

# Race and Consumer Bankruptcy

by

Edward R. Morrison and Antoine Uettwiller\*

Among consumers who file for bankruptcy, African Americans file Chapter 13 petitions at substantially higher rates than other racial groups. Some have hypothesized that the difference is attributable to discrimination by attorneys, who “steer” African American debtors into Chapter 13, instead of Chapter 7, which is less lucrative for the attorneys. We explore an alternative hypothesis: Among distressed consumers, African Americans have longer commutes to work and supermarkets, rely more heavily on cars for these commutes, and therefore have greater demand for a bankruptcy process (Chapter 13) that allows them to retain their cars. We begin by showing that African Americans tend to have longer commuting times than other consumers and, when they do have longer commuting times, they also have relatively high Chapter 13 filing rates. We show this using data from Atlanta, Chicago, and Memphis, each of which has been identified as a location with overrepresentation of African Americans in Chapter 13. We then test our hypothesis that African Americans’ reliance on automobiles is a cause of their substantially higher use of Chapter 13. We do this using data from Chicago, where the city recently implemented an aggressive program to collect parking debts by seizing the cars and suspending the licenses of consumers with large debts. We show that this city-wide program disproportionately affected African Americans living on the West and South Sides of the City. Because African Americans were most affected by the program, their share of Chapter 13 filings increased substantially. Although we do not disprove the possibility of discrimination by attorneys, our data show that selection effects are potentially as important in explaining racial patterns in Chapter 13 cases.

DEAR COLLEAGUES: THE FOREGOING ABSTRACT DESCRIBES A WORK-IN-PROGRESS THAT I WILL PRESENT AT THE UPCOMING BLUE SKY MEETING ON MONDAY, NOVEMBER 27. THIS PROJECT EXTENDS PRIOR WORK SUMMARIZED IN THE ATTACHED PAPER.

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# Consumer Bankruptcy Pathologies

by

Edward R. Morrison and Antoine Uettwiller\*

This paper questions several long-standing descriptions of consumer bankruptcy in the United States. We focus on Chapter 13, which discharges debts after consumers pay disposable income to creditors for up to five years. Many studies document pathologies, including high failure rates, racial disparities, low creditor recoveries, and attorney biases. We observe the same patterns in new data drawn from Cook County, Illinois, but show that these pathologies are central tendencies that ignore substantial heterogeneity across consumers. Several pathologies are driven by subsets of consumers; some disappear once we take account of consumer heterogeneity. We present new evidence that some pathologies reflect biases in nonbankruptcy law, not in the bankruptcy process itself. (JEL: J22, K35, D14)

## 1 Introduction

The United States is one of the few countries in the world to offer consumers alternative paths to achieving a discharge of debt in bankruptcy court. One path is liquidation in Chapter 7: the consumer obtains a discharge by liquidating assets. Another is a “reorganization” in Chapter 13: the consumer obtains a discharge by complying with a repayment plan, which involves paying all disposable income to creditors during a three- to five-year period.

An emerging empirical literature documents the characteristics of consumers who select Chapter 13 and their case outcomes. The literature points to puzzling patterns and pathologies: Although Chapter 13 is primarily attractive as a way to

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avoid liquidation of assets, it rarely does that in practice. The vast majority of consumers – over two-thirds – fail to complete their repayment plans. Their cases are terminated – either dismissed or converted to Chapter 7 – exposing their assets to the very liquidation they tried to avoid. This pattern is especially puzzling because Chapter 13 cases are substantially more expensive for the consumer: fees charged by attorneys and trustees (who assist the court in administering the bankruptcy process) are at least three times as large as in Chapter 7. Why do consumers pay such high fees to commence a process that is highly likely to fail?

Other studies have pointed to racial disparities in Chapter 13: African-American consumers are substantially more likely to choose Chapter 13, instead of Chapter 7, than other racial and ethnic groups. Cases filed by African Americans are also substantially more likely to terminate prematurely, leading to liquidation of their assets. These racial disparities are thought to be driven, at least in part, by attorneys who systematically “steer” African-American clients into Chapter 13. Indeed, a related literature suggests that the high fees available in Chapter 13 lead attorneys to push consumers, regardless of race, into Chapter 13 even when there is little financial benefit (relative to Chapter 7) for the consumer. And although attorneys may benefit from Chapter 13, an emerging set of studies suggests that creditors obtain little or no benefit. One study reports that the median recovery to both secured and unsecured creditors is zero in Chapter 13 cases.

These patterns and pathologies – high failure rates, racial disparities, attorney agency problems, and low financial benefits to both consumers and creditors – raise questions about (i) why rational consumers select Chapter 13 even when the apparent benefits are low and (ii) whether these pathologies can be mitigated by legal or other reforms.

The goal of this paper is to present a new battery of facts drawn from bankruptcy cases filed in an urban setting, Cook County, Illinois, which includes Chicago and immediately surrounding suburbs and is within the jurisdiction of the Bankruptcy Court for the Northern District of Illinois. In some respects, these facts complement the findings of prior scholars. But the paper also presents new patterns that cast doubt on inferences drawn from prior studies. In particular, we present the following findings.

First, prior studies ignore substantial heterogeneity in the benefits of Chapter 13 cases to consumers. Some consumers have incurred fines that are dischargeable in Chapter 13, but not in Chapter 7. Some have become delinquent on mortgages and seek additional time to “come current” on past-due amounts. Some must use Chapter 13 because their incomes disqualify them from filing for Chapter 7. Once we account for this heterogeneity in case type, a number of patterns and pathologies become questionable.

Second, it is often said that Chapter 13 is a way to “save your home” from liquidation, but our data from Cook County show that this is not true for over a third of consumers. A large proportion of Chapter 13 filers – between one-third and a half – are filing because local governments have suspended, or are threatening to suspend, their driving licenses or seize their cars because they have accumulated

excessive fines (usually parking tickets). These consumers tend to have few or no assets and incomes near the poverty line. They appear to be filing to prevent the government from holding their licenses or cars as hostages for repayment.

Third, failure rates vary substantially by consumer type in our data. They are half as large among consumers who file Chapter 13 in order to save their homes as among consumers with excessive fines.

Fourth, racial disparities observed in prior work appear to be a product, at least in part, of racial disparities in the incidence of fines. At least in Cook County, African Americans may be substantially more likely to incur fines. Among consumers without parking tickets, we observe smaller disparities in the proportion of cases filed by African Americans. Moreover, even though African Americans make up the bulk of consumers with fines, case outcomes among these consumers exhibit few of the racial disparities found in prior studies. Paradoxically, the category of cases generating the appearance of racial discrimination – consumers with fines – is also the category where we are least likely to observe race-based differences in case outcomes.

Finally, creditor recoveries vary substantially with the value of the assets at risk of liquidation, but in a counterintuitive way. Unsecured creditors achieve higher returns in Chapter 13 (relative to Chapter 7) when their expected recovery in Chapter 7 is smaller. This appears to be due, in part, to efforts by bankruptcy trustees to require consumers in Chapter 13 to pay at least 10% recoveries to unsecured creditors, even when these creditors would receive nothing in Chapter 7. The policy applied by trustees might also contribute to Chapter 13 failure rates, because consumers agree to pay more than they can potentially afford.

