TECHNICAL REPORT

The Effects of the Changes in Chapter 7 Debtors' Lien-Avoidance Rights Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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Summary

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) limited the types and quantities of exempt household goods on which debtors could avoid certain liens. Part of the motivation for these changes was a perception that debtors were using their household goods as collateral to obtain loans that they never intended to repay. The perception was that debtors intended from the outset to file for bankruptcy and avoid the nonpossessory, nonpurchase money lien and then avoid the debt.[1]

There was some concern that BAPCPA may have induced changes in the use of nonpossessory, nonpurchase money security liens. Debtors might have become less willing to obtain loans secured by a nonpossessory, nonpurchase money lien because surrendering the assets cannot be avoided in a subsequent bankruptcy. Alternatively, lenders might have become more willing to give loans using nonpossessory, nonpurchase money liens knowing that the liens on certain items can no longer be avoided. The U.S. Congress directed the Executive Office for U.S. Trustees (EOUST) to examine the effects of the changes in debtors' lien avoidance rights (BAPCPA, §313[b]). EOUST, in turn, asked the RAND Corporation to examine whether there had been a change in business practices associated with a debtor's right to avoid a nonpossessory, nonpurchase money lien on household goods (e.g., whether the amounts and types of loans secured by debtors' household goods have changed since BAPCPA).

We conducted both qualitative and quantitative research to assess the effects of the new definition of the types and quantities of household goods exempt from certain liens. We interviewed bankruptcy attorneys, judges, trustees, creditors, and U.S. trustee (UST) office staff as to whether they are seeing any changes related to the new limits on lien avoidance for household goods. We consistently heard that no one is noticing any changes in debtor or creditor behavior due to the new definition of *household goods*. Some interview participants noted that it may be too early to tell whether businesses are changing their practices related to this issue.

Our quantitative research seems to support the view that not much has changed due to the new limits on lien avoidance for household goods. We drew a sample of 100 Chapter 7 bankruptcy cases (50 pre-BAPCPA and 50 post-BAPCPA) from each of eight judicial districts. For pre- and post-BAPCPA filers, we compared the debtors' financial characteristics (such as personal property, household goods, assets, and liabilities), the amounts and frequencies of loans secured with the BAPCPA-affected goods, and debtors' intentions regarding disposition of debts secured with such goods.

[1] *Nonpossessory, nonpurchase money* means that the debtor owned the asset against which the lien was taken before using the asset as collateral for debt and that the creditor did not take possession of the asset as security for the debt.

We found no significant difference in the general financial characteristics of Chapter 7 debtors filing pre- and post-BAPCPA. Given the wide variability in debtor financial characteristics, however, this lack of significance may be due to insufficient statistical power. Although we cannot make any conclusions regarding actual changes, we did see a noticeable drop in the amount of the average Chapter 7 debtor's real property and secured debts.

With respect to BAPCPA-specific effects, we cannot draw any conclusions. Although we had an overall sample size of 800 (400 pre- and 400 post-BAPCPA), only about 10 percent of these cases (36 pre-BAPCPA and 42 post-BAPCPA) had a loan potentially secured with BAPCPA-affected goods.[2] Of these, we could not determine from the information contained in the debtor schedules whether the loans were possessory or nonpossessory. As a result, it was impossible to conduct any meaningful statistical analysis about BAPCPA's effect either from the secured-loan information or debtors' intentions regarding such loans. The only conclusion we can draw from the data we collected is that, based on our sample, even before BAPCPA was enacted, it appears that debtors seldom used BAPCPA-affected goods to secure loans (either possessory or nonpossessory) and attempted to use a lien-avoidance provision for such loans even less frequently (in fewer than 1 percent of the filings). This is not surprising, given that items on which it is even legal to take a nonpossessory, nonpurchase security interest—antiques, works of art and jewelry (other than wedding rings)—are ones that most Chapter 7 debtors do not even own.

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2 From the cases, we could not determine the exact nature of the goods that were used to secure these loans, so we had to use proxies for BAPCPA-affected goods.