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In This Issue

WEST®

Credit Card Reform and Bankruptcy Reform

Michael Simkovic*

Consumer advocates won a victory with the passage of the Credit Card Accountability Responsibility and Disclosure Act of 2009.[1] (Credit Card Act). The Credit Card Act bans certain pricing practices that were confusing to credit card users. Ironically, the seeds of this legislative victory may have been sown through an earlier legislative defeat—the Bankruptcy Abuse Prevention And Consumer Protection Act of 2005 (BAPCPA).[2] In passing the Credit Card Act, the U.S. Congress Joint Economic Committee cited a study of the effects of BAPCPA on credit card industry profits and prices.[3] The study revealed

** Michael Simkovic is a 2007 graduate of Harvard Law School and a former Olin Fellow. He gives his deepest thanks to Elizabeth Berney, Elizabeth Warren and Russell Franklin for providing comments and insight on short notice, and for helping this paper reach its intended audience. He thanks Adam Levitin for generously sharing his credit card industry data and Todd Zywicki for making reprints of his work available. The views expressed in this paper are those of Michael Simkovic and do not necessarily reflect the views of Harvard Law School, the Olin Center or any other person or organization.*

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that the credit card industry may have misled Congress about the probable effects of BAPCPA. The complete and final version of this study was recently published in the American Bankruptcy Law Journal.[4] What follows is a summary.

BAPCPA increased the costs and decreased the benefits of bankruptcy to consumers. Supporters of the law claimed that it would benefit consumers as well as creditors, because reducing the losses faced by creditors would lower the cost of credit to consumers. Critics of the law depicted it as special interest legislation designed to profit credit card companies. This study tests whether BAPCPA: (1) reduced the number of bankruptcies; (2) reduced credit card company losses; (3) lowered the cost to consumers of credit card debt; or (4) increased credit card company profits. The data suggests that although bankruptcies and credit card company losses decreased, and although credit card companies achieved record profits, the cost to consumers of credit card debt actually increased. In other words, BAPCPA profited credit card companies at consumers' expense.

I. Background on Bankruptcy Reform

President George W. Bush signed BAPCPA into law on April 20, 2005, and most of its provisions came into effect 180 days later, on October 17, 2005. With regard to consumers, the statute made it more difficult to discharge debt.[5] In particular, BAPCPA broadened the categories of debt that are nondischargeable and adopted "means testing" that limits access to Chapter 7 and pressures debtors to file for Chapter 13 instead.[6] The statute also imposed filing barriers, including higher filing fees, a lengthening of the period between permitted discharges, and an increase in the costs and risks faced by professionals who assist consumers filing for bankruptcy.[7]

Unsecured creditors, including credit card issuers, were the most likely beneficiaries of BAPCPA. Whereas secured creditors, such as mortgage or auto lenders, are protected under Chapter 7 by their security interests, unsecured creditors often receive little or nothing in a Chapter 7 case. Pushing filers into Chapter 13 should increase recovery for unsecured creditors.[8]

A key justification for BAPCPA was that it would make credit more affordable to consumers. President Bush explained that he signed the law "because when bankruptcy is less common, credit can be extended to more people at better rates."[9] Similarly, the House of Representatives Report approvingly cited the Senate Judiciary Committee testimony of Professor Todd Zywicki.[10] In his full testimony, Professor Zywicki argued that bankruptcy increases the price that consumers pay for credit card debt and that BAPCPA would reduce these costs to consumers:

> This bankruptcy "tax" takes many forms. It is obviously reflected in higher interest rates.... It is [also] reflected in shorter grace periods for paying bills and higher penalty fees and late-charges for those who miss payments... [R]educing the number of strategic bankruptcies will reduce the bankruptcy tax paid by every American family.... These reforms will make the bankruptcy system more fair, equitable, and efficient, not only for bankruptcy debtors and creditors, but for all Americans.[11]

This promise of cost savings to the average American family was critical to the passage of BAPCPA. As Professor Elizabeth Warren explained in 2004:

> [I]t is hard to persuade Congress to vote for something that could easily be characterized as a bill to squeeze hard-working families

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> down on their luck in order to improve profits for a few big corporate lenders. [Claims of cost savings to the average family are] a way to appear to align the interests of ordinary families with billion-dollar multi-national lenders.... [A] promise of $400 to each hard-working family in America will give politicians plenty of political cover for their votes [in favor of BAPCPA].[12]

With the promise that any gains from BAPCPA would not be captured by lenders, but would be shared widely with the voting public, advocates of the statute garnered more widespread support for the law. However, critics were skeptical that benefits would be passed on to consumers.[13]

II. Methods

If the supporters of BAPCPA were right, then the statute should have reduced the number of personal bankruptcies, reduced credit card company losses, and reduced the cost of credit to users of credit cards. Any such costs savings could manifest across credit cards' multiple price points, including: (1) late fees, (2) over-limit fees, (3) annual fees, (4) interest rates and (5) grace periods. This study tests whether BAPCPA led to these effects by comparing absolute levels and trends—in personal bankruptcies, credit card lenders' charge-offs, late fees, over-limit fees, interest rates and grace periods—before and after the effective date of the statute.

To control for other factors that might have caused higher or lower costs of consumer credit, the present study considers changes in the spread between the annual percentage rates (APRs) charged on credit card balances and the risk free interest rate. The risk free interest rate reflects broad macroeconomic factors that affect economy-wide costs of credit.[14]

III. Results: The Effects of Bankruptcy Reform on the Credit Card Industry

A. Bankruptcies and credit card company losses fell sharply

After BAPCPA went into effect, both personal bankruptcy filings and credit card company losses declined sharply. This is reflected in Figure 1[15] which also demonstrates the historical correlation between personal bankruptcy filings and credit card company loss rates.

Figure 1 illustrates a spike in bankruptcy filings between the enactment of BAPCPA and its effective date, as consumers scrambled to file under the old, more debtor-friendly rules. The sharp drop in bankruptcy filings in 2006 may be due in part to households on the verge of bankruptcy in 2005, who would have filed in 2006 but for their decision to seek the protection of the pre-BAPCPA statute. Nonetheless, at least some of the reduction in bankruptcy filing rates and credit card company losses appears to be permanent. Although bankruptcy filings and loss rates increased in 2007 compared to 2006, 2007 rates remained significantly below recent pre-BAPCPA rates (2002 to 2004). These results are reflected in Figure 2, which shows annual credit card loss rates before, during and after BAPCPA.