We present these and other facts in this short paper for two reasons: to raise questions about prior work, and to motivate future scholarship. Section 2 describes the institutional setting that we study here. Section 3 summarizes the patterns and pathologies documented in prior work. Sections 4 and 5 describe our data and present summary statistics that confirm what was found in prior work. Section 6 presents our results. Section 7 concludes. Because our results are drawn from Cook County, Illinois, future work is needed to assess whether patterns observed here are evident in other areas too. In many respects, as shown below, the characteristics of Cook County consumers are very similar to those documented in other studies. There are, however, features of the institutional environment in Cook County that could raise doubts about the generalizability of our findings. We discuss these issues in section 7.

## 2 Institutional Background

Bankruptcy is a collective proceeding to remedy mass default by a consumer. Most consumers use either Chapter 7 or Chapter 13 to conduct this proceeding. Chapter 7 allows a consumer to trade assets for a discharge of most debts. She gives up assets that are not *exempt* under state or federal law. In Illinois, for example, the consumer

is permitted to keep retirement savings, up to \$2,400 of the value of a motor vehicle, \$15,000 in home equity, and \$4,000 of other property. The value of property in excess of these limits must be distributed to creditors. In practice, however, the vast majority of Chapter 7 bankruptcies involves consumers who give up no assets because all of their property is exempt.

Chapter 13 offers a different bargain: The consumer trades her future disposable income for a broader discharge of debts. She keeps most or all of her assets. The consumer pays her disposable income during a three- to five-year period. The payments are made to a trustee (*Chapter 13 trustee*), who distributes the payments to creditors in order of priority and charges a fee for this service. If the consumer makes all payments scheduled under her *Chapter 13 plan*, she receives a discharge of most debts. Importantly, the discharge in Chapter 13 is broader than in Chapter 7. In particular, a consumer can discharge civil fines owed to government agencies in Chapter 13, but not in Chapter 7.

A Chapter 13 plan is equivalent to an agreement in which creditors lease assets to the consumer in exchange for monthly rental payments. The value of the assets ( $A$ ) is equal to that of the consumer's nonexempt property. The lease term ( $N$ ) is largely fixed by statute: It is three years for consumers with incomes below the state median, it is five years for those with higher incomes, and it can be a shorter period either if the consumer agrees to pay unsecured creditors in full or if the parties consent. The monthly payments ( $b$ ) are also fixed by statute: They must have a present value ( $V$ ) at least as large as the assets  $A$  and not less than the consumer's disposable monthly income ( $y$ ). In practice, consumers propose plans that pay all disposable income ( $b = y$ ). If  $r$  is the monthly discount rate, a Chapter 13 plan promises the following payment stream:

$$V = \sum_{t=1}^N \left( \frac{1}{1+r} \right)^t b \geq A.$$

Notice that all of the parameters except  $r$  are fixed either by statute or by the existing value of the consumer's assets.

The foregoing suggests that a consumer may choose Chapter 13 instead of Chapter 7 in order to prevent liquidation of assets or take advantage of the broader discharge. There is a third reason: Some consumers are ineligible for Chapter 7 because their incomes exceed a *means-test* threshold or because they have already obtained a Chapter 7 discharge in the recent past.

The bankruptcy judge has two primary tasks. One is to decide whether to approve the consumer's plan. A judge will terminate a case – that is, dismiss it or convert it to Chapter 7 – if the plan violates the statute or the consumer is highly unlikely to be able to complete the plan of payments. The second is to decide whether a case should be terminated after an event of default. Consumers commonly miss one or more scheduled payments. A judge can terminate the case, offer forbearance by deferring payment of overdue amounts to a later date, or grant the

consumer's motion to modify the plan (perhaps to reduce the payments due under the plan).

In the typical case, there are three types of creditors: secured, priority, and general unsecured. Secured creditors include mortgage auto, and other lenders with security interests in collateral. Priority debts are unsecured claims that receive priority over general unsecured claims under federal law. These include debts owed for federal taxes and for domestic support obligations. General unsecured claims are a residual category often dominated by credit-card lenders. A Chapter 13 plan generally cannot be confirmed unless it promises to pay secured debt in full or according to its contractual terms (or secured creditors consent to different treatment) and unless it promises to pay most priority debts in full. Unsecured creditors need only be paid at least what they would receive in a Chapter 7 liquidation.

### 3 *Patterns and Pathologies in Prior Scholarship*

Empirical bankruptcy scholarship in the United States presents several patterns and pathologies – some better established and some more puzzling than others – about consumers who select Chapter 13 and their case outcomes.

Perhaps the most durable pattern is that Chapter 13 is primarily attractive to consumers seeking to prevent liquidation of an asset, such as a home or car, as documented by White and Zhu (2010), among others. Indeed, this proposition is seemingly self-evident, because the principal distinguishing feature of Chapter 13, relative to Chapter 7, is avoidance of liquidation.

Another durable pattern is the high rate of termination: Around two-thirds of Chapter 13 cases terminate before the consumer has completed the repayment plan. Li (2007) and Sullivan, Warren, and Westbrook (2003) summarize various studies documenting this pattern. If a case terminates prematurely, either it is converted to a liquidation under Chapter 7 or it is dismissed, allowing creditors to pursue state-law remedies to liquidate the consumer's assets. Thus, a "failed" Chapter 13 case merely delays liquidation. Given the relatively high costs of Chapter 13, which has substantially higher attorney and other fees than Chapter 7, it has long been puzzling why Chapter 13 cases fail as often as they do and why consumers choose Chapter 13 when failure rates are so high.

Chapter 13 cases also exhibit racial disparities and, perhaps, racial discrimination. Braucher, Cohen, and Lawless (2012) show that, among bankruptcy filers, African Americans are substantially more likely than other racial or ethnic groups to file a Chapter 13 case. Using a field experiment, they present evidence that lawyers are more likely to counsel (steer) African-American clients toward Chapter 13 than clients from other racial or ethnic groups.<sup>1</sup> Case outcomes also exhibit racial disparities, as Van Loo (2009) shows using 2001 data: The success rate (de-

<sup>1</sup> Lefgren, McIntyre, and Miller (2010) and McIntyre, Sullivan, and Summers (2015) present additional evidence that attorneys steer clients toward Chapter 13 because these cases are more lucrative.

fined as obtaining a discharge in Chapter 13) for white consumers was 28 %, but only about 20 % for African Americans. Braucher, Cohen, and Lawless (2012) also find that the probability of termination during the first ten to fourteen months after case filing is substantially higher for African Americans (36 %) than for other groups (about 26 %).

