



May 12, 2020

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COVID-19 Caused Bankruptcies: A Focus On “Personal” Debt

Americans are in an unemployment crisis due to COVID-19 business closings, and many are accruing debt in order to maintain their basic lives – unpaid utilities, buy food on credit, etc. For many, the vehicle to obtain that debt is credit cards, home-equity loans, or simply failing to pay creditors who invoice customers after providing goods and services, such as doctors.^[1]

Many Americans incurred this debt believing they had no choice, and with the expectation and intention that they will pay when they return to work. This belief is bolstered by descriptions of unemployment as “temporary.” Congress assumed the same when it passed enhanced unemployment compensation that expires during the summer of 2020.^[2] Unfortunately, many business leaders now warn that what started as a furlough or temporary layoff will in fact be permanent. Because of this, personal bankruptcies seem, sadly, inevitable.

When incurring debt, the intent and expectation that debt will be paid can be important for both moral and legal reasons. If we see bankruptcies with this type of debt incurred under COVID-19 caused exigent circumstances, counsel and bankruptcy courts will have to determine the dischargeability of these debts. This blog post offers a starting point for that determination.

Congress restricted the ability of bankrupt individuals to obtain a discharge via Chapter 7 if they were discharging mostly debts incurred for a “personal purpose.” The idea was that debtors who knew they were headed for bankruptcy should not be able to discharge debts incurred recklessly that they never intended to pay (i.e. the vacation at Disneyland charged to a credit card the week before a planned bankruptcy filing). One bankruptcy judge described Congress’ concerns as directed at “unscrupulous” debtors.^[3]

For Chapter 7 debtors, Congress’ restriction are in Bankruptcy Code Section 707 and related provisions. 11 U.S.C. Section 707 titled

Dismissal of a Case or conversion to a case under chapter 11 or 13 states in relevant part:

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, **may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts**, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the **granting of relief [a discharge of debts] would be an abuse of the provisions of this chapter**. . . (emphasis added).

A quick primer here regarding the "conversion" referenced in the above-quoted section of the bankruptcy code: (i) The Chapter 7 bankruptcy case to which 11 U.S.C. Section 707 applies is a classic "straight" bankruptcy in which most of the debtor's debts are eliminated or "discharged" in exchange for the debtor surrendering all non-exempt assets; and (ii) A Chapter 7 case can sometimes be "converted" into a Chapter 13 case which requires a debtor to make payments over 36 to 60 months before receiving a discharge, but permits the bankrupt debtor to retain certain property. Many debtors consider a Chapter 7 fresh start bankruptcy case more beneficial than a Chapter 13 bankruptcy payment plan.

The definition of "consumer debt" that triggers Section 707(b) is found in Bankruptcy Code section 101(8). That definition is "debt incurred by an individual primarily for a personal, family, or household purpose." There seems to be little doubt that debt incurred to obtain food, clothing, utilities, or medical services for the debtor qualify as "consumer debt." Given that determination, a chapter 7 case that has the requisite portion of those debts is subject to dismissal or conversion if the tests of section 707 and related sections are not met. In bankruptcies caused by COVID-19, this result seems unfair and not what Congress intended when it enacted the provisions designed to discourage "unscrupulous" debtors. Pre COVID-19, others have agreed with this concern in certain circumstances.

The *In re William Sijan* case, S.D. Ohio Bankr. Case No. 19-53347 (Feb. 12, 2020), involved a medical debt incurred involuntarily by the debtor who unexpectedly required six weeks in an intensive care unit after being told that the alternative was death. Medical debt seems clearly to be “incurred . . . primarily for a personal . . . purpose” and so Section 707(b)(1) was implicated due to the size of Mr. Sijan’s medical debt.^[4] When the United States Trustee moved to dismiss Mr. Sijan’s Chapter 7 case, the debtor responded by arguing that he did not “voluntarily incur” the emergency medical debt. Before examining the application of Section 707(b)(1), the *Sijan* court reviewed the purpose of that section saying:

. . . the Bankruptcy Code includes provisions, such as 11 U.S.C. § 707(b), which is intended to prevent debtors from obtaining Chapter 7 shelter if they have an ability to pay their creditors [perhaps via a Chapter 13 payment plan], and § 727, which is intended to keep unscrupulous debtors from obtaining bankruptcy relief. *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989); *Wise v. Wise (In re Wise)*, 590 B.R. 401, 429 (Bankr. E.D. Mich. 2018) (citing *Robin Singh Educ. Servs., Inc. v. McCarthy (In re McCarthy)*, 488 B.R. 814, 825 (1st Cir. BAP 2013); see also H.R. REP. NO. 109-31, pt. 1, at 2 (2005) (stating that the provisions Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 were enacted to deter abuse in consumer bankruptcy filings).