The value of this decrease in credit card loss rates is difficult to estimate, but may be as high as $8.6 billion in 2006 and $5.9 billion in 2007.[16] The true value is likely slightly lower because this estimate is based on revolving credit, which is primarily but not exclusively credit card debt,[17] and because some of the decrease in charge-offs may be due to factors other than BAPCPA, such as improved information technology or collections techniques.

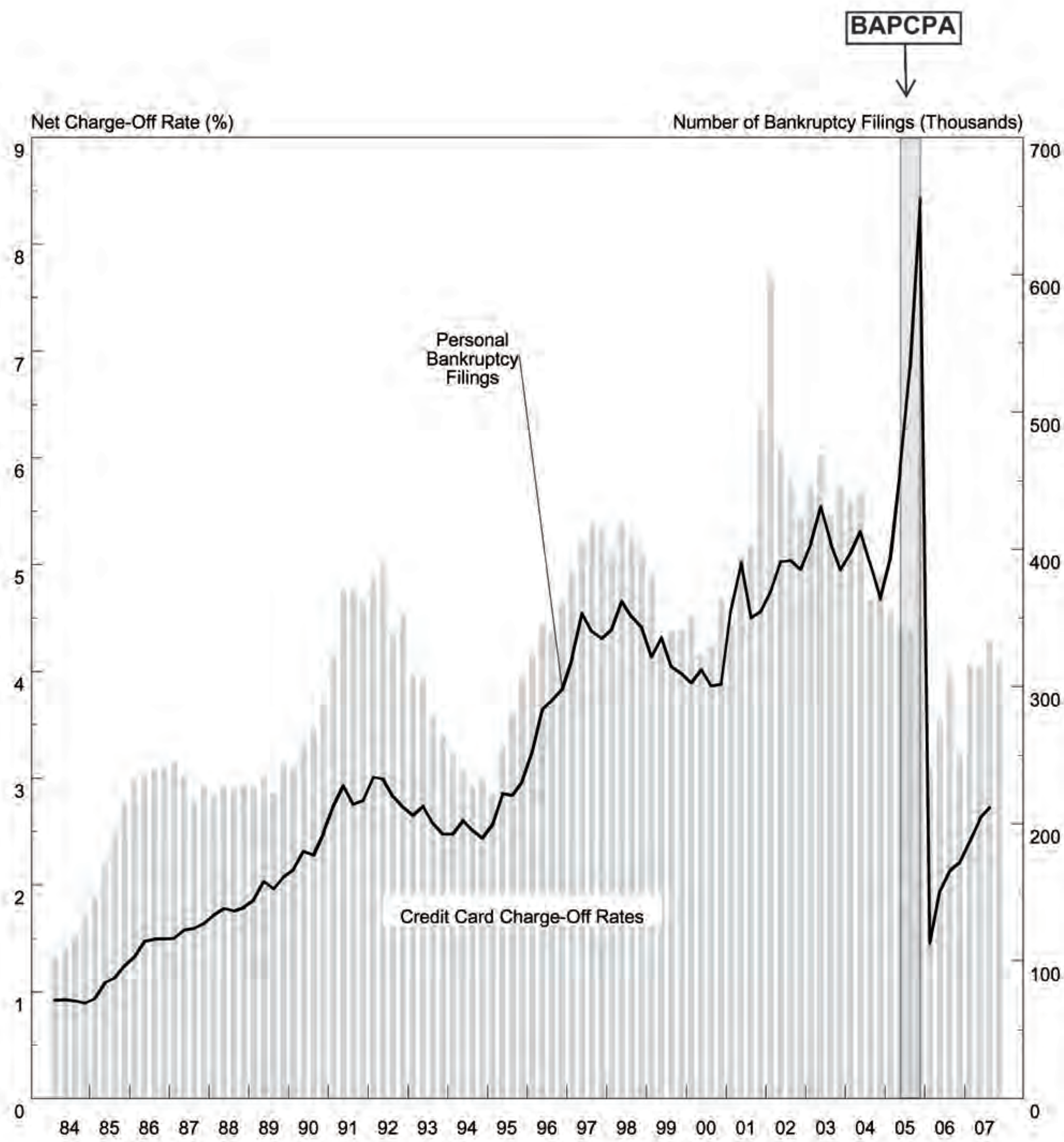
B. Credit card late fees and over-limit fees increased while grace periods decreased

Credit card fees have been climbing and have become less transparent over the years[18] and there is no evidence that BAPCPA reversed this trend.

Figure 3 shows that late fees and over-limit fees have been climbing since well before bankruptcy reform, and that this trend continued after BAPCPA. Average late fees increased 5% from April 2005 to December 2007. During the same period, over-limit fees increased 17%.[19] At the same time, however, annual fees—which as an upfront flat fee, are the most transparent and easiest for consumers to understand and comparison shop—have been falling since well before BAPCPA[20] and have continued to fall afterward.

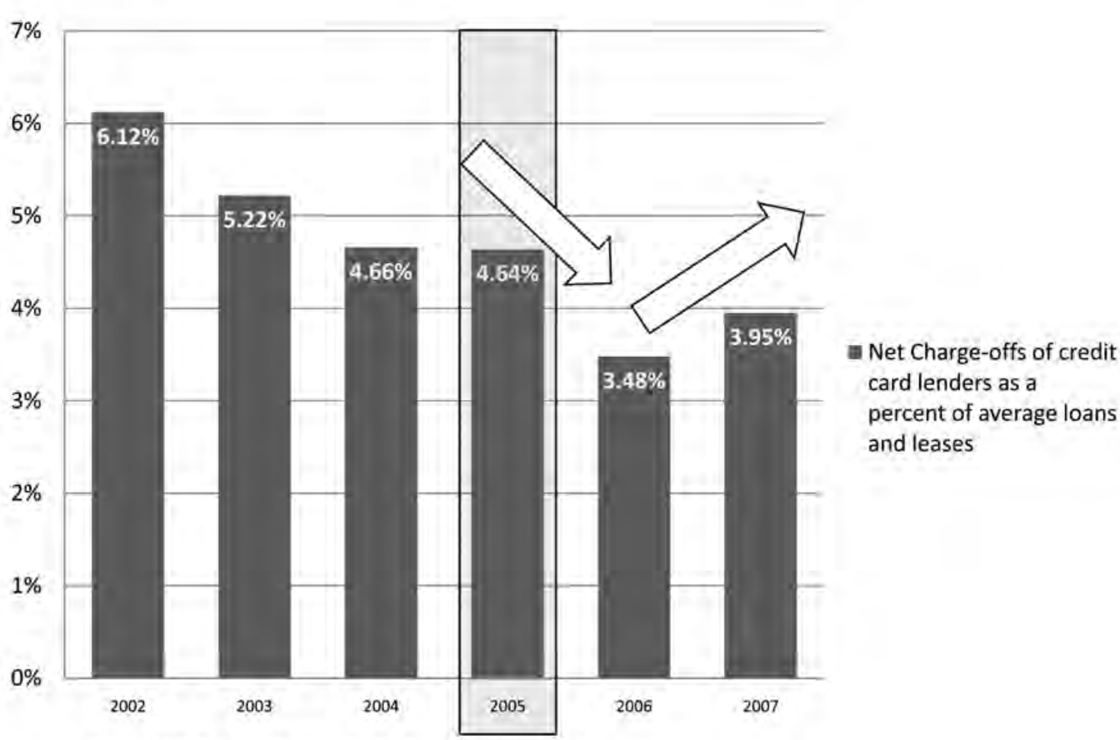
Figure 1: Credit Card Loss Rates and Personal Bankruptcy Filings

