Some circuits have adopted a limited "special circumstances" exception to otherwise strict, judicially imposed involuntary bankruptcy requirements. Under this rule, courts will depart from their judicially created "Almost Per Se Rule"²⁰⁰ against awarding involuntary bankruptcy on a single-creditor petition if "(1) the sole creditor would be without an adequate remedy in non-bankruptcy law or (2) there is a showing of special circumstances amounting to fraud,

194. See, e.g., *Bankers Trust Co. v. BT Serv. Co. v. Nordbrock* (In re Nordbrock), 772 F.2d 397, 399 (8th Cir. 1985) (stating that single creditor seeking debt collection via involuntary bankruptcy is "a practice condemned in prior decisions"). New York, however, has departed from this rule. See *Crown Heights Jewish Cmty. Council, Inc. v. Fischer* (In re Fischer), 202 B.R. 341, 347–48 (E.D.N.Y. 1996) (finding that "the Almost Per Se Rule is inconsistent with the language of 11 U.S.C. § 303(h)(1)"). Courts still adhering to this rule have carved out two exceptions, which are the basis for the "special circumstances" exception. See *infra* Part III.A.3.

195. Cf. *Godshall & Gilhuly*, *supra* note 184, at 1326–27 (analyzing "bona fide dispute" requirement and noting "the degree of ingenuity of alleged debtors in developing such disputes").

196. See 11 U.S.C.A. § 303(i).

197. *Godshall & Gilhuly*, *supra* note 184, at 1333. But see *Mason v. Smith*, 672 A.2d 705, 708 (N.H. 1996) (holding that debtor cannot seek any remedies against petitioning creditor for failed involuntary bankruptcy petition that are not expressly authorized by Bankruptcy Code).

198. See, e.g., *MAG Bus. Servs. v. Whiteside* (In re Whiteside), 240 B.R. 762, 766 (Bankr. W.D. Mo. 1999) ("[T]he remedy of involuntary bankruptcy was not intended to be a substitute for ordinary debt collection procedures."); *Remex Elecs. Ltd. v. Axl Indus., Inc.* (In re Axl Indus., Inc.), 127 B.R. 482, 484 (S.D. Fla. 1991) ("Allowing creditors to use the bankruptcy court as a routine collection device would quickly paralyze the court."); *In re Broshear*, 122 B.R. 705, 707 (Bankr. S.D. Ohio 1991) ("It is not acceptable to initiate an involuntary bankruptcy in furtherance of debt collection activities by a creditor or creditors against a debtor."). But see *In re All Media Properties, Inc.*, 5 B.R. 126, 137 (Bankr. S.D. Tex. 1980) ("The purpose of an involuntary [bankruptcy] procedure is to provide a method for creditors to protect their rights against debtors who are not meeting their debts.").

199. See *Godshall & Gilhuly*, *supra* note 184, at 1316 ("[T]he perceived benefits of an involuntary bankruptcy petition are almost always illusory and are almost always outweighed by the litigation and practical difficulties of advancing such a case.").

200. *Crown Heights Jewish Cmty. Council, Inc. v. Fischer* (In re Fischer), 202 B.R. 341, 347–48 (E.D.N.Y. 1996).

trick, artifice or scam.”²⁰¹ Courts in several circuits have embraced the special circumstances exception,²⁰² though others refuse to adopt the rule.²⁰³ Most courts that allow the exception, however, invoke it only in single-creditor cases and only when there are no statutory grounds for denying involuntary bankruptcy, such as the requirement that debts not be in bona fide dispute.²⁰⁴ In its current limited state, therefore, the special circumstances exception is dwarfed by overall judicial reluctance to grant involuntary bankruptcy petitions and offers little relief to creditors.