Another pattern (or pathology) emerging from the literature is that a nontrivial proportion of consumers file for Chapter 13 even when there is no obvious financial benefit. This phenomenon is a potential implication of the previous two: If some consumers are being steered to Chapter 13 even though they are better suited to Chapter 7, these consumers may derive little financial benefit from the Chapter 13 filing. McIntyre, Sullivan, and Summers (2015) present preliminary evidence from Texas, comparing consumers with different amounts of collateral at risk of liquidation. If a principal goal of Chapter 13 is to prevent liquidation of assets, consumers with relatively little collateral should derive less benefit from Chapter 13 than consumers with large amounts of collateral at risk of liquidation. They find that the likelihood of filing for Chapter 13 depends on the consumer's attorney: Consumers represented by attorneys with a high propensity to use Chapter 13 are more likely to file for Chapter 13 than consumers represented by other attorneys, even if the consumer has little collateral at risk of liquidation.<sup>2</sup>

Finally, creditor recoveries in Chapter 13 are thought to be meager. Using Delaware data from 2001–2002, Eraslan et al. (2014) find that the median recovery rate is zero for both unsecured and secured creditors. Norberg and Velkey (2006) find that unsecured-creditor recoveries average about 19 % overall and about 34 % in cases that reach completion. Lupica (2012) finds a slightly lower recovery rate (26.4 %) to unsecured creditors in completed Chapter 13 cases after 2005.

#### 4 Data

We link two data sets describing Chapter 13 cases filed in Cook County, Illinois. We selected Cook County because of its size and diversity (along economic, racial, and ethnic dimensions), because of its inclusion among jurisdictions cited by Braucher, Cohen, and Lawless (2012) as those exhibiting the highest racial disparities, and because of the availability of data. Our primary data set is drawn from the files of the National Data Center (NDC), which provides case management assistance to Chapter 13 trustees. The NDC data include nearly 81,000 cases filed or closed between 2011 and 2015. The data include information about the plan proposed by the consumer, the amounts owed to various creditors, and the consumer's monthly payment history. Because we are able to track monthly payments and distributions to each creditor, we can measure – at a monthly frequency – the delinquency status of every consumer and the recoveries of each creditor.

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<sup>2</sup> Because the authors do not observe collateral values, they use the value of secured debt as a proxy for the value of collateral.

We link the NDC data to court filings maintained by the Bankruptcy Court for the Northern District of Illinois, whose jurisdiction includes Cook County. From this court, we obtained a copy of the docket text, bankruptcy petition, financial schedules, Chapter 13 plan, plan modifications, and other documents (*court data*) for every case. We searched these documents mechanically or by hand to extract financial and demographic information about each consumer, including name, income, number and ages of household members, property address, assets and liabilities, and exempt and nonexempt property. We limit our sample to cases filed by consumers living in Cook County. The court data include bankruptcy filings for a longer period (1981 to present) than the NDC data and include both Chapter 7 and 13 filings. Although we focus primarily on the intersection between the NDC and court data, we use the nonintersecting court data to illustrate differences in the characteristics of Chapter 7 and 13 consumers.

Because we have each consumer's name and property address, we can also estimate gender, race, and ethnicity. We estimated gender using a database (Genderbase) purchased from a vendor. We estimated race and ethnicity using Census Data (which report race and ethnicity by zip code from the 2010 census and by surname from the 2000 census) and data provided by Tzioumis (2015) (which reports race and ethnicity by first name based on multiple mortgage databases with information from 2007–2010). We combine these data using an algorithm similar to the one in Elliott et al. (2009). We assign a person's race or ethnicity if the algorithm estimates a probability greater than 70%. Our data allow us to identify only three mutually exclusive categories: African American, Hispanic, and Other.

After linking our data, we drop cases filed during any calendar year during which we have fewer than 100 cases. Table 1 shows the number of cases by filing year. The total is 80,613, and over three-quarters of the cases were filed between 2011 and 2015. Our final database is a mixture of retrospective data (cases closed during 2011–2015) and prospective data (cases originated during 2011–2015). The retrospective data are subject to a survivorship bias; the prospective data are subject to censoring because we cannot follow them beyond December 2015. Although we generally present results using the full sample, we obtain closely comparable results in the prospective sample.

*Table 1*  
Chapter 13 Cases by Filing Year

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Observations	484	1,357	3,064	5,126	7,940	10,110	12,232	13,561	15,303	11,436	80,613



### 5 Summary Statistics

Table 2 describes the financial, demographic, and plan characteristics of consumers in our sample. The median consumer is 46 years old, lives in a two-person household, and has annual income equal to about \$35,000, which is about two-thirds of the state median income (\$53,234) and double the poverty line in 2011 (\$16,000 for a two-person household). The median consumer's debt-to-assets ratio exceeds three. The vast majority of households are single adults with one or more dependent children. Although the table does not report gender, consumers were equally likely to be male or female. These statistics are broadly consistent with prior work.<sup>3</sup>

Only about 40 % of bankruptcy filers own real estate ("homeowners" in Table 2), and 37 % have mortgages, indicating that saving one's home is a likely motivation for less than half of consumers.<sup>4</sup> Saving one's automobile may be the more common goal of Chapter 13, as Panel B shows: nearly 60 % of filers have auto debt with an average balance of about \$15,000. However, a majority of consumers have few, if any, assets (nonexempt property) that would be liquidated in Chapter 7. Panel B reports that nearly 75 % have less than \$1,000 in nonexempt property. We chose this threshold because McIntyre, Sullivan, and Summers (2015) and Lupica (2012), among others, have estimated average attorney fees in Chapter 7 around \$1,000. Over half of consumers neither own a home nor have less than \$1,000 in nonexempt property. The financial benefit of Chapter 13 is not obvious for these consumers.

Panel C shows that most cases terminate prematurely. Over fifty percent of cases have failed, and this represents a lower bound because a third of cases remain ongoing. Similar termination rates are reported by Dobbie and Song (2015) and Li (2007), among others. Also consistent with prior work, our data show that creditor recoveries are generally meager. The mean recovery is 17 %; the median is zero. Recovery rates, however, are much more substantial among discharged (88 % median recovery) than terminated (0 % median recovery) cases.

These statistics confirm some longstanding patterns and pathologies reported by the literature, including a substantial proportion of consumers using Chapter 13 to save assets (homes or cars) and high failure rates. Table 3 confirms other patterns.

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<sup>3</sup> Using a national sample of both Chapter 7 and 13 filings during 2007, Braucher, Cohen, and Lawless (2012) report median annual income of about \$27,000 and that the median consumer had one dependent. However, the debt-to-assets ratio in their sample was only 1.7, perhaps reflecting the inclusion of Chapter 7 filers with lower debt levels (they are less likely to have mortgages). In a study collecting data from filings during 1994 in seven judicial districts, Norberg and Velkey (2006) report that consumers had income equal to about 60 % of state median household income, were equally likely to be male or female, and had at least one dependent in at least 62 % of cases. Using a national sample, Dobbie and Song (2015) report an average age equal to about 43.