1984-2007



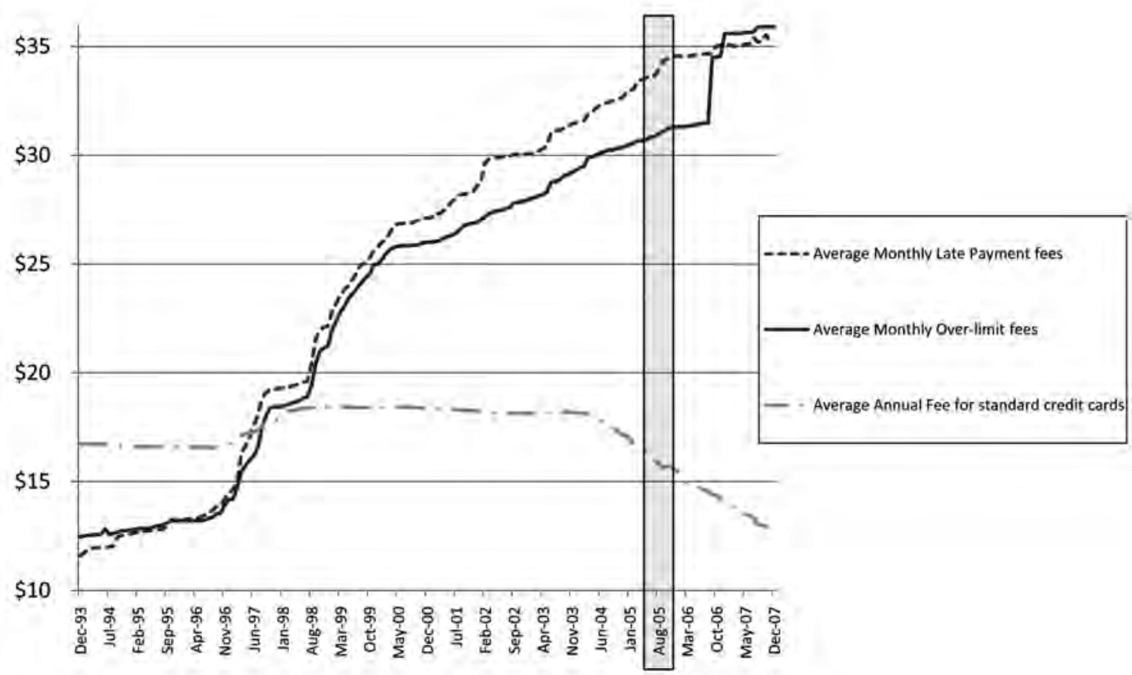
Sources: FDIC Quarterly Banking Profile, Fourth Quarter 2007
Bankruptcies - Administrative Offices of the United States Courts; Charge-off rates - Call reports and Thrift Financial Reports

Figure 2: Credit card lenders' charge-offs declined in 2006, but climbed in 2007



Source: FDIC Quarterly Banking Profile, December 2007 report

Figure 3: Late payment and over-limit fees have increased



Source: CardWeb CardData

A substantial proportion of credit card users pay late fees and over-limit fees. In 2005, issuers reporting to the Government Accountability Office charged late fees to 35% of their active U.S. accounts and over-limit fees to 13% of their active U.S. accounts.[21] The likelihood of incurring a late fee has increased over time as credit card companies reduced grace periods. This trend continued after BAPCPA, as shown in Figure 4 below. Indeed, from 2005 to 2007, grace periods fell 1.5%.[22]

C. Credit card interest rates and the spread above the risk-free rate both increased

The interest rates charged by credit card companies have increased after BAPCPA. Figure 5 shows that the annual percentage rate (APR) on standard, gold and platinum cards have all increased.

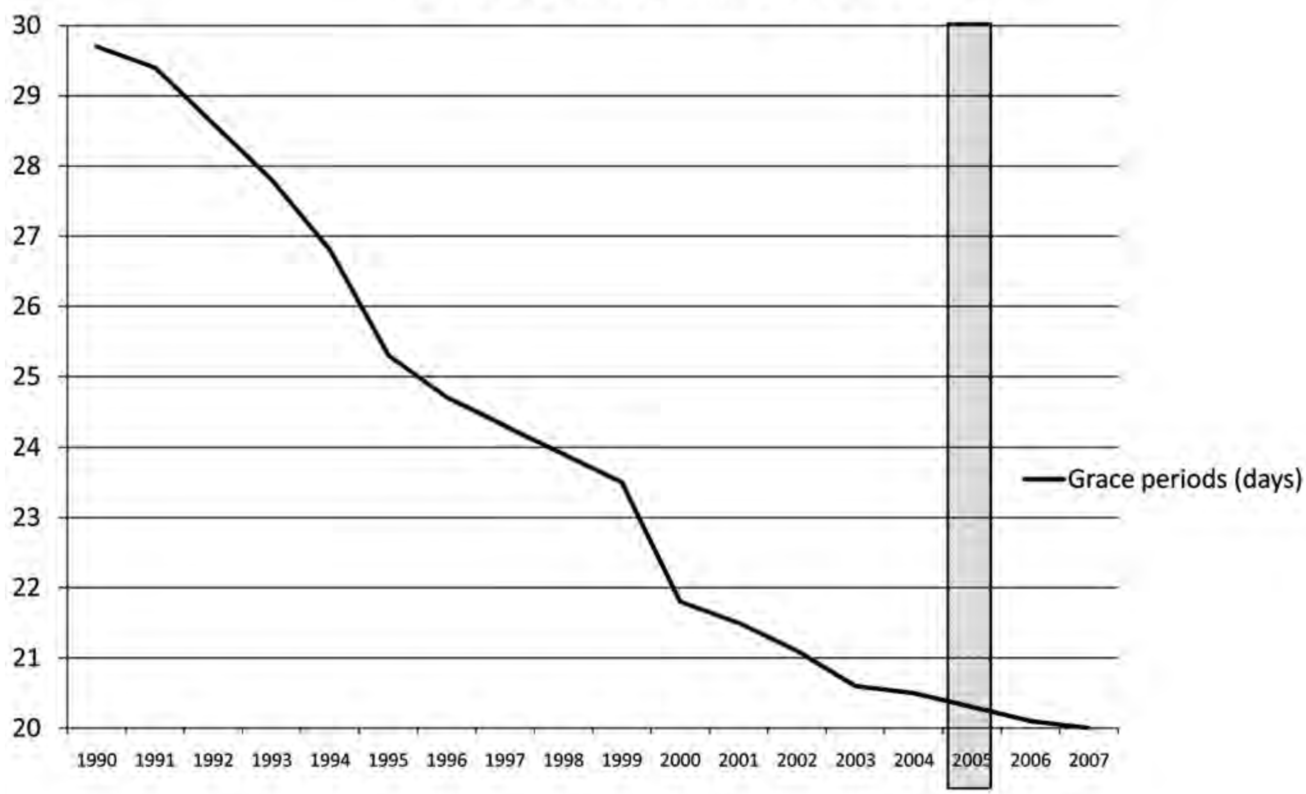
APRs on standard credit cards increased 8% from April 2005 to December 2007.[23] The Government Accountability Office estimates that 70% of credit card company revenues come from interest charges.[24]

