NCLC National Consumer Law Center

NATIONAL HEADQUARTERS
7 Winthrop Square, Boston, MA 02110
(617) 542-8010

WASHINGTON OFFICE
Spanogle Institute for Consumer Advocacy
1001 Connecticut Avenue, NW, Suite 510
Washington, DC 20036
(202) 452-6252

NCLC.ORG

Comments to the Department of Justice

Regarding Policy Initiatives Concerning the Ability of Americans in Financial Distress to Access the Bankruptcy System

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We appreciate the opportunity to comment on the Department of Justice's review process for exploring access-to-justice initiatives related to access to the bankruptcy system. The National Consumer Law Center,[1] on behalf of its low-income clients, submits these comments based on our experience and our work in providing training and assistance to attorneys across the country who represent consumers in bankruptcy cases.

Our comments and recommendations focus on three issues that were not addressed by other participants in the review process. We urge DOJ to fully consider the issues raised by the other participants, including the National Association of Consumer Bankruptcy Attorneys and the National Bankruptcy Conference, particularly issues related to trustee-imposed document production requirements, the burdensome and unnecessary credit counseling requirement, and access issues related to the difficulty of debtors in paying for attorney representation before filing bankruptcy.

[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of twenty-one practice treatises and annual supplements on consumer credit laws, including *Consumer Bankruptcy Law and Practice* (12th ed. 2020). NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

1. Filing Fee Waivers

Prior to the 2005 Bankruptcy Act, the total filing fee for a Chapter 7 bankruptcy case was $209. Since that time there have been multiple filing fee increases, as to both the statutory fee and those set by the Judicial Conference.[2] Consumer debtors must now pay a total filing fee of $335 to file a Chapter 7 case.

In the 2005 Bankruptcy Act, Congress mandated that debtors must go through pre-bankruptcy credit counseling and post-bankruptcy debtor education. This now adds another $25 to $50 to the cost of filing bankruptcy. Not surprisingly, debtors today also face increased legal fees in seeking bankruptcy relief as a result of the 2005 Bankruptcy Act. Attorneys must complete additional forms, perform various calculations of the debtor's income and expenses, and collect additional documents from the debtor such as months' worth of paystubs and tax returns for multiple years. According to a GAO report on the costs of the 2005 Act, bankruptcy cases now involve a greater number of motions and hearings, which further increase the time an attorney spends on a case.[3] As a result, the total cost of filing a Chapter 7 bankruptcy case has nearly tripled, from under $1,000 in most cases before 2005 (an amount many working families could scrape together) to $2,500 or more, an amount well beyond the reach of many.

The increased cost of bankruptcy filing has resulted in a denial of access to bankruptcy relief for many financially distressed consumers. Even consumers who would benefit from bankruptcy often do not file because of the cost of filing bankruptcy. This can be shown by considering the bankruptcy filing rates at the height of the Great Recession. A RAND study of American families during the Great Recession found that by April 2010, 39 percent of households had experienced financial distress.[4] However, less than 1.4 percent of the 116.7 million American households filed bankruptcy in 2010. There remained a steady decline in bankruptcy filings after 2010, despite the continuation of challenging economic times for a number of years. We are likely to experience a similar pattern in the wake of the COVID-19 pandemic, with many debtors in financial distress simply being too poor to file bankruptcy.

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[2] The statutory fee for filing an individual Chapter 7 bankruptcy provided for in 28 U.S.C. § 1930(a)(1)(A) is currently $245. Combined with the additional noticing fee of $75 assessed in all Chapter 7 cases pursuant to 28 U.S.C. § 1930(b), and another $15 fee used to provide funds necessary for additional trustee compensation as required by 11 U.S.C. § 330(b)(2), the total fee is $335.

[3] United States Government Accountability Office, "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," p. 22, June 2008 (finding that the average attorney fee in chapter 7 consumer bankruptcy cases had increased by 51 percent after the 2005 Act).

