After the water has receded, after much of the physical devastation is repaired, countless families face a hurricane’s most lasting legacy: financial disaster. The car may be gone, the house may be gone, and the credit card bills may have been washed away, but the obligation to pay for all of them remains. The financial stress on families is easy to predict as many people go weeks or even months without a paycheck.

When there is a series of major disruptions like the 2005 hurricane season, hundreds of thousands of middle class families may deplete their savings and turn to credit cards to supplement the aid they receive from charities and the government. Additionally, victims of natural disasters often return home to find that they have lost substantial assets. Insurance may cover some of the damage, but insurance companies’ liability is often limited. Every aspect of a family’s financial circumstances is exposed to the effects of a natural disaster.
Many disaster victims eventually turn to bankruptcy. (See the sidebar “Personal Bankruptcy Options.”) It is possible to analyze bankruptcy filing data following hurricanes of the past 25 years, but limitations in the data make the tools blunt. The filings can be compared only year by year, not quarter by quarter. More important, the long-term data are available only on a state-by-state basis.

To Robert Lawless, a professor at the University of Nevada at Las Vegas, that seemed problematic. A hurricane that hit Houston, for example, might have no effect on families and small businesses in El Paso, Dallas, or Austin. In order to detect a difference statistically, the regional effects would have to be large enough to change the bankruptcy filing numbers for the entire state. As a result, when Lawless decided to analyze the data, he expected to find no statistical correlations. Even if there were important effects following a hurricane, he thought, the rough data would reveal only powerful ones.

In fact, Professor Lawless discovered that in the three years following a hurricane, the growth in bankruptcy filings is about 50 percent higher in states that have suffered a direct hit. In the same time period, the growth in nearby states is about 20 percent higher.

The data show that the location of the disaster also is significant. When the damage occurs in regions where there are many low-cost homes, FEMA payments are lower, and there is a corresponding increase in bankruptcy rates. The highest increase in bankruptcy filings in the past 25 years occurred when Hurricane Elena hit Mississippi in 1985, resulting in a 71.8 percent bankruptcy-filing increase in the following three years.

Changes to the Code

At the same time that victims are digging out from the recent hurricanes, the legal landscape is changing. The 2005 amendments to the Bankruptcy Code went into effect on October 17, about the time the lights were scheduled to go back on in New Orleans. The amendments to the law, more than 400 pages of new procedures, are designed to reduce bankruptcy filings through three principal mechanisms:

- **Paperwork.** The new law requires more documentation of a debtor’s financial circumstances, such as six months of paycheck stubs, tax returns, and a full accounting of the monthly budget down to utility payments and insurance bills. The obligations are not limited to those who have high incomes or who have no good reason for filing; they apply across the board.

- **Screening.** Through the application of a complex formula, debtors who have incomes above the median for family size and whose allowable expenses are small enough to leave them with $100 or more of “excess income” each month will be denied access to Chapter 7 and debt liquidation. In addition, no debtor may file for bankruptcy without consulting an approved credit counselor, and no debtor will receive a discharge without attending financial education classes.
• Reduced Protection. Tenants who could not be evicted from their apartments under the old laws—so long as they remained current on their post-bankruptcy rent payments—now can be dispossessed. In addition, people filing for bankruptcy will not get relief from as much credit card debt as would have been the case before October 17, 2005.

The new law means that natural-disaster victims, like anyone else, must meet a higher standard if they seek relief through a bankruptcy filing.

Along the Gulf of Mexico right now are other challenges that those planning for disasters elsewhere should note. The legal system in Louisiana was disrupted, so the state bar urged postponement of the effective date of the new laws in the disaster areas. The bar described a “widespread paralysis” of the legal community and difficulty in communicating with clients. Moreover, courts and lawyers scrambling to relocate faced a shortage of office space and adequate infrastructure.

In the three years following a hurricane, the growth in bankruptcy filings is about 50 percent higher in states that have suffered a direct hit.

The new statute has ambiguities that, in time, litigation will clarify, but disaster victims seldom have that kind of time. Additionally, there is uncertainty about whether judges will have the ability to waive some statute requirements for the hurricane victims. Past provisions of the Bankruptcy Code permitted a judge to consider all the facts and circumstances in determining whether a particular bankruptcy petition constituted an “abuse” of the bankruptcy system, but the amended law gives judges less discretion. So, for example, when Mississippi bankruptcy judge Edward Ellington was asked whether debtors whose paperwork was buried in mud could be excused from producing pay stubs and old bills showing regular household expenses, he replied, “I can’t grant the waiver on the front end because I just don’t have the authority to do it.”

In recognition of the difficulties facing victims of natural disasters, on the eve of implementation of the new law, the Justice Department issued special guidelines to the court-appointed officials (trustees) who administer a filer’s “bankruptcy estate.” The guidelines said trustees would certify that credit counseling was unavailable (thereby waiving the requirement that a debtor be counseled before filing) and that the trustee would not object if the debtor did not produce necessary paperwork, meet statutory deadlines, and so on. Although debtors’ attorneys hailed the acknowledgment of the problem, they pointed out that creditors may object whenever debtors violate the law—in short, it is not within the power of the trustees to waive statutory requirements. Also, many debtors’ attorneys worry that the coverage is too narrow, leaving out many Mississippi, Alabama, and Texas families that were flooded. It is also unclear how long such waivers will remain in place.

In spite of such challenges, many people are likely to seek bankruptcy relief in the wake of the hurricanes. Some may just put it off. Indeed, Lawless’s data show that the largest effects from past hurricanes are felt in the third year after storms hit, suggesting that many families will recover as best they can, and then confront their overall financial condition.

More research on natural disasters’ effect on bankruptcy filing needs to be done and new techniques discovered for ferreting out the details. If enough Katrina victims, for example, remain in the places where they have taken refuge, the filing rates may show less relative increase. A diaspora could present a new challenge to studying the effects of natural disasters on bankruptcy filings.

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Endnotes

1 Most of those with modest incomes have no flood insurance, which must be paid for separately. FEMA will provide some insurance for some of those who can afford the insurance, but the amount is capped.


5 11 U.S.C. 521(b).


7 Use of a credit card to obtain cash advances totaling more that $750 obtained within 70 days of the bankruptcy filing will be presumed fraudulent and nondischargeable. 11 U.S.C. §523(a)(2)(C)(II). This provision is amended to be more favorable to creditors than its previous version.


8 The fact that the amendments create specific exceptions for military personnel who are away on active duty or for the disabled suggests that Congress did not believe it had left general discretion with the courts to waive specific requirements. 11 U.S.C. 109(h)(4); 707(b)(2)(D).


10 Office of Legislative Affairs, Department of Justice, letter to Chairman Sensenbrenner (October 5, 2005).

11 Statement of the National Association of Consumer Bankruptcy Attorneys (October 5, 2005).