As credit card interest rates have increased, so too has the spread between those rates and the risk-free rate. The risk-free rate declined 12% from April 2005 to December 2007 as the yield on the five-year T-note fell from 3.9% in April 2005 to 3.5% in December 2007.[25] As the risk-free rate declined, credit card interest rates continued to rise, thereby increasing the spread by 14%.[26]

Figure 6, page 8, shows the dramatic increase in the spread between credit card interest rates and risk free rates after BAPCPA went into effect.

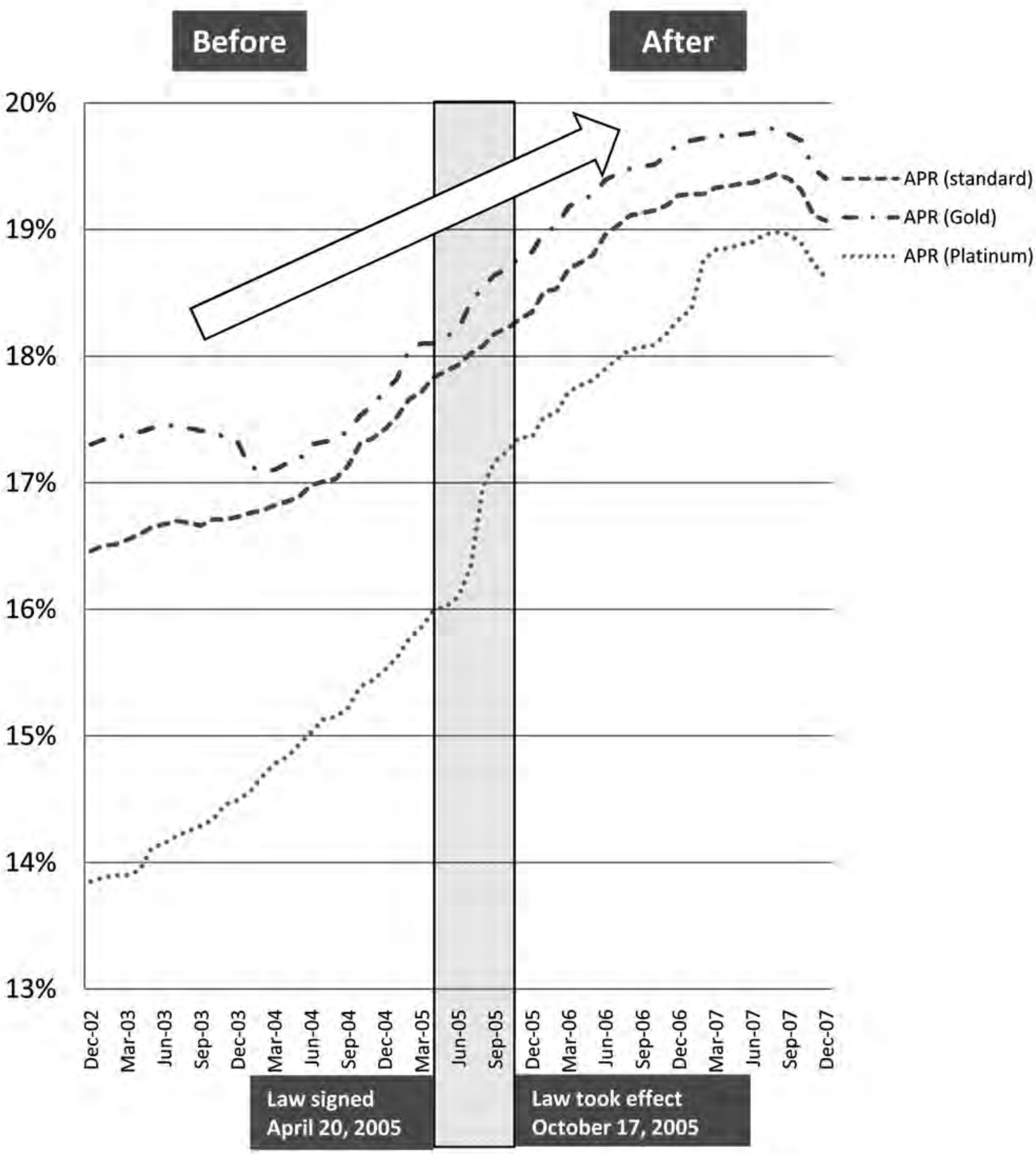
Even if the spread had remained the same, customers would have suffered harm, because credit