Finally, unsecured creditors—even those who did not join the involuntary claim—must share proceeds from the debtor’s estate pro rata.²⁰⁵ Therefore, there is little incentive for creditors to run the substantial risks of seeking involuntary bankruptcy when they can just be free riders off a petition filed by other creditors. It is not surprising, then, that involuntary bankruptcies are exceedingly rare;²⁰⁶ as currently structured, creditors find that they are just not worth the risk.²⁰⁷

201. *In re B.D. Int’l Disc. Corp.*, 13 B.R. 635, 638 (Bankr. S.D.N.Y. 1981) (citing *In re Arker*, 6 B.R. 632 (Bankr. E.D.N.Y. 1980); *In re 7H Land and Cattle Co.*, 6 B.R. 29 (Bankr. D. Nev. 1980)).

202. See, e.g., *Concrete Pumping Serv., Inc. v. King Constr. Co.* (*In re Concrete Pumping Serv., Inc.*), 943 F.2d 627, 630 (6th Cir. 1991) (noting exception “where there is evidence of ‘fraud, artifice, or scam’” (quoting *In re Smith*, 123 B.R. 423, 426 (Bankr. M.D. Fla. 1990))).

203. See *Rothery v. Cunningham* (*In re Rothery*), 211 B.R. 929, 934–35 (B.A.P. 9th Cir. 1997) (rejecting exception and stating that court is “unpersuaded by the reasoning” in Texas case applying it), *rev’d* on other grounds, 143 F.3d 546 (9th Cir. 1998); Bruce H. White & William L. Medford, *Exceptions to Involuntary Petition Requirements: Are You Pushing Your Luck?*, *Am. Bankr. Inst. J.*, Oct. 2001, at 32, 33 (“[T]he special-circumstances exception is not recognized by all courts.”).

204. See White & Medford, *supra* note 203, at 32 (stating that no decisions adopting the special circumstances exception “contain findings that would otherwise prevent the entry of an order for relief”). But see *In re Moss*, 249 B.R. 411, 424 (Bankr. N.D. Tex. 2000) (broadening scope of special circumstances exception beyond single-creditor case by finding that there is “no logical reason why that exception should not be available to avoid dismissal of an involuntary petition on other technical grounds”).

205. See Wesley H. Avery, *Involuntary Bankruptcy Petitions: The Ultimate Debt Collection Device?*, 116 *Banking L.J.* 683, 688 (1999) (stating that under involuntary bankruptcy, “assets of the debtor will be used to pay all creditors who are determined to have allowed claims against the debtor’s estate, not just the claims of the petitioning creditors, if allowed”); David A. Samole & Lisa B. Keyfetz, *New Law, New Tools for Creditors: A Fresh Look at the Involuntary Bankruptcy Petition*, *Bus. L. Today*, Nov.–Dec. 2005, at 17, 19 (stating that nonexempt debtor equity “accrue[s] to the benefit of all unsecured creditors pro rata . . . not just the petitioning creditors”).

206. See, e.g., John E. Sullivan III, *New Rules, Old Game, Tr. & Est.*, June 2005, at 59, 60 (finding that in 2004 only 602 involuntary bankruptcies were filed, compared to 1.6 million voluntary bankruptcies).

207. See Godshall & Gilhuly, *supra* note 184, at 1341 (“[I]t should be clear that commencing an involuntary bankruptcy case against a defaulting borrower rarely makes economic sense for a creditor.”). But see Susan Block-Lieb, *Why Creditors File So Few Involuntary Petitions and Why the Number Is Not Too Small*, 57 *Brook. L. Rev.* 803, 806 (1991) (arguing that creditors’ “preference for a negotiated resolution of a debtor’s

B. *Expanding the Special Circumstances Exception to Make Involuntary Bankruptcy More Plausible*

To date, it appears that no court has ruled on a case in which creditors attempted to force involuntary bankruptcy on an opportunistic debtor who had used informal bankruptcy to avoid BAPCPA's exemption caps.²⁰⁸ Should a case arise, however, courts could significantly deter future opportunistic informal bankruptcy by broadening the special circumstances exception to cover all judicially created obstacles against involuntary bankruptcy.²⁰⁹ This exception is particularly applicable to individuals who would be forced to relinquish significant assets under BAPCPA's restricted exemptions but instead use state law exemptions and informal bankruptcy to avoid BAPCPA's reach.

