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THE NEW (PROPOSED?) BANKRUPTCY ACT: 
THE DEVELOPMENT OF ITS STRUCTURAL 
PROVISIONS AND THEIR IMPACT ON THE 
INTERESTS OF CONSUMER-DEBTORS

Samuel J.M. Donnelly*

INTRODUCTION

Law reform is slow work and only for the long winded as 
Arthur T. Vanderbilt once remarked.1 In October, 1977, when 
the Judiciary Committee of the House of Representatives with- 
drew the proposed bankruptcy act from consideration on the 
floor,2 its sponsors must have had a new awareness of this now 
ancient saying. The recent passage (February 1, 1978) by the 
House of its committee's bill without the Danielson-Railsback 
amendment3 may indicate that the long campaign is near its 
close. A brief glance at the proposed act's historical evolution 
will illustrate the duration of the law reform's effort.

The Commission on the Bankruptcy Laws of the United 
States made its report in 1973. During the ninety-fourth Con- 
gress the appropriate subcommittees of the Senate4 and House 
of Representatives5 completed their hearings. In the ninety- 
fifth, the present Congress, a substantially new bill, resembling 
in some respects the Commission bill, was introduced.6 Hereaf-

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tance in the preparation of this article.

1. "Manifestly, judicial reform is no sport for the short-winded or for lawyers who 
are afraid of temporary defeat." A. VANDERBILT, INTRODUCTION TO MINIMUM STANDARDS 
of JUDICIAL ADMINISTRATION xix (1949).
4. The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Sub- 
comm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 
94th Cong., 1st Sess. (1975) [hereinafter cited as Senate Hearings].
5. Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Sub- 
comm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 94th 
6. Since 1800 there have been several federal legislative efforts to regulate the 
field of bankruptcy in the United States. For a concise history of bankruptcy law up 
to 1973, see Countryman, A History of American Bankruptcy Law, 81 COM. L.J. 226 
(1976).

Beginning in 1973, the Commission on the Bankruptcy Laws of the United States
ter it will be referred to as the House version of the bankruptcy act. It was this bill which the Judiciary Committee withdrew and which has now been passed by the House.\footnote{7}

The purpose of this article is to compare some structural provisions of the House version, which apparently will be the basis for the new law when eventually passed, with the bill proposed by the Bankruptcy Commission.\footnote{8} The Senate version,\footnote{9} which was introduced on October 31, 1977, substantially resembles the House version. There are, however, some significant variations in the Senate bill which will provide an occasional basis for comparison with the solutions to recurrent problems proposed by the Commission and the House. The provisions selected for comment are those which potentially affect the interests of consumers.\footnote{10} It will be argued that some
of the substantive changes are beneficial while others are contrary to the interests of consumer-debtors. Indeed, in regard to some aspects of the proposed bankruptcy law, consumer advocates who often admire instantaneous reform may prefer careful consideration and long thought. A second purpose for the article is to provide a basis both for examining the legislative history of the proposed law and for critiquing the process by which its provisions are being settled.

As a working premise it is granted that a result adverse to consumer-debtors may nevertheless serve more general public interests. Consumers, however, are largely unorganized individuals who as debtors establish relations with a number of organizations both private and governmental. One could argue, then, that the consumer-debtor stands in a position where he is the least able of the contending forces to protect his interests during the process leading to enactment of the proposed law and after its effective date. For this reason, it may be sensible to be peculiarly concerned with the impact of the proposed changes on the interest of the consumer-debtor.11 In the instance of provisions which are contrary to the consumer inter-

posed to the consumer-creditor. All too many times the consumer purchases goods on a lay-away basis and expends substantial amounts of money in expectation of receiving the goods upon final payment only to find that he cannot take possession of the goods nor can he recover the money expended due to the intervention of bankruptcy. These consumers “find themselves without remedy when the business with whom they are dealing applies for formal insolvency relief . . . .” House Hearings, supra note 5, at 1700 (statement of Elinor C. Guggenheimer). The problem is exacerbated by the fact that “[m]any of these consumers fall into low and moderate income brackets—for it is these people who can only afford to purchase goods and services on a layaway basis. It is also the poor who are more likely to deal with unstable businesses in marginal neighborhoods, the type of businesses which are most likely to fail.” Id. A further problem arises because of the low priority status given to these consumer creditors as opposed to the priorities given to federal taxes and secured creditors.

A possible solution to these problems would be to give specific sanction to elevating the consumer creditor to the status of a secured creditor with a lien on the assets of the business. It should be noted that during the House debate Massachusetts Congressman Drinan proposed an amendment that would place consumer-creditors on equal footing with judgment lien creditors. 123 Cong. Rec. H11733 (daily ed. Oct. 28, 1977).

In a different context, bankruptcy poses another problem to the consumer-creditor, i.e., wages lost to his bankrupt employer. Although this problem is somewhat alleviated by § 4405(a)(3) of the Commission bill, which protects the worker’s wages for 3 months after the failure of the employer to pay them, it has been suggested that the time period be extended in order to embrace not only total failure to pay but partial payment as well. House Hearings, supra note 5, at 2429 (statement of Max Zimay).