Figure 4: Grace periods have shrunk



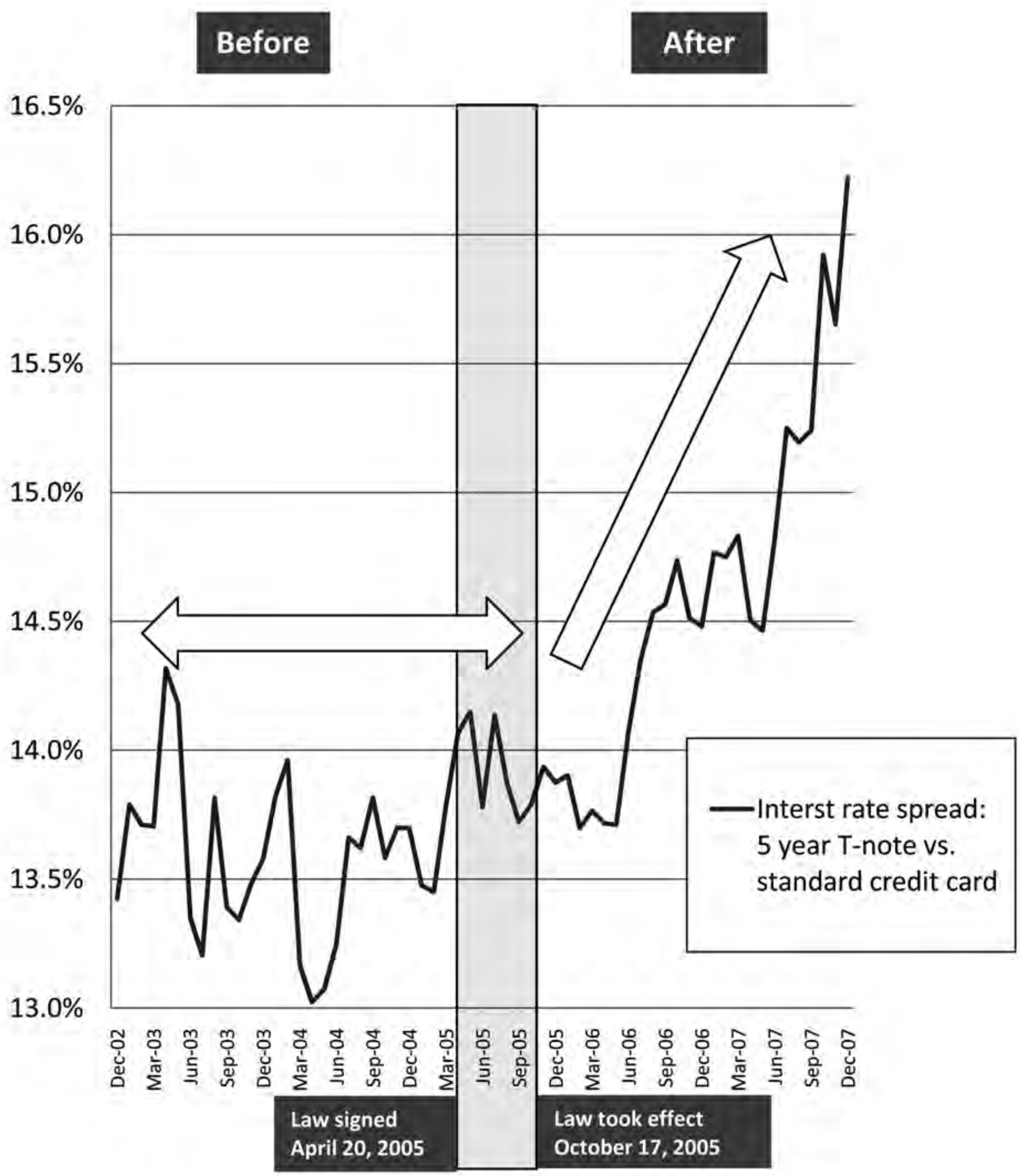
Source: CardWeb CardData

Figure 5: Credit card interest rates continued to climb after bankruptcy reform



Source: CardWeb CardData

Figure 6: Credit card interest spreads dramatically increased after bankruptcy reform took effect



Source: CardWeb CardData, Bloomberg

would be no less expensive, and customers would have lost the protection afforded them under the pre-BAPCPA statute. The widening of the spread highlights the fact that credit card companies benefited at consumers' expense.

D. Credit card companies achieved record profits

Even though credit card companies saved billions because of reduced loan loss rates after BAPCPA,[27] the cost to credit card customers increased 5% to 17%.[28] This combination of lower costs and higher prices drove record profits, as shown in Figure 7.

IV. Discussion: A Market With Minimal Price Competition

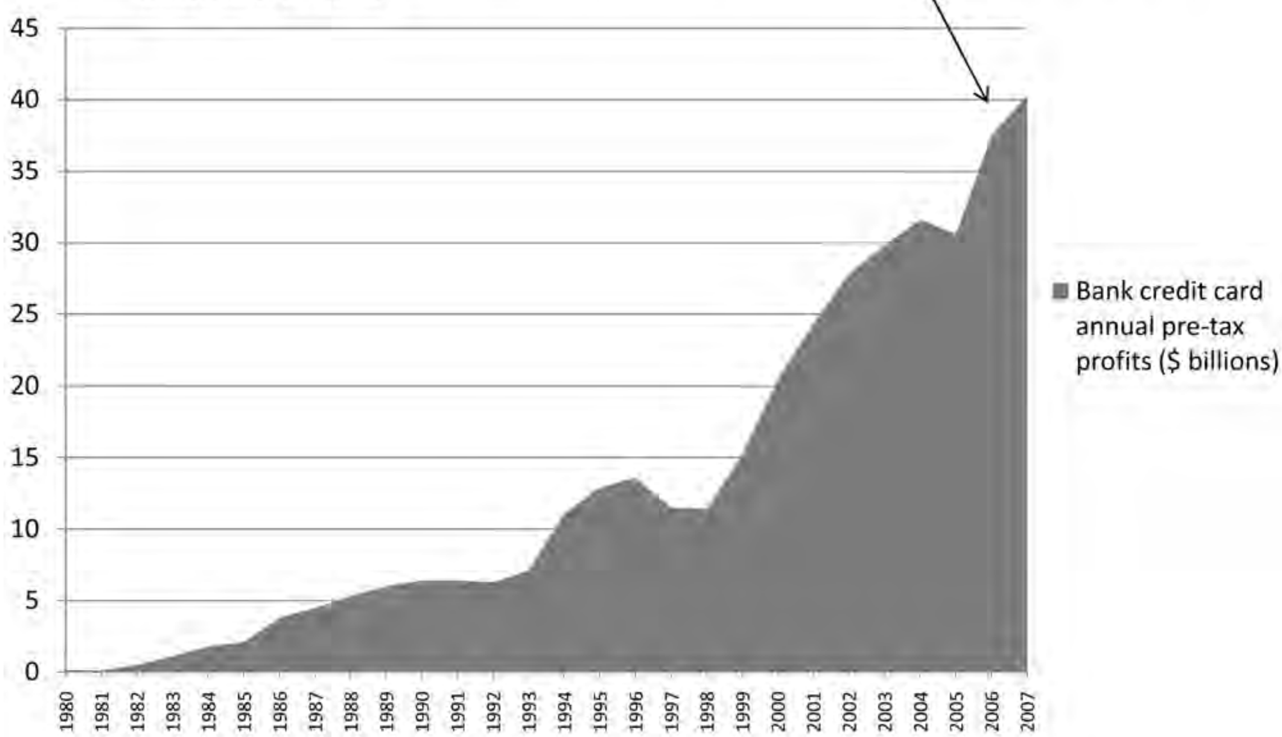
What could explain the lack of benefit to consumers, in spite of the clear benefit to credit card companies? Credit card companies can retain the benefit of fewer bankruptcies rather than share it with their customers if credit card companies can avoid competing with one another on price.