For many years, bankruptcy courts have put a gloss on the term “consumer debts” requiring that the debt be voluntarily incurred. See, *IRS v. Westberry*, 215 F.3d 589, 591 (6th Cir. 2000) (court used the voluntariness requirement to exclude tort judgments and IRS liens from consumer debts).^[5] I agree with most commentators that consumer debts should be voluntary. I must admit my first reaction to the *Westberry* facts is not to consider a tort judgment or IRS lien as “incurred . . . primarily for a personal . . . purpose.” Still, courts choose to use the voluntariness requirement to exclude those debts from the definition of “consumer debts” rather than analyze the purpose for which the debt was incurred (as opposed to why the debt went unpaid – so that the money was used for other purposes).

The *Sijan* court extended the voluntary debt idea beyond taxes and judgments to emergency life-saving medical debts. After acknowledging that most medical debts (regular visits, cosmetic procedures, elective procedures, a planned course of treatment) are consumer debts because they are voluntary and for a personal purpose, the *Sijan* court found that is not true with respect to life saving emergency medical care, saying:

Furthermore, the Debtor did not voluntarily incur the debt arising out of his emergency medical treatment at Broward Health Medical Center. The Debtor did not intend to have a near-death experience and be subjected to six weeks of medical treatment after visiting the emergency room. This is more akin to judgment from a tort action, in which some sort of accident occurs and the debtor is found liable for the unforeseen damages.

Many may confidently argue that 30 million Americans did not voluntarily incur “personal purposes” debt for food and other necessities during these times when the economy was essentially closed due to combat the COVID-19 pandemic. The legal analysis will include whether the COVID-19 caused debt portfolio presented by a debtor is more like planned medical treatments or unplanned ones. Subjective and objective anticipation may be debated. The question of the choices that the consumer debtor has made may also see play, as present data suggests there are few replacement jobs available during the COVID-19 unemployment surge, even if closed child care centers and schools were not an issue. Counsel, debt counselors, creditors, and debtors will all have to work through these issues if, and likely when, the COVID-19 caused personal bankruptcy cases begin to hit America’s bankruptcy courts.

[Vince Mauer](#) has a master’s degree in Business Administration and passed the CPA exam. Licensed to practice law in Ohio and Iowa, he has represented financial institutions and other commercial clients for over 30 years. Vince joined FBT after working in an IRS District Counsel’s Office and also works on tax matters. For more information contact vmauer@fbtlaw.com.

*To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a **Coronavirus Response Team**. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.*

[1] The government recognized people's need for cash and sent millions of Americans \$1,200.

[2] Unfortunately, neither stimulus payments or unemployment compensation were instantaneous or necessarily adequate to fund Americans' necessities. Hence, the debt. See <https://www.marketwatch.com/story/10-legal-ways-to-scrounge-up-rent-money-2020-05-11?mod=home-page>

[3] See the *Memorandum Opinion and Order Granting Debtor's Motion for Summary Judgment Denying United States Trustee's Motion to Dismiss*. Doc #20 from *In re William Sijan*, S.D. Ohio Bankr. Case No. 19-53347 (Feb. 12, 2020). Hereinafter, this decision is the "Order."

[4] Mr. Sijan's medical debt was about three-fourths of his total debt.

[5] The money not paid to the IRS in *Westberry* was used by the debtor for family purposes and so the bankruptcy court held that the debt owed to the IRS was a consumer debt. The Sixth Circuit disagreed stating in part: "[f]irst, a tax debt is 'incurred' differently from a consumer debt. Although it is true that tax debts may be incurred under the Bankruptcy Code, this incurrence is not voluntary on the part of the taxpayer. See *Reiter*, 126 B.R. at 964; see also *Marshalek*, 158 B.R. at 706 (stating that 'volition is essential' to a classification as consumer debt in finding that a vehicular accident judgment was not consumer debt under Chapter 7). We may at least hope to choose to incur consumer debt; its certainty being nothing like death and taxes. See Letter from Benjamin Franklin to Jean-Baptiste Le Roy (Nov. 13, 1789)."

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