<sup>4</sup> This is somewhat below the mean (52 %) reported by Dobbie, Goldsmith-Pinkham, and Yang (2015), who analyze a random sample of credit users during the period 2002–2006. It is substantially less than the 95 % homeownership rate observed by White and Zhu (2010) in a study of Chapter 13 filers in Delaware during 2006.

Table 2  
Characteristics of Chapter 13 Consumers

	Mean	Median	Std. dev.
<i>Panel A: Demographic Characteristics</i>			
Age	45.71	46.00	13.54
Household size	2.48	2.00	1.58
% households with children	60.97	–	48.78
% households with > 1 adult	26.73	–	44.25
<i>Panel B: Financial Characteristics</i>			
Assets	89,504.86	20,450.00	163417.38
% with nonexempt property < \$1000	74.90	–	43.36
% homeowner	40.30	–	49.05
% not homeowner and nonexempt property < \$1000	54.83	–	49.77
Debt	127,700.82	61,571.83	150786.11
% with mortgage	37.46	–	48.40
% with auto debt	58.92	–	49.20
Annual income	41,747.41	34,596.00	194577.26
% below poverty line	7.17	–	25.80
% below 150 % of poverty line	23.81	–	42.59
% above state median	15.39	–	36.08
<i>Panel C: Plan and Case Characteristics</i>			
Terminated (%)	51.15	–	49.99
Discharged (%)	14.42	–	35.13
Open (%)	34.43	–	47.52
% recovery to general unsecured creditors	17.21	0.00	31.98
% recovery in discharged cases	63.26	88.10	39.31
% recovery in terminated cases	3.87	0.00	12.53
Trustee %	3.29	3.00	0.85
Attorney fee	2,626.50	3,400.00	1498.71
Observations	80,599		

Panel A shows that African Americans account for a substantially higher proportion of Chapter 13 cases (44 %) than Chapter 7 cases (23 %), consistent with the argument by Braucher, Cohen, and Lawless (2012), among others, that Chapter 13 exhibits disparate treatment by race.<sup>5</sup>

Panel B analyzes case characteristics and outcomes by race, confirming that termination rates are substantially higher for African Americans (about 55 %) than for other groups (between 45 and 49 %). Van Loo (2009) and Braucher, Cohen, and Lawless (2012) report a similar pattern. Equally important, African-American consumers are substantially more likely to be in poverty and less likely to have

<sup>5</sup> According to the 2010 Census, African Americans account for about 25 % of the Cook County population.

Table 3  
Consumer Characteristics by Race

	%
<i>Panel A: Race</i>	
Chapter 13 Cases	
African American	44.04
Hispanic	7.35
Other	48.61
Chapter 7 Cases	
African American	23.06
Hispanic	15.44
Other	61.50
<i>Panel B: Case Characteristics by Race</i>	
African American	
% terminated	54.65
Income < poverty line	9.41
Income < 150 % of poverty line	30.59
Nonexempt property < \$1000	79.86
% Homeowner	33.29
% Not homeowner and nonexempt property < \$1000	62.54
Hispanic	
% terminated	45.32
Income < poverty line	4.44
Income < 150 % of poverty line	19.02
Nonexempt property < \$1000	67.69
% Homeowner	56.03
% Not homeowner and nonexempt property < \$1000	38.60
Other	
% Terminated	48.80
Income < poverty line	5.56
Income < 150 % of poverty line	8.41
Nonexempt property < \$1000	71.13
% Homeowner	44.72
% Not homeowner and nonexempt property < \$1000	49.82

assets – a house or other substantial (nonexempt property) – that are protected by a Chapter 13 filing. Nonexempt assets are property that would be liquidated in Chapter 7. This finding is consistent with the work of McIntyre, Sullivan, and Summers (2015), who find that many consumers file Chapter 13 cases when there is no apparent financial benefit for doing so.

## 6 Results

Although the foregoing summary statistics confirm patterns and pathologies documented in other studies, our data allow us to explore whether these statistics vary across subgroups of consumers. This is an important exercise because the “pathologies” of Chapter 13 may reflect the behavior of particular types of consumers. This is indeed the case, as we show in section 6.1. Our data also allow us to identify patterns in trustee and attorney behavior that have been difficult to study using prior data sets. We present evidence in section 6.2 that one of Chapter 13’s pathologies – high termination rates – is driven, in part, by the decisions of trustees (who appear to require consumers to pay creditors more than the statute requires) and attorneys (whose cases tend to terminate soon after they are paid in full). Finally, in section 6.3, we document the recoveries of unsecured creditors. Our data allow us to compare recoveries in Chapter 13 with expected recoveries in Chapter 7, something prior literature has not done. Although our results are drawn from Cook County, Illinois, and may differ from patterns in other jurisdictions, they show that a number of long-standing patterns and pathologies may merit reexamination.

### 6.1 Case Heterogeneity

The statistics reported in section 5 conceal substantial heterogeneity across consumers, as Table 4 illustrates. We stratify consumers based on characteristics that affect the consumer’s ability or incentive to use Chapter 13.

The bankruptcy statute restricts access to Chapter 7 by high-income consumers, who face a presumption of “abuse” if they use that style of bankruptcy. These consumers are said to fail the *means test*. Parra (2016) documents a discontinuous drop in the probability of a successful (i.e., nondismissed) Chapter 7 filing as consumer income rises above the income thresholds set out by the means test. In other words, higher-income consumers face severely limited access to Chapter 7. They file for Chapter 13 because they have few (or no) other options. We identify these consumers in column I. It has long been thought that Chapter 13 is an avenue for “saving your home.”

Columns II and III include homeowners, but we separate owners who have become delinquent on their mortgages (*arrears*) from those who are not delinquent. We make this distinction not only because delinquent homeowners may be higher-risk consumers, but also because a delinquent homeowner may use the Chapter 13 process to take advantage of the automatic stay, not to obtain a discharge. Because the automatic stay halts collection efforts by the mortgage lender, the homeowner can use the Chapter 13 process as an opportunity to repay outstanding arrears. Once those are paid, the original mortgage is reinstated, as discussed by White and Zhu (2010). At this point, the homeowner may allow the process to terminate (without obtaining a discharge). Thus, homeowners with arrears may have relatively high termination rates because they are using Chapter 13 to obtain temporary for-

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Table 4  
Heterogeneity across Consumers: Stratifying Consumers by Potential Motivation for Using Chapter 13

	I	II	III	IV	V	VI	VII
	Means test	Homeowner, no arrears	Homeowner arrears	Tickets and fines	Auto debt, no tickets	Other	Pro Se
Terminated	36.59	35.28	46.65	53.15	44.41	51.81	93.08
< Poverty line	0.00	1.58	0.37	12.69	3.63	10.71	11.58
< 150 % Poverty line	0.00	8.31	4.87	39.14	15.00	31.79	29.22
Homeowner	74.37	100.00	100.00	19.31	48.61	0.00	50.47
Nonexempt property < \$1000	51.42	43.67	54.65	86.57	74.13	86.74	63.09
Not homeowner and nonexempt property < \$1000	19.65	0.00	0.00	75.98	46.98	86.74	40.06
African American	31.17	37.64	40.48	58.94	40.67	43.51	50.36
Hispanic	8.23	10.77	9.82	4.95	7.93	7.37	6.73
Other	60.42	51.31	49.70	36.11	51.40	47.78	32.34
% of cases	5.97	14.51	19.50	33.95	24.41	8.28	5.99

bearance, not to obtain a discharge. Jacoby (2007) discusses this phenomenon and collects relevant literature, but argues that the phenomenon is probably rare.