Several factors enable credit card companies to avoid price competition. One is industry consolidation. Figure 8, page 11, shows the trend toward consolidation, which had been going on for some time and has continued after the enactment of BAPCPA.

In 2005, the top 10 issuers controlled 87% of the market. Ten years earlier, the top 10 controlled only 56%.[29] With fewer companies controlling a larger share of the market, it has become easier to avoid "price wars" that benefit consumers but harm all of the producers in an industry.[30]

The credit card industry might also be able to avoid price competition because of complex, multi-tiered pricing that can make it difficult for

Figure 7: Credit card companies had record profits in 2006 and 2007 after a downturn in 2005



Source: Cardweb

customers to comparison shop.[31] Pricing can include multiple variables—annual fees, late fees, over-limit fees, currency conversion fees, cash-advance fees, standard interest rates, cash-advance interest rates, introductory interest rates, penalty interest rates, etc. These fees and interest rates—complex in their own right—are presented in a form that is difficult to understand.[32] Customers faced with such complex pricing systematically miscalculate and underestimate the cost of credit card debt.[33]

The empirical record on consumers' ability to comparison shop points toward a market that is far from price-competitive. Studies have shown that most consumers will irrationally choose a card with a low introductory interest rate over a less expensive card with a higher introductory rate. After the introductory rate expires, these consumers generally fail to switch to a lower interest card.[34] According to the General Accountability Office, many consumers do not fully appreciate—and therefore cannot comparison shop—late fees and penalty interest rates because of faulty disclosures by credit card companies.[35] Studies suggest that although customers who were assessed late fees in the recent past can learn to avoid fees in the short-term future, the learning is at best temporary.[36] Finally, although over half of consumers can rationally choose between a lower interest rate card with an annual fee and a higher interest rate with no annual fee, a substantial minority (40%) will initially make the wrong choice.[37] Whatever the underlying reason, rising prices in the face of falling risks and costs demonstrate that the credit card industry is not price-competitive.

In 2000, Professor Todd Zywicki published an article defending credit card companies against charges that the industry was not competitive and that regulations could squeeze their profit margins without harming consumers. Professor Zywicki wrote: "[I]f the credit card market is largely competitive, then bankruptcy losses will [be passed on] to consumers, rather than being primarily a wealth transfer from credit card issuers to consumers in the form of reductions in these profits."[38] Zywicki asserted that the industry was competitive, even though credit card interest rates did not respond to rising bankruptcy losses, because credit card companies passed those costs on to consumers in other ways: through "increased fees and penalties for late payments and [over-limit fees]…. [T]he increase in these fees by card issuers is a direct response to the increased default rate in recent years";[39] and through the "steady erosion in the length of the non-interest grace period."[40]

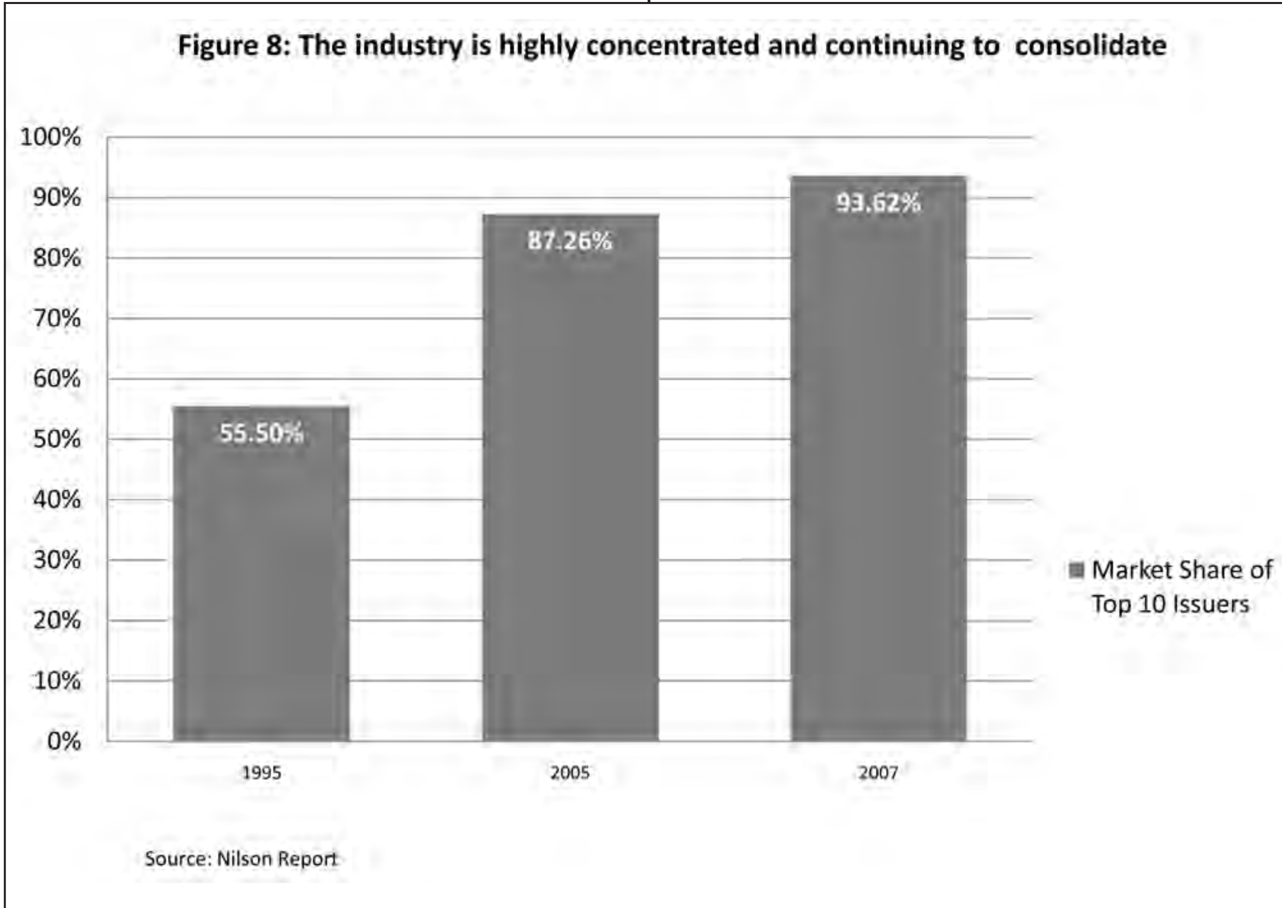
After BAPCPA, interest rates and fees continued to rise and grace periods continued to fall, even though credit card companies reaped tremendous gains from declining bankruptcy losses. This demonstrates—under the very criteria set forth by Professor Zywicki—that the credit card market is not price-competitive. This lack of price competition explains why the benefits of bankruptcy reform accrued exclusively to credit card lenders and were not shared with the average American family, and why—by Professor Zywicki's own criteria—BAPCPA was a failure.