1. *Applying the Special Circumstances Exception to Informal Bankruptcy.* — Creditors can argue persuasively that opportunistic informal bankruptcy deprives them of an "adequate remedy in non-bankruptcy law."²¹⁰ Bankruptcy courts usually invoke the adequate remedy exception only when bankruptcy law offers procedural remedies unavailable under state law.²¹¹ Here, by contrast, creditors are arguing that the state law remedy is substantively inadequate—that creditors would get more under bankruptcy law. Even so, creditors have a strong case, especially when dealing with egregious opportunistic debtors who have moved to unlimited homestead exemption states and would fall under BAPCPA's exemption limitations.²¹² In such cases, creditors could recover on most of their claims under bankruptcy law, but would recoup virtually nothing under state law, where the generous exemptions would apply in full force.²¹³

financial difficulties," more so than technical requirements, explains infrequency of involuntary petitions).

208. See Samole & Keyfet, *supra* note 205, at 17 ("[T]here is no published case law to support the use of an involuntary bankruptcy petition to obtain otherwise exempt equity in homestead property for the benefit of creditors.").

209. There is precedent for expanding the special circumstances exception. See *In re Moss*, 249 B.R. at 424.

210. *In re B.D. Int'l Disc. Corp.*, 13 B.R. 635, 638 (Bankr. S.D.N.Y. 1981) (citing *In re Arker*, 6 B.R. 632 (Bankr. E.D.N.Y. 1980); *In re 7H Land and Cattle Co.*, 6 B.R. 29 (Bankr. D. Nev. 1980)). For a somewhat contrary opinion, see *In re Smith*, 123 B.R. 423, 426–28 (Bankr. M.D. Fla. 1990) (dismissing involuntary bankruptcy case despite creditor's claim that he could only recover assets in ERISA plan under bankruptcy law, and not at all under state law). In that case, however, the court based its decision partly on its finding that a creditor's ability to reach an ERISA plan in a state or bankruptcy context was an unsettled legal issue.

211. Courts have applied the exception to allow creditors to bring preference actions, which can only be brought in bankruptcy court. See 11 U.S.C. § 547 (2000 & Supp. V 2005) (describing preference actions); *In re H.I.J.R. Props. Denver*, 115 B.R. 275, 278 (D. Colo. 1990) ("Since a preference action can only be brought in the bankruptcy court, [creditor] had no adequate remedy under state or federal non-bankruptcy law . . ."); *In re Wagner*, 53 B.R. 93, 95 (Bankr. W.D. Wis. 1985) (holding that "arguably preferential transfers" contributed to finding of special circumstances).

212. See *supra* Part I.C.1.

213. See *supra* notes 55–56 and accompanying text.

This substantive difference is so great that a court should find that it amounts to a special circumstance; creditors truly are denied an appropriate remedy under nonbankruptcy law. The more egregious the case—that is, the more opportunistic the debtor—the more appropriate the special circumstances exception.

Bankruptcy courts often associate fraud with fraudulent transfers or cases where debt was acquired through fraudulent practices.²¹⁴ A court should also find “fraud, trick, artifice or scam”²¹⁵ if it determines that a debtor is merely delaying bankruptcy until the forty month exemption restriction under § 522(p) lapses, at which point the debtor can claim a large state exemption.²¹⁶ Purchasing a large homestead, then delaying bankruptcy just to wait out the BAPCPA exemption limitations appears to meet the definition of “trick,” or, in bankruptcy language, appears to be an action done “with the intent to hinder [or] delay . . . a creditor.”²¹⁷

Courts should be especially willing to force involuntary bankruptcy on debtors who would fall under § 522(q)’s exemption limitation for fraud.²¹⁸ A court that decides a debtor’s actions place her under the scope of § 522(q) has likely already found the necessary fraud to grant the involuntary bankruptcy petition under the special circumstances exception.