Column IV focuses on the subset of consumers with government fines – usually parking and traffic tickets – in excess of \$500.<sup>6</sup> The bankruptcy statute gives two reasons why Chapter 13 is attractive for these consumers: First, traffic and parking tickets and other fines can be discharged in Chapter 13, but not in Chapter 7. Second, the Chapter 13 process triggers an automatic stay that prevents the state or city government from suspending the consumer’s driver’s license or seizing or disabling the consumer’s vehicle (and the government must return licenses or vehicles that have been seized or disabled). In Illinois, a driver’s license can be suspended if the driver has accumulated ten or more unpaid parking tickets, or at least five unpaid tickets for certain moving violations. The median fine is \$60.<sup>7</sup> Among consumers with tickets or other fines, the average consumer has over \$4,000 in such debt (the median consumer has over \$2,700).

Column V identifies consumers with auto debt but no tickets or other fines. These consumers, like homeowners, are thought to see Chapter 13 as an avenue for preventing liquidation of their property.

Columns I through V are not mutually exclusive. Columns VI and VII identify two residual categories that include consumers who are excluded from the preceding columns: Consumers who did not exhibit any characteristic listed in prior columns (“Other”) or who were not represented by an attorney (“Pro Se”). The latter consumers are a high-risk group, most of whom fail to file required documents and have their cases dismissed within the first two or three months.

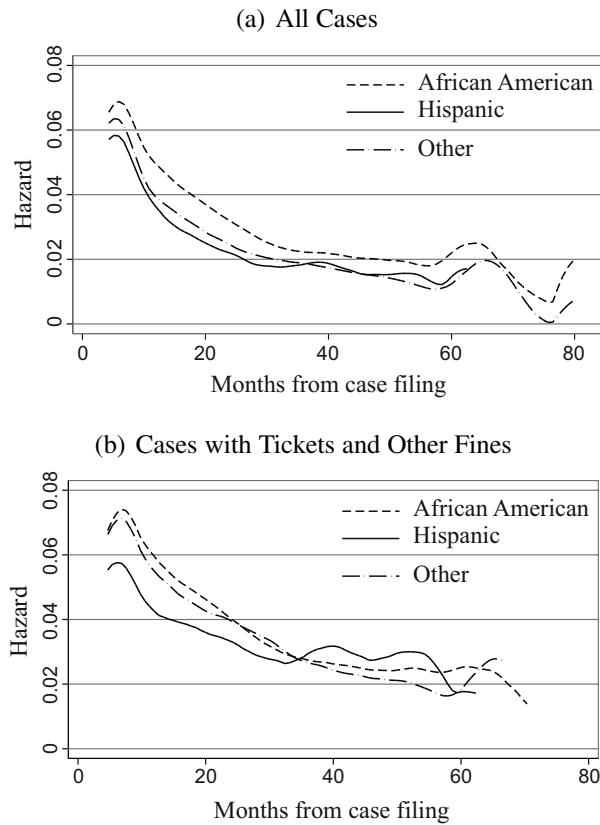
The most striking pattern in Table 4 is the percentage of cases – about a third (see the final row of column IV) – in which consumers have tickets or other fines that, in total, amount to at least \$500 (if we do not apply this floor, over 50% have tickets or fines). Putting aside Pro Se and Other cases, the cases in column IV are extreme in multiple respects: They exhibit the highest termination rates, lowest homeownership rates, highest rates of consumers with no apparent financial benefit from filing (“Not homeowner and nonexempt property < 1000”), and the highest proportion of African-American filers. Although the proportion of African Americans in the other categories is greater than the proportion in Chapter 7 cases (see Panel A of Table 3), the difference is substantially smaller after excluding cases with tickets or other fines.

Put differently, although prior work has pointed to many pathologies in Chapter 13 bankruptcy, in Cook County these pathologies appear to be driven primarily by consumers using Chapter 13 to cope with fines, such as parking tickets. Additionally, Table 4 is pointing to a potential confound ignored in prior work documenting racial disparities in Chapter 13: African Americans may be more likely

<sup>6</sup> We assume a consumer has fines if his or her creditors include Cook County or the City of Chicago. We verified in a random sample of cases that debts to these entities are highly likely to be parking or traffic tickets.

<sup>7</sup> Fines are summarized at this web address: [http://www.cityofchicago.org/city/en/depts/fin/supp\\_info/revenue/general\\_parking\\_ticketinformation/violations.html](http://www.cityofchicago.org/city/en/depts/fin/supp_info/revenue/general_parking_ticketinformation/violations.html).

Figure 1  
Hazard of Termination by Race, Ethnicity, and Case Type



than other groups to accumulate debt related to parking tickets and other fines. Because of this, they are also more likely to use Chapter 13, which is the only avenue by which these debts can be discharged and by which the government can be stopped from seizing a driver’s license or vehicle.<sup>8</sup>

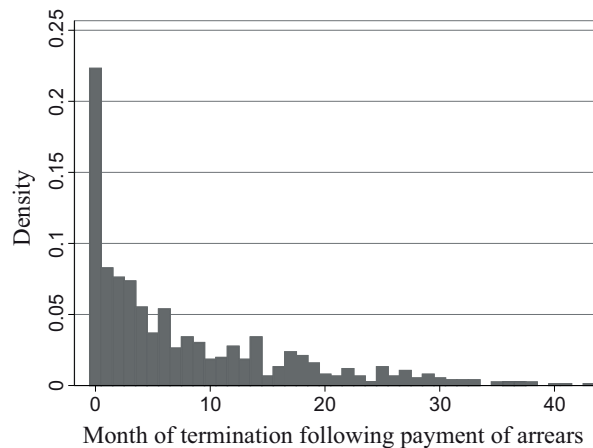
The importance of this confound is illustrated in Figure 1, which compares the monthly hazard of termination – the probability of termination in month  $t$ , conditional upon surviving to month  $t$  – for all cases and the subset of cases with tickets and other fines. In the full sample, shown in part (a), African-American cases have higher termination hazards in every month of the case, consistent with prior studies pointing to racial disparities in case outcomes. But when we limit the sample to cases with tickets and other fines, as part (b) does, the difference between African

<sup>8</sup> It is possible that, among consumers with parking tickets, African Americans are more likely than other groups to be steered by attorneys into Chapter 13. Although we cannot rule out this possibility, Figure 1 offers evidence against it. If African Americans are being steered into Chapter 13, even though they are a poor fit for it, they should have higher failure rates than other groups. Part (b) of the figure shows that African Americans and Others have similar hazard rates.