V. Conclusion: The Problem of Uncompetitive Markets

The data are unambiguous: BAPCPA benefited credit card companies and hurt their customers. While bankruptcy protection became less available, credit card companies increased prices by 5% to 17%. This contributed to a 25% increase in credit card industry annual profits from 2005 to 2007. Profits for 2006 were $7 billion higher than 2005, and 2007 profits were $10 billion higher than profits for 2006.[41]

During debates over BAPCPA, advocates of the statute insisted that bankrupt consumers were imposing costs on middle class American families.[42] If there were a bankruptcy "tax," then there should have been a bankruptcy "tax rebate" upon the passage of BAPCPA.[43] At least with respect to credit cards, there has not been one. In fact, prices have increased.

The data reveal a fundamental mistake made by credit industry advocates and the Congress that listened to them in 2005: the credit card market is not transparent and price-competitive. Key signs that the industry was not price-competitive—complex, misleading pricing structures and prices that did not respond to changes in costs—had been pointed out by researchers such as Lawrence Ausubel as early as 1997.[44] Those clear voices were lost in the din that surrounded passage of BAPCPA.



Notes

1. Pub. L. No. 111-24, 123 Stat. 1734–66 (2009).
2. Pub. L. No. 109-8, 119 Stat. 23 (2005).
3. See A Report by the Joint Economic Committee, Vicious Cycle: How Unfair Credit Card Practices are Squeezing Consumers and Undermining the Recovery 16 n.5, 17 n.10 (May 12, 2009), available at http://jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore_id=42840b23-fed8-447b-a029-e977c0a25544. The Committee also cited the work of Lawrence M. Ausubel, Ronald J. Mann, Elizabeth Warren, Adam J. Levitin, Thomas H. Jackson, Todd Zywicki, and several other scholars.
4. The Effect of BAPCPA on Credit Card Industry Profits and Prices, 83 Am. Bankr. L.J. 1 (2009)
5. See Ronald J. Mann, Bankruptcy Reform and the "Sweat Box" of Credit Card Debt, 2007 U. Ill. L. Rev. 375 (2007).
6. Chapter 7 is preferable to Chapter 13 for many financially distressed consumers because Chapter 7 results in a discharge of many debts, leaving future income relatively unencumbered, while Chapter 13 requires debtors to repay their debts from future income. Mann, 2007 U. Ill. L. Rev. 375, 380 (2007).
7. Mann, 2007 U. Ill. L. Rev. 375, 377 (2007).
8. Mann, 2007 U. Ill. L. Rev. 375, 379-380 (2007).
9. Press Release, George W. Bush, President Signs Bankruptcy Abuse Prevention, Consumer Protection Act (April 20, 2005) (on file with author).
10. H.R. Rep. No. 109·031, pt. 1 (2005).
11. Todd J. Zywicki, Statement to Senate Judiciary Committee (Feb. 10, 2005), 2005 WL 319924.
12. Elizabeth Warren, The Phantom $400, 13 J. Bankr. L. & Prac. 2, Art. 4 (2004). The $400 is an estimate of the cost of bankruptcy to each American family. According to Professor Warren, the $400 estimate was devised by lobbyists working for the credit industry using dubious analytical methods, then spread *as* a 'fact' through an aggressive, well-funded lobbying and public relations campaign.
13. See Elizabeth Warren, The Phantom $400, 13 J. Bankr. L. & Prac. 2, Art. 4 (2004) at 87; Ronald J. Mann, Bankruptcy Reform and the "Sweat Box" of Credit Card Debt, 2007 U. Ill. L. Rev. 375, 376 (2007); Letter from 110 Law Professors to Hon. F. James Sensenbrenner and Hon. John Conyers, Jr. (March 11, 2005), reprinted at 151 Cong. Rec. H1974-05.

