

# 'No money down' bankruptcies prevalent among the poor, minorities

November 14 2017, by Phil Ciciora

---

A new paper from a University of Illinois law professor who studies consumer credit issues examines the breakdown in access to justice among the poor and minorities in the bankruptcy system, from which about 1 million Americans will seek help this year.

A crucial decision for those filing for [bankruptcy](#) is whether to choose a traditional Chapter 7 bankruptcy, in which [attorney](#)'s fees are paid upfront, or a Chapter 13 bankruptcy, in which attorneys charge more than double their usual Chapter 7 rates but allow clients to roll the fees into a three- to five-year debt repayment plan – thus requiring "no money down."

But attorneys are increasingly using the more expensive no money down option – a tactic that's used even more often with blacks than with whites, according to research co-written by Robert M. Lawless, the Max L. Rowe Professor of Law at Illinois.

"This paper explores how bankruptcy attorneys are getting paid," said Lawless, also the co-director of the Program on Law, Behavior and Social Science at the College of Law. "Previous studies have documented a racial disparity in the bankruptcy [system](#). Our study suggests that how attorneys are being paid may be driving a lot of the disparity."

According to the paper, bankruptcy attorneys charge about \$1,200 to file a Chapter 7 bankruptcy, which clients must pay upfront, versus about

\$3,200 to file a Chapter 13 bankruptcy – but clients can amortize those fees over time as part of their debt repayment plan.

The paper analyzes new data from the Consumer Bankruptcy Project, a long-running research project that Lawless and his student research assistants collaborate on at Illinois. The paper finds the two most significant predictors of whether a consumer files a no money down bankruptcy are a person's place of residence and race.

"The reason for that? We can't definitively say," Lawless said.

One explanation might be the well-known income and wealth gaps between whites and blacks in the U.S., meaning that blacks will have less saved, and therefore less ability to pay an attorney's fees upfront.

"But even after we control for markers that should predict ability to pay, we still find that blacks end up more frequently in no money down cases," Lawless said. "What we can't say from our paper is what is driving this phenomenon. Is it implicit bias? Predatory behavior by bankruptcy attorneys?"

Another part of the explanation could be that bankruptcy filings are at their lowest level in 25 years.

"If you're a bankruptcy lawyer, your client base has shrunk," Lawless said. "There is more competitive pressure on consumer bankruptcy lawyers. They need to incentivize people to come through the door and then maximize the fees they can earn on the case."

The consumer bankruptcy system is one of the largest social safety institutions, and because attorneys serve as its gatekeepers, "they have the opportunity to advance or impede people's access to justice," Lawless said.

"The existence and increasing use of 'no money down' bankruptcy suggests that some people are receiving less from the bankruptcy system, despite paying more in attorney's fees," he said. "Most debtors don't really know the arcane rules of bankruptcy law, and they must rely on their lawyers to work in their best interests. But the system isn't working particularly well for blacks, which leads to an unequal bankruptcy system."

Chapter 7 and 13 bankruptcies also differ in the relief achieved. Almost all Chapter 7 cases end with the debtor receiving a discharge of their debts, but only around one-third of Chapter 13 cases end with the debtor having a clean slate, Lawless said.

"These no money down bankruptcy debtors suffer a double-whammy," he said. "They pay about \$2,000 more and have their cases dismissed at a rate 18 times higher than if they had filed Chapter 7. Nearly every aspect of their bankruptcies – both the benefits and the burdens of debt relief – will be different in Chapter 7 versus Chapter 13. Almost all [consumers](#) will hire a bankruptcy attorney and, because they must pay their attorneys, many consumers will file Chapter 13 to finance their access to the law, rather than because they prefer the law of Chapter 13 over Chapter 7."

The paper suggests reforms such as how attorneys collect fees from consumer debtors that could reduce the potential conflict between clients' and attorneys' interests, as well as making filing for Chapter 7 more accessible to the average debtor.

"The benefit of filing for Chapter 13 bankruptcy is you can pay over time, but the downside is that it's more expensive," Lawless said. "For people in that situation, it represents a significant amount of money. But it's a boon to bankruptcy attorneys because they might be filing dozens or even hundreds of cases per year."

Until the law is changed, though, no money down bankruptcies exist as yet another instance in which cash-strapped, lower-income and minority individuals pay more and receive less, Lawless said.

"The consumer bankruptcy system not only is one of the largest social safety institutions, it also is one of the most-used parts of the federal judicial system," he said. "We must continue to examine the extent of the regional and racial disparities in filings, and if confirmed, reform this integral part of our legal system."

The paper will be published in the *Southern California Law Review*.

**More information:** Foohey, Pamela and Lawless, Robert M. and Porter, Katherine M. and Thorne, Deborah, 'No Money Down' Bankruptcy (March 1, 2017). *Southern California Law Review*, 2017, Forthcoming; UC Irvine School of Law Research Paper No. 2017-12; University of Illinois College of Law Legal Studies Research Paper No. 17-19. Available at SSRN: [ssrn.com/abstract=2925899](https://ssrn.com/abstract=2925899)

Provided by University of Illinois at Urbana-Champaign

Citation: 'No money down' bankruptcies prevalent among the poor, minorities (2017, November 14) retrieved 24 April 2024 from <https://phys.org/news/2017-11-money-bankruptcies-prevalent-poor-minorities.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.