[4] RAND Labor and Population, Effects of the Financial Crisis and Great Recession on American Households, Michael Hurd And Susann Rohwedder, Nov. 2010. The study measured financial distress by considering the following factors: if the respondent and/or spouse is unemployed, or if the household is more than two months behind on mortgage payments (or in foreclosure), or if the value of the house is less than the amount of the mortgage.

To potentially offset the increased costs of filing bankruptcy, the 2005 Bankruptcy Act amended 28 U.S.C. § 1930(f)(1) to permit the waiver of Chapter 7 filing fees for debtors with incomes less than 150% of the applicable official poverty line. In addition to the income test, the debtor must be unable to pay the filing fee in installments. While the filing fee is not the only cost that has contributed to blocking access to bankruptcy relief for many debtors, waiver of the $335 filing fee, particularly if combined with free legal services and pro bono representation or reduced fee private representation, can make the difference for many low-income debtors as to whether they can access the bankruptcy system.

Regrettably, this change, although intended to increase access to justice for indigent debtors, has not been implemented uniformly. In some judicial districts, over 10% of individual Chapter 7 cases are filed with a fee waiver. In other districts, even those with a high incidence of individuals living below the poverty level, less than 1% or 2% of cases are filed with a filing fee waiver.

In the districts with low waiver rates, we believe that a local legal culture has developed to inhibit debtors and their attorneys from seeking fee waivers. Because panel trustees do not receive a portion of their compensation in cases in which the filing fee is waived, some trustees have taken steps to discourage attorneys from seeking waivers, such as by requesting additional documentation in addition to Official Form 103B to establish eligibility or by threatening to or actually filing objections to fee waiver applications. More subtle forms of persuasion are used by some trustees to discourage waiver applications, such as making attorneys who seek waivers for their clients wait longer for their cases to be heard at section 341 meetings. Even legal services and pro bono attorneys in some districts have reported on NCLC's bankruptcy practice listserv that they have completely stopped filing fee waiver requests for their clients out of concern that they and their clients will be treated more harshly by some trustees.

Courts in some districts have also adopted an informal policy (typically not codified in a local rule or set out in a published opinion) that filing fees requests will not be granted if the debtor's attorney is being compensated in any amount. Some attorneys report that judges in some districts will not approve fee waivers if the attorney is paid more than petition preparers (generally $200 to $300). One attorney stated on a bankruptcy listserv that the Chapter 7 trustee told him that he was planning to object to the entry of a fee waiver order because the attorney "didn't have enough skin in the game." The attorney explained that the trustee believed he did not sufficiently slash his compensation enough to justify a fee waiver and that if the attorney was paid "$500 or lower, he probably would not object."

These informal policies and practices are in direct conflict with the national judiciary policy on fee waivers adopted by the Judicial Conference of the United States. Section 820.20(a)(5) of the Bankruptcy Case Policies provides:

> A debtor may qualify for a waiver of the filing fee even if the debtor has paid or promised to pay a bankruptcy attorney, bankruptcy

petition preparer, or debt relief agency in connection with the filing.[5]

We recommend that the DOJ:

a) Obtain data from the Administrative Office of the U.S. Courts on the percentage of total fee waiver cases by districts.[6] In those districts with a very low percentage of debtors seeking waivers, DOJ should investigate the reasons why waivers have not been sought and develop a plan for encouraging the use of waivers.

b) Issue guidance to panel trustees on the Judicial Conference's Bankruptcy Case Policies for filing fee waivers. This guidance should be incorporated into a new section of DOJ's Handbook for Chapter 7 Trustees that would address how trustees should appropriately respond in cases in which the debtor has filed an application to have the filing fee waived.

c) Require private trustees to inform the United States Trustee if they intend to challenge a fee waiver application based on the application of the law to the facts of the case or an unsettled question of law. This would provide the United States Trustee with an opportunity to assess whether there is merit to the trustee's position and possibly intervene in the case if the position is meritless (or convince the trustee to withdraw the challenge). Such a requirement could have avoided the challenge brought by the trustee in the recent case, *In re* Johnson, No. 21-10228, 2021 WL 4047460 (Bankr. D. Kan. Sept. 3, 2021). Despite contrary language in the Judicial Conference's Bankruptcy Case Policies and Official Form 103B (and its cross-references to monthly income as reported on Schedule I, line 10 (Official Form 106I)), the trustee argued unsuccessfully that debtors' gross income, rather than net take-home pay, should be used in determining whether the debtors' income exceeded 150 percent of the official income poverty line.