2. *Maintaining Consistency with the Text of the Bankruptcy Code.* — A broadening of the special circumstances exception is particularly appealing because it in no way departs from the language of the Bankruptcy Code. Though Congress certainly has placed significant hurdles for creditors seeking an involuntary bankruptcy petition, the true creditor deterrent has been courts’ exceedingly strict interpretation of these standards against creditors.²¹⁹ Courts have, on their own, broadly interpreted these statutory hurdles, added a virtual per se rule against single-creditor petitions, awarded debtors attorneys’ fees and costs as a matter of course, and decreed that involuntary bankruptcy cannot be used as a debt collection device.²²⁰ This Note’s proposal calls merely for eliminating these judi-

214. See, e.g., *Concrete Pumping Serv., Inc. v. King Constr. Co.* (In re Concrete Pumping Serv., Inc.), 943 F.2d 627, 630 (6th Cir. 1991) (finding fraud where debtor avoided satisfying judgment by recouping her company’s assets via suspicious security agreement and using assets to start identical business); *In re Norriss Bros. Lumber Co.*, 133 B.R. 599, 608–09 (Bankr. N.D. Tex. 1991) (finding “arguable fraudulent conveyances” surrounding company’s disbanding and ruling that conveyances constitute special circumstances).

215. *In re B.D. Int’l Disc. Corp.*, 13 B.R. at 638 (citing *In re Arker*, 6 B.R. 632; *In re 7H*, 6 B.R. 29).

216. See *supra* Part I.C.1.

217. 11 U.S.C.A. § 522(o) (West 2007).

218. See *id.* § 522(q) (capping total exemptions at \$136,875 when debt is acquired via various fraudulent actions); *supra* Part I.C.2.

219. See Ponorof, *supra* note 193, at 351–52 (“[C]ourts have largely neutralized any benefits that creditors might have otherwise gained by resort to the involuntary bankruptcy remedy.”).

220. See *supra* Part III.A.2.

cially imposed hurdles and more strictly interpreting statutory obstacles when creditors can show special circumstances, which roughly approximates to cases where a debtor is behaving opportunistically. Considering that Congress passed BAPCPA with the goal of curbing bankruptcy abuses,²²¹ this new judicial rule is far more in line with congressional intent than is courts' current overly hostile attitude.

Courts wishing to bypass statutory restrictions on involuntary bankruptcy may find support in a recent Supreme Court case strengthening bankruptcy courts' power to act outside the express limits of the Bankruptcy Code. In *Marrama v. Citizens Bank of Massachusetts*, the Supreme Court ruled that a debtor does not have an absolute right to convert her bankruptcy from Chapter 7 to Chapter 13,²²² even though the Code grants debtors the right to convert "at any time"²²³ and deems any waiver of that right "unenforceable."²²⁴ The Court found that "[n]othing in the text of [any relevant provision] limits the authority of the court to take appropriate action in response to fraudulent conduct by the atypical litigant who has demonstrated that he is not entitled to the relief available to the typical debtor."²²⁵ It concluded that, under § 105(a) of the Bankruptcy Code, bankruptcy judges have "broad authority to take necessary or appropriate action 'to prevent an abuse of process.'"²²⁶

The Court's holding does not directly apply to involuntary bankruptcy, where there is not yet any "debtor" to commit an "abuse of process." However, bankruptcy courts could read the ruling as an expansion of § 105(a)'s grant of equitable powers, which allows bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.²²⁷ If so, bankruptcy courts dealing with opportunistic debtors may now have increased equitable authority to look past even statutory restrictions on involuntary bankruptcy.

221. See *supra* notes 10, 84–88 and accompanying text.

222. 127 S. Ct. 1105, 1111–12 (2007).

223. 11 U.S.C. § 706(a) (2000 & Supp. V 2005).