Americans and Other (not Hispanic) consumers shrinks substantially. The hazard curves are virtually on top of each other for most months.<sup>9</sup> This pattern indicates that, although African Americans are more likely to accumulate tickets and other fines, African Americans with this type of debt have similar case outcomes to non-Hispanic consumers. Hispanic consumers, however, have the lowest hazard rates, both in the full sample and in the subset with tickets and other fines.

Table 4 also points to a phenomenon that is sometimes thought rare: Homeowners using Chapter 13 to pay arrears, not to obtain a discharge. Notice first that the termination rate is over eleven percentage points higher for homeowners with arrears (column III) than for those without (column II). Otherwise, the consumers are comparable across most dimensions. The elevated termination rate for homeowners with arrears could reflect their incentive to abandon the Chapter 13 case after repaying arrears. Figure 2 provides evidence supporting this hypothesis. Here we plot the probability that a consumer stops payment during the months following repayment of arrears (the *x*-axis, in other words, measures time relative to the month in which arrears are paid in full). We see a spike in the probability of stopping payment in the same month that arrears are paid in full. The probability gradually declines in subsequent months. We view this as evidence consistent with the hypothesis that one of the pathologies of Chapter 13 – high failure rates – reflects, in part, decisions by homeowners to abandon their plans after paying arrears.

Figure 2  
Distribution of Months in which Homeowner Stops Payment  
Following Full Payment of Mortgage Arrears



<sup>9</sup> In competing-risk survival models, race is a large and highly significant predictor of failure. When we subset on consumers with at least \$500 in debt related to tickets and other fines, the effect of race falls by over 50% and is insignificant.



## 6.2 Other Drivers of Early Termination: Trustee and Attorney Behavior

Prior scholarship has pointed to potential biases (agency problems) in attorney and trustee behavior. Braucher, Cohen, and Lawless (2012), Lefgren, McIntyre, and Miller (2010), and McIntyre, Sullivan, and Summers (2015) present evidence indicating that attorneys steer clients, especially African Americans, into Chapter 13 cases instead of Chapter 7. Van Loo (2009) observes that trustees file motions to terminate a case more frequently when the case is filed by an African American. Our data point to different behavioral patterns that may contribute to Chapter 13 termination rates.

Trustees in our Cook County data appear to require or strongly encourage consumers to submit Chapter 13 plans that pay at least 10% recoveries to general unsecured creditors. Part (a) of Figure 3 plots the distribution of promised payoffs for the first proposed plan, showing spikes at 10% and 100%. The first spike is consistent with the hypothesis that trustees resist plans that pay less than 10% to general unsecured creditors. These spikes, however, could reflect the distribution of income and assets among consumers. A Chapter 13 plan must pay unsecured creditors no less than they would receive in a Chapter 7 liquidation. Additionally, the consumer must promise to pay all of her disposable income.<sup>10</sup> Using those statutory requirements, and assuming that the typical consumer has disposable income equal to about 11% of her monthly income (this was the average in our data), we imputed for each consumer the minimum payoff that must be promised to unsecured creditors in a Chapter 13 plan.<sup>11</sup> Part (b) compares this *imputed plan payoff* with the actual payoff proposed in each plan, showing that the spike at 10% is a substantial deviation from what the statute requires. Nothing in our data indicates that these deviations are attributable to the trustees, but we have been told by judges on the bankruptcy court that trustees will not recommend confirmation of plans that do not provide for at least a 10% payoff to general unsecured creditors. Braucher (1993) observed a similar pattern, with trustees and judges resisting plans that offered less than a *floor* recovery to unsecured creditors (between 10% and 100% in her data).

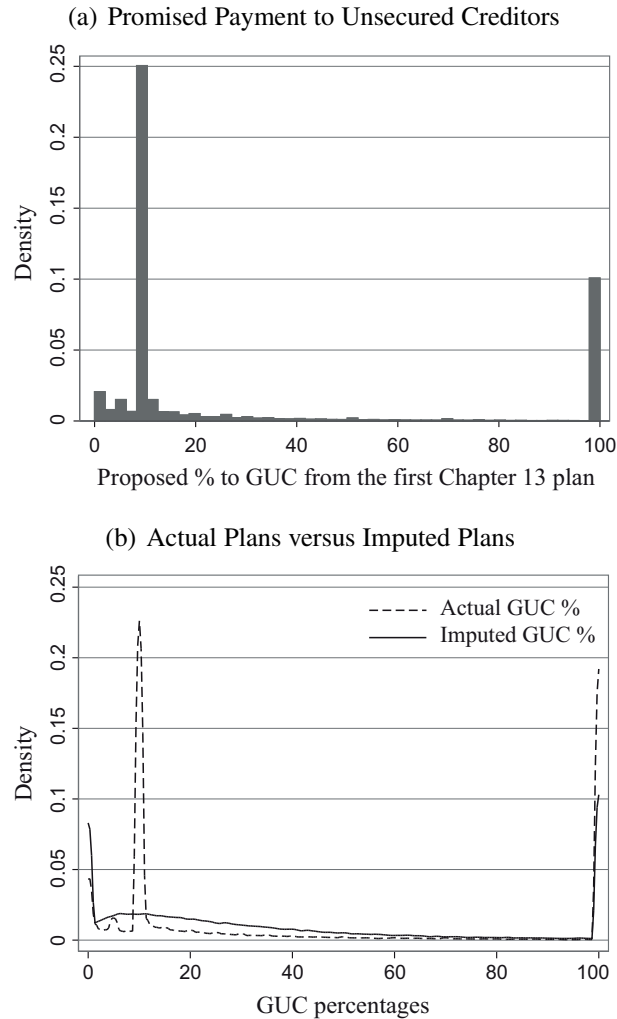
If trustees in Cook County do resist plans that offer less than a 10% floor recovery, consumers seeking to use Chapter 13 may understate their monthly expenses in order to show that they have sufficient disposable income to pay the floor recovery. Because they are pledging income that may be needed for expenses, these consumers are more financially fragile, and will likely have higher failure rates, than consumers who propose plans that are more consistent with their ability to pay. We explore this phenomenon in Table 5, which compares termination rates of consumers whose plans exceed the statutory requirement and consumers whose plans

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<sup>10</sup> This requirement is binding, however, only if a creditor or the trustee objects. This rule is set out in 11 U.S.C. § 1325(b). We do not know how often consumers propose plans that will pay less than disposable income and that do not face objections.

<sup>11</sup> The procedure for calculating this payoff is described in the online appendix, available at [http://www.coll.mpg.de/sites/www/files/Morrison\\_OnlineAppendix.pdf](http://www.coll.mpg.de/sites/www/files/Morrison_OnlineAppendix.pdf).

Figure 3  
Distribution of Promised Payoffs to General Unsecured Creditors:  
Actual versus Imputed Plans



do not. Consumers with 10% plans have higher termination rates than consumers with any other promised payoff to unsecured creditors. Among consumers with 10% plans, those who are paying more than the statutory requirement have a termination rate of about 50%, substantially higher than the 42% rate among those who are not paying more than the statutory requirement. These patterns suggest that, by objecting to plans that offer less than a 10% payoff to unsecured creditors, trustees are exacerbating Chapter 13's termination rate.