2. Administration of Small Asset Cases.

The Earned Income Tax Credit (EITC) and the Child Tax Credit have served a vital role of providing working families the means to meet the basic necessities of life. They have served an important role in allowing families to avert emergencies such as eviction or repossession of the family car, and maintain a modest lifestyle on low wages.[7] Too often, however, they are diverted from their intended purposes when families seek bankruptcy relief.

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[5] Judicial Conference of the United States, Bankruptcy Case Policies, Chapter 7 Fee Waiver Procedures, § 820.

[6] We believe the Administrative Office compiles these statistics in Table F-10A2.

[7] NCLC has documented how the loss of EITC refunds in another context, through intercept by student loan creditors, can hurt families. *See* "Voices of Despair, Student Borrowers Trapped in Poverty When the Government Seizes Their Earned Income Tax Credit" (March 2018), https://www.nclc.org/images/pdf/student_loans/voices-of-despair.pdf.

In recent years, as the tax credits have sometimes resulted in larger refunds, they have attracted the attention of bankruptcy trustees. In the many states where they cannot be fully exempted, trustees have taken tax credits, with large portions of the funds not even being distributed to creditors but simply used to pay the trustees' commissions and fees.[8] Even in states where the credits can be exempted, trustees have taken advantage of pro se debtors who fail to properly claim the credits as exempt.

Most Chapter 7 bankruptcy cases are "no-asset" cases in which none of the debtor's assets are administered by the trustee. In a study of consumer Chapter 7 bankruptcy asset cases in which some assets of the debtor were administered by the trustee, it was reported that trustees took some form of tax refunds in 65% of the asset cases in the sample.[9] This amounted to $333,621 in tax refunds from the 98 asset cases in the sample, with an average capture of $3,404 per asset case.

The Chapter 7 Trustee Final Reports that are available on the USTP's website show that in opt-out states where there is no EITC or wildcard exemption, there tend to be many small asset cases (generally less than $4,000) that are administered by the trustee. [10] This is generally not true in states that have an EITC or substantial wildcard exemption. However, the Final Reports also show that the availability of exemptions is not the only driving factor, as there are some districts with few small asset cases despite limited exemptions. This suggests a more randomized practice in which the determination of whether a debtor may have to turn over a needed tax refund may depend upon which private trustee is assigned to the debtor's case.

The DOJ's Handbook for Chapter 7 Trustees provides that "[p]rior to administering a case as an asset case, the trustee must consider whether sufficient funds will be generated to make a meaningful distribution to unsecured creditors."[11] Our review of the Chapter 7 trustee asset reports show that the "meaningful distribution" requirement is often disregarded. There are numerous cases in which trustees have administered very small estates in the amount of $1,500 or less (likely a debtor's tax refund) and nominal amounts were distributed to unsecured creditors. For example, the 2019 asset report lists a case in Indianapolis in which the debtor's estate having total gross receipts of $826 was administered, and $382.07 was distributed to the debtor's unsecured creditors. Many of the cases with slightly larger estates that were administered, in the range of $1,500 to $4,500, also typically resulted in insignificant

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[8] Although the Bankruptcy Code does not have a specific exemption to cover tax credits, it does provide a "wildcard" exemption that can be used to cover some or all of a tax refund or credit. However, states are permitted to opt out of the federal bankruptcy exemption scheme. Most states have opted out, and in those states, consumers are required to use state law exemptions in a bankruptcy case. Some states do not have a "wildcard" exemption that could be used to exempt an EITC, or the designated dollar amount of the "wildcard" exemption is too low to fully exempt the EITC.