224. *Id.*

225. *Marrama*, 127 S. Ct. at 1111 (quoting 11 U.S.C. § 105(a)).

226. *Id.* at 1112 (quoting 11 U.S.C. § 105(a)).

227. 11 U.S.C. § 105(a). Until *Marrama*, courts had limited a bankruptcy judge's discretion under § 105(a) to deviate from the text of the Bankruptcy Code. See Jeffery W. Warren & Shane G. Ramsey, Revisiting the Inherent Equitable Powers of the Bankruptcy Court: Does *Marrama v. Citizens Bank of Massachusetts* Signal a Return to Equity?, *Am. Bankr. Inst. J.*, Apr. 2007, at 22, 22, 62–63 (2007) (arguing that *Marrama* "appears to have reversed this limiting decisional trend by approving a bankruptcy court's broad acts of equitable pragmatism, notwithstanding statutory language suggesting that a different course of action must be taken").

C. *Challenges to Expansion of the Special Circumstances Exception*

1. *An Unfair Burden on Debtors.* — The most apparent concern over expanding the special circumstances exception is that in their attempt to thwart opportunistic debtors, courts will harm honest debtors as well, forcing them into bankruptcy when they could have and wanted to recover financially on their own. This potential burden is what led Congress and the courts to make involuntary bankruptcy such a difficult remedy to invoke.²²⁸ To be sure, even this Note's proposed small broadening of involuntary bankruptcy—stating that courts should invoke the special circumstances exception when a debtor under state law has more exemptions than under BAPCPA, has debt exceeding the BAPCPA levels, and yet refuses to declare bankruptcy—may potentially lead to creditor abuse against nonopportunistic debtors. For example, individuals who honestly and unexpectedly incur significant debt (above BAPCPA levels) should not immediately be forced into bankruptcy just because they could exempt less under BAPCPA than under the relevant law, at least not without being given a chance to recover financially. Courts, therefore, must refine a rule for expanding the special circumstances exception before invoking it even against opportunistic debtors; for example, they could require that a debtor be making little or no effort to repay her debts for several months after they became due.²²⁹

Ultimately, however, fears of abuse against honest, nonopportunistic debtors are unwarranted. This Note's proposal leaves all statutory hurdles to involuntary bankruptcy intact. In particular, debtors can still show that they are generally paying off their debts as they become due or that a creditor's claims supporting the involuntary petition are subject to a bona fide dispute.²³⁰ The initial burden of proof for all these tests remains on the creditor,²³¹ and creditors still risk liability for costs and attorneys'

228. See, e.g., *In re Reid*, 773 F.2d 945, 946 (7th Cir. 1985) (pointing out involuntary bankruptcy's "serious consequences to the alleged debtor, such as loss of credit standing, inability to transfer assets and carry on business affairs, and public embarrassment"); Eric J. Taube, *Involuntary Bankruptcy: Who May Be a Petitioning Creditor?*, 21 *Hous. L. Rev.* 339, 339 (1984) (stating that involuntary bankruptcy "is one of the most extreme remedies available to a creditor in its efforts to collect debts" and that "[t]he effect of the allegation itself, even without the entry of an order for relief against the debtor, can be devastating"); Samole & Keyfetz, *supra* note 205, at 17 (noting "obvious burdens imposed on debtors").

229. Congress, of course, could specifically delineate circumstances under which opportunistic debtors can be forced into bankruptcy. However, the current special circumstances exception is an entirely judicial construction, and there is little indication Congress will codify this rule. See White & Medford, *supra* note 203, at 33 ("The special-circumstances exception is judicially created with no codified support."); *infra* Part III.B.2.