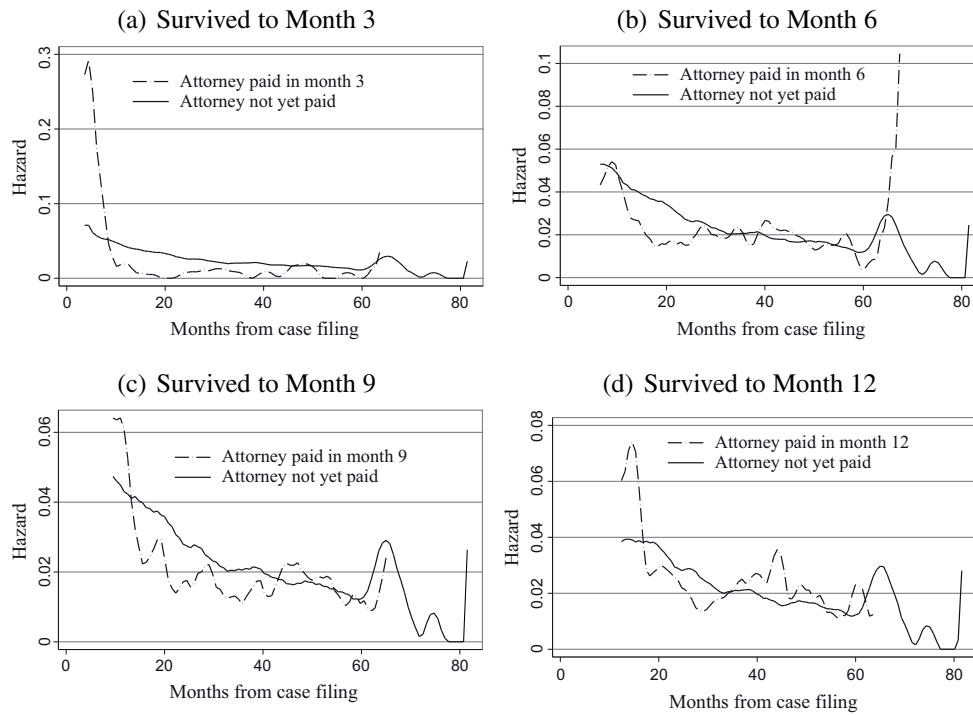
Attorneys, too, may exacerbate the failure rate, and not just by steering consumers into Chapter 13 even though they would have greater success in Chapter 7.

*Table 5*  
 Termination Rates by Promised Payout to General Unsecured Creditors:  
 Comparing Plans that Promise More or Less than Statutory Requirement

	Plan payoff > statutory requirement	Plan payoff ≤ statutory requirement	% of cases
<i>Plan Promises Payoff Equal to ...</i>			
under 10 %	41.71	33.76	11.15
10 %	49.87	42.12	50.86
10 to 99 %	37.16	36.00	17.07
100 %	32.69	38.46	20.92
% of cases	85.88	14.12	100.00

Figure 4 plots the hazard of failure for cases that survive at least three, six, nine, and twelve months. Among cases that survive  $n$  months (where  $n = 3, 6, 9,$  or  $12$ ), we compare the hazard of termination among cases that paid attorneys in full during month  $n$  with the hazard of termination among cases that did not pay the attorney in month  $n$  or any prior month. Thus, we are comparing two groups of cases, both

*Figure 4*  
 Hazard of Case Termination  
 by Month in which Attorney was Paid in Full



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of which survived  $n$  months and neither of which paid the attorney in full in any prior month. The only difference between the groups is that one paid the attorney in full in month  $n$ . For example, panel (a) compares cases in which the attorney was paid in month 3 (dashed line) to cases that survived at least 3 months but did not pay the attorney in full by month 3 (solid line). The dashed and solid lines plot the monthly hazard during the months after month 3. In each panel of Figure 4, we observe a sharp increase in the failure rate during the months immediately following payment of the attorney. In parts (a), (c), and (d), we see an increase both relative to subsequent months and relative to cases in which the attorney had not yet been paid. These patterns suggest, tentatively, that attorneys may devote less attention and care to cases after being paid, thereby elevating failure rates.<sup>12</sup>

### 6.3 Creditor Recoveries

Although prior scholarship has studied creditor recoveries, we are unaware of studies comparing creditors' Chapter 13 recoveries with their expected recoveries in Chapter 7. Under the bankruptcy law, creditors should receive a stream of payments with present value no less than what they would be paid in Chapter 7.

Table 6 computes the difference between the payoff (in percent) that general unsecured creditors received in Chapter 13 cases relative to what they would have received in a Chapter 7 liquidation. That is, we compute the percentage recovery in Chapter 13 ( $x\%$ ) and subtract from this the percentage recovery expected in Chapter 7 ( $y\%$ ) to obtain the marginal gain to general unsecured creditors ( $x\% - y\%$ ). For example, among cases in which creditors would have received nothing in Chap-

Table 6  
Difference between Percentage Recovery in Chapter 13 and  
Percentage Recovery Expected in Chapter 7

% Recovery expected in Chapter 7	Marginal Gain from Chapter 13			% of subsample
	Mean gain	Median gain	Std. dev.	
<i>Panel A: Discharged Cases</i>				
0	56.70	51.20	40.22	57.83
0 to 10	56.58	61.70	39.19	8.44
10 to 20	46.21	47.87	39.18	4.72
Over 20	2.34	0.00	37.26	29.01
<i>Panel B: Terminated Cases</i>				
0	2.76	0.00	10.08	77.58
0 to 10	0.80	-2.32	12.89	6.65
10 to 20	-8.58	-12.93	15.41	29.57
Over 20	-60.65	-60.85	34.03	12.82

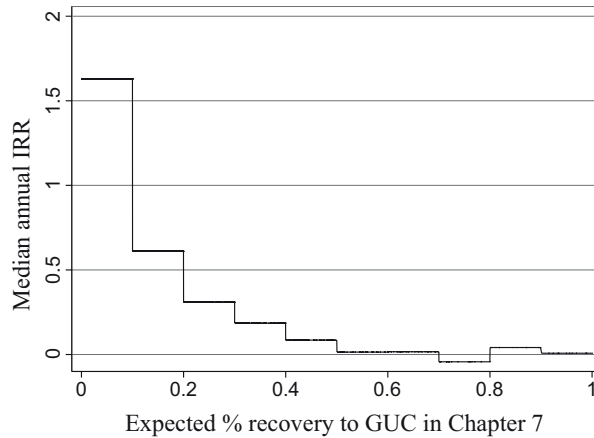
<sup>12</sup> The same patterns are evident in competing-risk regressions that estimate the effect of attorney payment on case termination, conditional on a battery of consumer demographic and financial characteristics.

ter 7 (0%), the median Chapter 13 recovery was 51% among discharged cases and 0% in terminated cases. Similarly, among cases in which creditors would have received a 0 to 10% recovery in Chapter 7, the median Chapter 13 recovery was 62% for discharged cases and -2% for terminated cases.