[9] Dalié Jiménez, The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases, American Bankruptcy Law Journal, Vol. 83, p. 795, 2009.

[10] The trustee asset reports are available here: https://www.justice.gov/ust/bankruptcy-data-statistics/chapter-7-trustee-final-reports.

[11] Handbook for Chapter 7 Trustees, Page 4-3.

distributions to unsecured creditors. In a 2019 case in Omaha, for example, the debtor's estate having total gross receipts of $2,355.42 was administered, and only $451.06 was paid to unsecured creditors.

The lack of guidance in DOJ's Handbook on what constitutes a meaningful distribution to unsecured creditors has contributed to the excessive number of small asset cases that are administered by trustees. The Handbook language focuses on assets that a trustee would need to recover and sell, addressing factors such as how to determine the fair market value of the property, anticipated costs of sale and administration, exemptions, amount of perfected security interests, and tax consequences. While these factors are relevant to the recovery of non-liquid assets, particularly those that need to be recovered by the trustee through an avoidance action, they provide little guidance in cases involving a small cash asset such as an EITC or tax refund that the trustee simply demands from the debtor. This lack of guidance has apparently been construed by some trustees to mean that any liquid asset such as a tax refund that does not require costs to convert to cash, no matter how small in amount, can provide a meaningful distribution.

Factors related to court administration that should be relevant in small asset cases are not discussed. For example, cases involving a tax refund will typically be treated initially by the court as a no asset case. This means that creditors will be sent Official Form 309A informing them that no property appears to be available to pay creditors and that they should not file a proof of claim. The Handbook does not discuss that the trustee should consider the court system's administrative costs of re-noticing all creditors that the case is no longer a no-asset case, that creditors must now file claims, and that a claims bar date has been set. It also does not discuss that the trustee should consider the administrative costs of the court clerk's office in receiving and processing creditors' proofs of claim, particularly if the potential distribution may be pennies on the dollar. Another factor that should be considered is the administrative costs in processing these nominal payments to creditors.

Moreover, the Handbook has no discussion about the factors a trustee should consider in assessing whether a potential distribution to unsecured creditors is meaningful. Using the Omaha case as an example, only $451.06 was paid to unsecured creditors, which was approximately 19% of the amount administered ($2,355.42). If the debtor in that case had $25,000 in unsecured creditors and they all filed allowed claims, approximately 1.8% of the unsecured claims would be paid. If the debtor had an additional $30,000 in student loans (not an uncommon occurrence these days), the distribution to unsecured creditors would be approximately 0.8%. These are not meaningful distributions under any circumstances, yet there is no guidance in the Handbook instructing trustees to consider distribution factors, such as the amount of scheduled unsecured debt and the anticipated pro rata distributions to unsecured creditors. Without this guidance, trustees will exercise their own discretionary notions about what is meaningful, resulting in a non-uniform practice and the potential for disparate impact on debtors' retention of vital assets intended to support families, especially families with children.

We recommend that the DOJ:

a) Conduct a study of small asset cases as identified by the Chapter 7 Trustee Final Reports, particularly those in which the only asset administered was a tax refund. Data from a random sample of cases should be collected and analyzed, including the amount of gross receipts, the amount of administrative costs (including trustee compensation from commissions, trustee and outside counsel attorney fees, trustee and other professional fees), court administrative costs, the total number of unsecured creditors, the total amount of unsecured claims, and the percentage of unsecured creditors that file proofs of claim.

b) Informed by the study results, the DOJ should amend the Handbook for Chapter 7 Trustees to include specific guidance on how trustees should assess whether recovery and administration of a small asset will produce a meaningful distribution to unsecured creditors. DOJ should consider establishing objective criteria, such as percentages or dollar amounts, that should be applied in determining what is meaningful.