230. See *supra* Part III.A.1.

231. See *In re Caucus Distribs., Inc.*, 106 B.R. 890, 909 (Bankr. E.D. Va. 1989) (placing burden of proof on creditor to show debtor is generally not promptly paying debts); David S. Kennedy et al., *The Involuntary Bankruptcy Process: A Study of the Relevant Statutory and Procedural Provisions and Related Matters*, 31 *U. Mem. L. Rev.* 1, 15 (2000) ("[C]ourts have held that the burden of proof regarding whether a particular

fees.²³² Additionally, this proposal calls for courts to modify their approach toward involuntary bankruptcy only when debtors are trying to avoid BAPCPA's \$137,000 exemption caps. Only a small minority of debtors would ever be in a position to exempt more than that amount.²³³ In short, even after broadening the special circumstances exception, involuntary bankruptcy includes enough debtor protections to make such abuse against nonopportunistic debtors unlikely.

2. *Congressional Rather Than Judicial Change.* — A second challenge to broadening the special circumstances exception argues that Congress, not the courts, is the most appropriate forum for reforming involuntary bankruptcy procedures.²³⁴ To be sure, congressional action is the major means of bankruptcy change,²³⁵ and Congress could certainly lower involuntary bankruptcy hurdles when creditors seek to force bankruptcy against opportunistic debtors. For example, Congress could institute a means test associated with involuntary bankruptcy,²³⁶ perhaps allowing creditors to meet a lower burden of proof against consumer debtors who have substantially more assets or income than median levels.

Yet this Note proposes that courts lead the way in relaxing involuntary bankruptcy standards because Congress is highly unlikely to make the required revisions to the Bankruptcy Code. Academics and consumer advocates have almost universally criticized BAPCPA for selling out to the creditor lobby at the expense of individual debtors.²³⁷ Given this hostility, it is unreasonable to expect that Congress will relax the requirements of involuntary bankruptcy anytime soon; the political opposition to such creditor-friendly changes would be substantial.²³⁸

debt is the subject of a bona fide dispute initially rests with the non-moving party (i.e., the petitioning creditors).”).

232. See 11 U.S.C.A. § 303(i) (West 2007); supra Part III.A.1.

233. See L. Jacobo Rodriguez, *Bankruptcy Reform Needed Now More Than Ever*, Sept. 27, 2002, at http://www.cato.org/pub_display.php?pub_id=3609 (on file with the *Columbia Law Review*) (“[B]ecause the exemption levels are usually high or filers have few nonexempt assets, in over 90 percent of Chapter 7 cases there is no property to be liquidated.”).

234. See, e.g., *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) (“[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.”); *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434, 455 (1940) (“A bankruptcy court . . . is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act.”). But see supra notes 222–227 and accompanying text (arguing that *Marrama v. Citizens Bank of Massachusetts*, 127 S. Ct. 1105 (2007), may have granted bankruptcy courts expanded equitable powers).

235. See supra note 25 and accompanying text (stating that Constitution grants Congress explicit authority to make bankruptcy laws).

236. For a brief explanation of a bankruptcy means test, see supra Part II.C.2.

237. See supra notes 16–19 (detailing opposition to BAPCPA, mainly on grounds that law was heavily influenced by creditor lobby).

238. Cf. Deborah L. Thorne & Jesus Batista, *Involuntary Bankruptcy: The Last Word on When the Dispute Is Bona Fide!*, *Bus. Credit*, May 2004, at 78, 78 (“[A]n involuntary bankruptcy petition is among the most powerful weapons in the creditor’s arsenal . . .”).

It is also doubtful that Congress could modify the Bankruptcy Code without ultimately relying on court interpretation to enforce the new provisions against opportunistic debtors. Consider if Congress codified the judicial special circumstances exception²³⁹ for use against opportunistic debtors. In that case, Congress would still have to define such terms as “adequate remedy in non-bankruptcy law”²⁴⁰ or “fraud, trick, artifice or scam.”²⁴¹ Yet Congress has historically left such definitions to the courts; for example, it has relied on the courts to define “fraud” as it relates to fraudulent transfers in prebankruptcy planning.²⁴² In the end, therefore, it will be up to the courts to ensure that involuntary bankruptcy truly deters opportunistic activity. Given that courts have created the toughest hurdles to involuntary bankruptcy,²⁴³ it makes sense that they be given a prominent role in a solution that involves relaxing these restrictions.