14. The complete version of this study considers several other factors that might have affected the results, such as inflation, population growth, unemployment, real GDP growth, and household debt levels The complete version also includes a detailed explanation of data sources. The results are substantially the same after accounting for these factors, and for the sake of brevity, these controls have been omitted from this summary.
15. The bars represent quarterly personal bankruptcy filings, in thousands. The line represents credit card company charge-offs as a percent of average loans and leases. The chart appeared in the FDIC's Quarterly Banking Profile, but has been modified for this paper to indicate the timing of bankruptcy reform. The timing of bankruptcy reform is represented by the large grey vertical rectangle, pointed out by the large down arrow. BAPCPA was enacted at the left-most portion of the rectangle, and its key provisions went into effect at the right-most portion of the rectangle. This convention for representing the timing of BAPCPA is used for all charts in this paper. Additional information about the FDIC's methodology is available in the complete version of this report.
16. The method by which this value was estimated is described in detail in the complete version of this article.
17. There is no government statistic measuring only credit card debt. Adam J. Levitin, A Critique of the American Bankers Association's Study of Credit Card Regulation, 3 n.2 (2008), available at http://papers. ssrn.com/sol3/papers.cfm?abstract_id=1029191.
18. In 2000, Professor Zywicki wrote that rather than increase interest rates, credit card companies instead increased late fees and over-limit fees, "so called 'hidden fees." Todd Zywicki, The Economics of Credit Cards, 3 Chap. L. Rev. 79, 103 (2000). According to the Government Accountability Office, many consumers do not fully appreciate these fees because of faulty disclosure by credit card companies. Furthermore, the portion of credit card company revenues attributable to penalty fees has been climbing. U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 67 (2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009). At the same time, credit card companies reduced or eliminated more transparent annual fees because of "hostility of consumers... evidenced by the fact that when annual fees were first imposed, consumers canceled over nine million bank cards in 1980, amounting to some 8% of the outstanding total." Todd Zywicki. The Economics of Credit Cards, 3 Chap. L. Rev. 79, 118 (2000). Average late fees among credit card companies with portfolios larger than $100 million climbed from under $13 in December 1994 to over $35 in December 2007 (CardWeb CardData). During the same period, over-limit fees climbed from less than $11 to more than $26 while annual fees on standard credit cards fell from $17 to $13 (CardWeb CardData).
19. CardWeb CardData. Fees are for portfolios greater than $100 million. Fees for portfolios less than $100 million showed a similar pattern. The Government Accountability Office estimates that 10% of credit card company revenues come from penalty fees. U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 67 (2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009).
20. As early as 2000, Professor Zywicki reported "the virtual elimination of annual fees" and that remaining annual fees were generally tied to particular services, such as frequent flyer miles, not plain vanilla cards offering only payment and credit services. Todd Zywicki. The Economics of Credit Cards, 3 Chap. L. Rev. 79, 118 (2000).
21. U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 5 (2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009) at 5.
22. CardWeb CardData.
23. APRs increased from 17.7% to 19.1%. The 8% increase refers to the percent increase above the 17.7% APR in April 2005 (19.1%/17.7% - 1).
24. U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 67 (2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009).
25. Bloomberg Professional Service.
26. The spread increased from 13.8% to 15.7%.
27. See supra Section 3A.
28. Nominal prices increased, except for annual fees, which were in decline long before bankruptcy reform. See supra Section 3A. Controlling for inflation and other factors, and excluding annual fees, real prices increased between 1% and 13%.
29. Nilson Report.
30. It also has become easier for credit card companies to organize and coordinate mutually beneficial activity, such as lobbying Congress to change the bankruptcy laws.
31. Adam J. Levitin, A Critique of the American Bankers Association's Study of Credit Card Regulation, 18 (2008), available at http://papers. ssrn.com/sol3/papers.cfm?abstract_id=1029191, at 18.
32. U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 67

(2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009). Professor Elizabeth Warren recently testified before the Senate about several techniques used by credit card companies that make credit card agreements and prices difficult to understand. Credit Card Practices: Hearing Before the Senate Committee on Banking, Housing and Urban Affairs, 110th Cong. (2007), 2007 WL 184875 (F.D.C.H.) (statement of Elizabeth Warren). According to Professor Warren, these "tricks" reduce transparency and contribute to a market that is not price-competitive.

33. Adam J. Levitin, A Critique of the American Bankers Association's Study of Credit Card Regulation, 18 (2008), available at http://papers. ssrn.com/sol3/papers.cfm?abstract_id=1029191, at 24-25.

34. Haiyan, Shui & Lawrence M. Ausubel, Time Inconsistency in the Credit Market, 9 (May 3, 2004) (unpublished manuscript), available at http://ssrn.com/abstract=586622.

35. 5 U.S. Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 77-79 (2006), www.gao.gov/cgi-bin/getrpt?GAO-06-929 (last visited February 6, 2009). See also Credit Card Practices: Hearing Before the Senate Committee on Banking, Housing and Urban Affairs, 110th Cong. (2007), 2007 WL 184875 (F.D.C.H.) (statement of Elizabeth Warren).

36. Sumit Agarwal, John C. Driscoll, Xavier Gavaix & David Laibson, Learning in the Credit Card Market (Feb. 8, 2008) (unpublished manuscript), available at http://ssrn.com/abstract=1091623.

37. Sumit Agarwal, Chomsisengphet Souphala, Chunlin Liu & Nicholas S. Souleles, Do Consumers Choose the Right Credit Contracts, Federal Reserve Bank Of Chicago Working Papers Series 4 (2006).

38. Todd Zywicki, The Economics of Credit Cards, 3 Chap. L. Rev. 79, 111 (2000).

39. Todd Zywicki, The Economics of Credit Cards, 3 Chap. L. Rev. 79, 103 (2000).

40. Todd Zywicki, The Economics of Credit Cards, 3 Chap. L. Rev. 79, 103 (2000).

41. (CardWeb CardData). Bank credit card annual pretax profits, excluding debit cards and private label credit cards, were $30.6 billion in 2005, $37.5 billion in 2006, and $40.3 billion in 2007. ($40.30) + ($37-30) = $17.

42. Todd J. Zywicki, Statement to Senate Judiciary Committee (Feb. 10, 2005), 2005 WL 319924.

43. Indeed, the credit industry essentially claimed as much with its advertisements of the $400 bankruptcy tax.

44. See Lawrence M. Ausubel, Credit Card Defaults, Credit Card Profits, and Bankruptcy, 71 Am. Bankr. L.J. 249, 263 (1997).

From the Appellate Courts

RECENT DECISIONS FROM THE APPELLATE COURTS

Austin L. McMullen
Max Smith
Bradley Arant Boult Cummings, LLP
Nashville, TN

FIRST CIRCUIT

Morse v. Rudler (In re Rudler), 576 F.3d 37 (1st Cir. 2009). Section 707(b)(2)(A)(iii)(I) of the means test allows a deduction from current monthly income of installment payments for property the debtor plans to surrender.

SECOND CIRCUIT

Chrysler LLC v. Indiana State Police Pension Fund (In re Chrysler LLC), 576 F.3d 108 (2d Cir. 2009). (1) Section 363 sale of substantially all of debtor's assets to newly formed entity did not constitute an impermissible "sub rosa" plan. Although statutory provision now codified as § 363 was originally intended to permit the sale of assets deteriorating in value, existence of an emergency is not prerequisite to a § 363 sale. Of concern, however, are asset sales under § 363 that dictate the terms of any future reorganization plan in the case. To balance the competing concerns of efficiency and safeguarding the Chapter 11 process, a good business reason is required for a § 363 transaction. In this case, the objecting parties—secured creditors not being paid in full from the sale—argue that the sale was a "sub rosa" plan because it transferred substantially all of the debtor's assets to a newly formed entity majority owned by labor union benefit funds that were unsecured creditors in the case. The court distinguished the assets transferred from the equity stakes in the new entity and held that the equity stakes were entirely attributable to new value in the form of financing, management and technology, none of which were assets of the debtor's estate. The lien holders' security interests, on the other hand, would attach to all proceeds of the sale. The court rejected