3. Enforcement Actions against Petition Preparers.

The number of individual debtors filing bankruptcy without an attorney has increased from approximately 6% of all cases filed in 2008 to over 9% of all cases in 2016.[12] The pro se case filing rate in some districts is more than double the national average.[13]

Not surprisingly, pro se debtors have a difficult time navigating the bankruptcy system and obtaining bankruptcy relief. Pro se chapter 7 debtors are nearly 10 times as likely to have their cases dismissed or their discharges denied than debtors with attorneys.[14] Another study found that 17.6 percent of pro se debtors had their cases dismissed or converted, while only 1.9 percent of represented debtors had that same outcome.[15]

It is common knowledge in the bankruptcy system that many pro se debtors are actually having their bankruptcy filing documents prepared by petition preparers. While the Bankruptcy Code requires that this be disclosed in the bankruptcy filing, petition preparers often go to great lengths to ensure that their identities and their fee arrangements with debtors are kept hidden from the court. In the course of engaging in unauthorized practice of law, petition preparers

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[12] *See* Ed Flynn, The Changing Profile of Chapter 7 Filers, Exhibit 2, American Bankruptcy Institute Journal, September, 2018

[13] *See, e.g.*, 24% in 2016 in the Central District of California, https://www.cacb.uscourts.gov/sites/cacb/files/documents/publications/Pro%20Se%202015-2016.pdf; 21% in 2019 in the District of Maryland, https://ecf.mdb.uscourts.gov/ecfstatsdash-new.html; and 18.5% in the District of Arizona, http://www.azb.uscourts.gov/sites/default/files/ProSeReportForWeb_12_2019.pdf.

[14] Ed Flynn, The Changing Profile of Chapter 7 Filers, American Bankruptcy Institute Journal, September, 2018.

[15] Angela Littwin, The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for its Surprising Success, 52 Wm. & Mary L. Rev. 1933 (2011).

often give inaccurate legal advice that is harmful to debtors, particularly with respect to claiming exemptions. Consumers are lulled into the false belief that paying a petition preparer is an adequate substitute for legal representation. Debtors are often solicited by petition preparers through various forms of mortgage modification and foreclosure rescue scams.

The Bankruptcy Code gives DOJ powerful enforcement tools to combat unlawful practices by petition preparers. Section 110 effectively permits petition preparers to provide only typing services and prohibits them from charging excessive fees, offering legal advice, executing documents on behalf of the debtor, advertising "legal" services, collecting clients' payments for court filing fees, or engaging in unfair, deceptive, or fraudulent conduct. The United States Trustee is authorized to bring enforcement actions against petition preparers and can seek restitution, actual and statutory damages, fines, injunctive relief, attorney fees and costs.

The United States Trustee Program has regularly engaged in bringing enforcement actions against petition preparers. However, Program annual reports suggest that there has been a recent decline in the number of actions taken. Despite the increase in pro se filings and the resulting likelihood that there has more activity by petition preparers, the most recent annual report (2019) shows that only 169 actions were taken. The annual reports from earlier years, even those with case filing rates comparable with 2019, show that the Program typically brought about 300 to 500 actions per year. While there may be good reason for the decline in 2019, DOJ should ensure that this does not reflect a change in priorities.

We recommend that the DOJ:

a) Determine the cause of the decline in enforcement actions brought in 2019 and, if appropriate, take action to ensure that this important consumer protection role for the United States Trustee Program remains a priority.

b) Explore new ways to more effectively protect consumer debtors from abuses by petition preparers. As a result of the COVID-19 pandemic, there are many homeowners who are seeking assistance with loss mitigation and avoiding foreclosure. Large numbers of tenants are facing eviction actions and will be confronted with judgments for back rent. We can certainly expect that there will be an increase in scammers preying upon these vulnerable consumers and that petition preparer "services" will be one of the schemes used to harm them. DOJ should coordinate with the CFPB, FTC and other regulatory agencies on new approaches to combat these scams.

We commend DOJ for its attention to these issues and for its interest in seeking greater access to bankruptcy relief for low-income consumers. If we can provide additional information, please feel free to contact John Rao, jrao@nclc.org.