CONCLUSION

For all the criticisms aimed at BAPCPA, perhaps the Act’s most damning problem is its failure to accomplish its purported primary purpose—stopping bankruptcy abuse. Even if the new law works perfectly, opportunistic debtors can still use generous or unlimited state property exemptions to shield their substantial assets from creditors via informal bankruptcy. In an effort to drive opportunistic debtors out of bankruptcy, Congress forgot that the ultimate goal was not merely to keep such debtors from filing bankruptcy, but rather to make them pay their debts. BAPCPA may achieve the first aim, but, because of informal bankruptcy, it is unlikely to meet the second, more fundamental goal.

This Note proposes a relaxation of judicially imposed obstacles to involuntary bankruptcy in order to help force opportunistic debtors under BAPCPA’s more restrictive exemption system. This remedy, however, is only a small step toward addressing the issues arising from the barely researched phenomenon of informal bankruptcy. Congress largely ignored informal bankruptcy when passing BAPCPA, and scholars have only recently begun to examine the practice. Analyses of BAPCPA’s impact routinely fail to consider informal bankruptcy as a substitute for formal bankruptcy filings.²⁴⁴ This Note itself addresses just one aspect of

239. See *supra* Part III.A.3 (describing special circumstances exception).

240. In *re* B.D. Int’l Disc. Corp., 13 B.R. 635, 638 (Bankr. S.D.N.Y. 1981) (citing In *re* Arker, 6 B.R. 632 (Bankr. E.D.N.Y. 1980); In *re* 7H Land and Cattle Co., 6 B.R. 29 (Bankr. D. Nev. 1980)).

241. *Id.*

242. See Moringiello, *supra* note 146, at 625–29 (detailing courts’ struggles with defining fraud given limited congressional guidance).

243. See *supra* Part III.A.2.

244. See, e.g., Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act: Hearing Before the S. Comm. on the Judiciary, 109th Cong. (2006) (written testimony of Robert M. Lawless, Professor, University of Illinois College of Law), available at http://judiciary.senate.gov/testimony.cfm?id=2442&wit_id=5936 (on file with the *Columbia Law Review*) (pessimistically analyzing decline in

informal bankruptcy—namely, its impact on state property exemptions—leaving many other aspects of this issue unexplored.²⁴⁵

Congress has a variety of options should it decide to address informal bankruptcy. It may be content to let state law govern debtors who do not declare formal bankruptcy—tacitly approving the opportunistic informal bankruptcy loophole—or it may eliminate all state discretion by federalizing exemption levels entirely.²⁴⁶ Yet because informal bankruptcy is such an easy and attractive option for opportunistic debtors, no legislative effort against bankruptcy abusers will ever be effective until courts, and especially Congress, properly address the widespread and likely growing informal bankruptcy phenomenon.

bankruptcy filing rates post-BAPCPA but failing to consider possible changes in informal bankruptcy levels); Charles J. Tabb, *Consumer Filings: Trends and Indicators, Part I*, Am. Bankr. Inst. J., Nov. 2006, at 1 *passim* (statistically analyzing post-BAPCPA drop in filing rates without attempting to measure changes in informal bankruptcy levels).

245. There are likely several open questions regarding informal bankruptcy and BAPCPA. For example, nonopportunistic debtors subject to means testing may also prefer informal bankruptcy to Chapter 13, which could be required under a means test. See *supra* notes 33–40 and accompanying text; Part II.C.2. Additionally, it is unclear how well courts will be able to detect opportunistic informal bankruptcy or differentiate it from tolerated prebankruptcy planning.

246. Congress seriously considered completely federalizing exemptions during debate over the Bankruptcy Reform Act of 1978. See Cole, *supra* note 54, at 247 (noting “occurrence of a heated battle over whether a federal exemption scheme would be adopted to replace the old system of looking to the states”).