We observe a similar pattern in both panels: As the expected recovery in Chapter 7 increases, the marginal gain from Chapter 13 declines. For discharged cases, the marginal gain from Chapter 13 in the median case is zero when the expected recovery in Chapter 7 is greater than 20%. This might seem consistent with the statutory mandate that unsecured creditors receive no less than they would recover in Chapter 7, but it is not clear that it is. The statute requires that they receive no less *in present value*. Put differently, the internal rate of return (IRR) for discharged cases should be positive for all cases, but it is zero for the median case when the Chapter 7 recovery exceeds 20%. We plot the annualized IRR in Figure 5, though we exclude cases with expected Chapter 7 recoveries equal to zero because the IRR for these cases is infinite.<sup>13</sup> For every expected recovery in Chapter 7 (*x*-axis), we plot the IRR for the median Chapter 13 case (*y*-axis). Although returns to general unsecured creditors are hardly meager in discharged cases, especially when expected recoveries in Chapter 7 are relatively low, they decline sharply as expected recoveries in increase. Among cases plotted in Figure 5 – that is, discharged cases with expected Chapter 7 recoveries greater than zero – over 34% have an IRR that is zero or negative.

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Figure 5  
Internal Rate of Return (IRR) to General Unsecured Creditors,  
Subsetting on Completed Chapter 13 Plans with Expected Chapter 7 Recoveries > 0%



Returns in *terminated* cases do appear meager (and often negative relative to Chapter 7), as Panel B of Table 6 shows, but these statistics are misleading. After a case terminates, creditors can seek to liquidate the consumer’s assets and obtain ad-

<sup>13</sup> We are able to compute the IRR because the NDC data provide the size and timing of payments to creditors.

ditional recoveries. Thus, Panel B of Table 6 significantly *understates* the marginal recovery to unsecured creditors. Indeed, if the value of the consumer's property does not change during the pendency of the Chapter 13 case, creditors will generally have a positive marginal return from Chapter 13 cases: They receive cash flows through the plan and, after it terminates, obtain the liquidation value of the debtor's nonexempt assets, which is what they expected from a Chapter 7 case. As long as the cash flows are sufficiently large to compensate creditors for the delay in obtaining the liquidation value of the debtor's assets, creditors always do better from a Chapter 13 case that fails than from a Chapter 7 filing.

## 7 Discussion and Conclusion

This paper presents new evidence – drawn from cases filed in Cook County, Illinois – that raises questions about patterns and pathologies documented in the consumer bankruptcy literature. Prior studies show that Chapter 13 cases have high (and difficult to explain) termination rates, exhibit racial disparities in filings and outcomes, and yield meager recoveries to creditors. Our data suggest that, at least in Cook County, Illinois, these pathologies are largely driven by a subsample of consumers for whom Chapter 13 is an avenue for bargaining with state and local governments. These consumers have accumulated fines, usually parking tickets, and are at risk of having their licenses or vehicles (or both) seized by the government. In these cases, the government has a “hostage taking” power that few creditors possess: It can seize property (a driver's license) that is valueless to the government or any other party, but is highly valuable to the consumer because it reduces the cost of commuting to work, especially for people with limited access to mass transit. These “parking ticket” cases have very high failure rates, in part due to the fact that a substantial number of these consumers have near-poverty incomes and little or no property that could be seized in liquidation. It appears that African Americans are particularly vulnerable to this hostage-taking. They account for well over fifty percent of people with tickets and other fines. Consumers in this category exhibit the “pathologies” commonly associated with Chapter 13. Those pathologies are much less pronounced among other consumers.

This finding suggests that some of the aberrational features of Chapter 13 may be a product of intersecting features of bankruptcy and nonbankruptcy law: (1) Chapter 13 permits the discharge of tickets and other civil fines (unlike Chapter 7) and requires the government to return suspended licenses and seized vehicles to the consumer as soon as she files for bankruptcy, and (2) government policy regarding tickets and other fines, which appears to affect African Americans more than other consumers.

Our data also confirm and extend other patterns observed in prior work, including potential biases in the behavior of trustees and attorneys. Our data suggest that Chapter 13 termination rates are elevated by trustee preferences for plans that pay at least 10 % recoveries to unsecured creditors. We also observe a spike in termina-

tion rates immediately after the consumer pays her attorney in full. Finally, our data show that creditor recoveries are not necessarily as meager as some have thought. Among cases with very low expected recoveries in Chapter 7, creditors' marginal recoveries are substantial in Chapter 13.

Because our results are drawn from a single geographic area (Cook County, Illinois) within the jurisdiction of a single court (the Northern District of Illinois), we cannot say whether the same patterns would be evident in other areas of the United States. In many respects, as section 5 showed, the demographic, financial, and case characteristics of consumers in our sample are comparable to the characteristics of consumers in samples studied by other scholars, who have focused on different geographic areas. But there are features of Cook County and the Northern District of Illinois that may distinguish it from other areas. One is the reliance of low-income consumers on personal automobiles for transportation. Limitations of Cook County's mass transit system may lead to greater reliance there than in other areas. Similarly, local policy regarding enforcement of traffic and parking tickets may be more aggressive, or have more disparate effect on African Americans, in Cook County than elsewhere (although recent media reports, including Lithwick, 2016, suggest otherwise). Another potentially distinctive feature is the jurisprudence of the Northern District of Illinois. In 2009, it joined a number of courts in recognizing the consumer's authority, under the bankruptcy law, to force creditors to return property to the consumer, including vehicles and drivers' licenses.<sup>14</sup> One more potentially distinctive feature is the trustees' preference for plans with a minimum 10% payoff to general unsecured creditors. Although this preference is not unique to Cook County – Braucher (1993) observed similar preferences in other areas – we do not know whether such a preference is commonly observed throughout the United States.

Although the generalizability of our results is a question for future work, we believe that this paper raises questions about underlying heterogeneity in consumer bankruptcy cases and points to potentially fruitful lines of inquiry, including the influence of government policy regarding fines on the use of Chapter 13 bankruptcy.

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<sup>14</sup> In *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), the Seventh Circuit held that creditors must return property after a consumer files for bankruptcy. Several other jurisdictions have reached the same conclusion, including the Second and Eighth Circuits in *Weber v. SEFCU (In re Weber)*, 719 F.3d 72 (2d Cir. 2013) and *Knaus v. Concordia Lumber Co. (In re Knaus)*, 889 F.2d 773 (8th Cir. 1989), and Bankruptcy Appellate Panels in the Sixth, Eighth, and Ninth Circuits (as summarized in *Weber v. SEFCU*), but others have disagreed, including the 11th Circuit in *Bell-Tell Federal Credit Union v. Kalter (In re Kalter)*, 292 F.3d 1350 (11th Cir. 2002).

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