Although beyond the scope of this article, these consumer-creditor problems merit the careful attention and concern of consumer advocates.

est one can locate and predict the adverse impact. These provisions, if passed, can then be watched in practice to determine whether the adverse impact has occurred. If experience, including empirical research, supports the predication, there would be a basis for further changes in the bankruptcy law. In addition, exploring the impact of the new law on consumer interests will provide a vantage point for examining its structural provisions and for critiquing the process which led to their inclusion.  

To determine how seriously consumer interests are affected either favorably or unfavorably, one must first form some notion of what consumers should seek or fear from a bankruptcy proceeding.

An examination of the structure of bankruptcy law may help in identifying the principal concerns which consumer-debtors should have. A straight bankruptcy may be voluntary or involuntary. Under its basic theory and structure all of the bankrupt debtor's property, with some exceptions such as exempt or abandoned property, is collected and distributed to creditors; in exchange the bankrupt, again with some exceptions, will receive a discharge from all of his debts. In a wage earner's proceeding the debtor may retain his property but must submit his future income to the control of the court as one factor in the arrangement which he will propose to his creditors. In straight bankruptcy the debtor's future income is unaffected by the proceedings. What a consumer should seek or fear from a bankruptcy proceeding will be related primarily to these structural features of bankruptcy law. From voluntary bankruptcy a consumer should want a discharge. In addition, he will normally want to retain a maximum amount of property. In order to increase the property retained or to achieve other goals, a consumer may choose to submit his future income to the control of the court in a wage earners' proceeding. Usually a consumer will find an involuntary bankruptcy undesirable and will fear its use by creditors if such use appears possible. An involuntary wage earners' proceeding would appear more threatening because the consumer's income will be affected for

12. In fact, drafts of this article have been forwarded to both Senate and House subcommittees in the hope that changes may be made prior to enactment.

13. Indeed, viewing proposed legislation from the vantage point of those who are least able to protect their interests provides a method, less complex than a complete interest analysis, of readily ascertaining the value of the legislation to segments of society which are affected by it. See J. Rawls, supra note 11, at 319.
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a period of time.

These structural features of bankruptcy law point to the basic interests of the consumer-debtor which are affected by bankruptcy. One concerned with these interests should examine any proposed changes in bankruptcy law to determine the manner in which they are affected by provisions related to the structural features of bankruptcy. It is arguable that provisions not so related affect the consumer-debtor only peripherally. If such provisions are favorable to the consumer, one might raise the possibility that they are window dressing.

The discussion in this article will be organized around the structural features of bankruptcy law which will be grouped under the three stages of a bankruptcy proceeding: the initiation of a voluntary or involuntary proceeding, the collection of the estate, and the distribution and discharge. The provisions of the Commission bill, the recently passed House version, and the current law will be compared to assess their impact on the basic interests of the consumer-debtor. In addition, the Senate bill will be commented upon when its provisions affecting consumer-debtors differ from those of the House. Since the structural features of bankruptcy are often interrelated, it will be necessary to discuss, under one heading, provisions which will be analyzed at greater length in another part.

INITIATION OF A BANKRUPTCY PROCEEDING

Involuntary Bankruptcy

Historically bankruptcy was a creditors' remedy. Only recently in Anglo-American legal history have debtors been allowed discharges or been permitted voluntary bankruptcy. However, periodically during the nineteenth century there was a popular demand for enactment of a bankruptcy law as a debtor relief measure. These laws were usually short lived. When Congress was debating the present bankruptcy act before passing it in 1898, two forces were in contention; southern and western populists represented the interests of debtors while a number of easterners supported the financial interests. The populists who sought enactment of a bankruptcy law to protect debtors were concerned with the dangers of involuntary bankruptcy. For example, Representative Lewis of Georgia declared: "Involuntary bankruptcy is a weapon in the hands of the creditor to press collections of debt harshly, to intimidate
Representative Sparkman of Florida argued that involuntary bankruptcy was "an engine of oppression" and "intended to bind hand and foot the debtors of this country and place them in the vise like grip of the greedy cormorants." The present statute, with its requirement that three creditors file an involuntary petition where there are twelve or more creditors and that the petition allege an act of bankruptcy, was the outcome of a compromise between "those who wanted to give the creditor an effective remedy to assure equal distribution of a bankrupt's assets and those who were determined to protect the debtor from the harassment of ill-considered or oppressive involuntary petitions, including those by a single creditor interest."

Arguably, the Congress which passed the present act intended that the number of involuntary bankruptcies would be limited. That, of course, is the impact of the provisions which it enacted. For example, during the year ending in June, 1975, there were 1,266 involuntary straight bankruptcies commenced but 208,064 voluntary straight bankruptcies. The provisions

<table>
<thead>
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<th>YEAR</th>
<th>VOLUNTARY</th>
<th>INVOLUNTARY</th>
<th>CONSUMER**</th>
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<td>47,650</td>
<td>1,249</td>
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<td>50,655</td>
<td>1,240</td>
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<td>122,499</td>
<td>1,382</td>
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<td>1963</td>
<td>128,405</td>
<td>1,409</td>
<td>139,191</td>
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<td>1964</td>
<td>141,828</td>
<td>1,339</td>
<td>155,209</td>
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<td>1965</td>
<td>149,820</td>
<td>1,317</td>
<td>163,413</td>
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<tr>
<td>1966</td>
<td>161,840</td>
<td>1,173</td>
<td>175,924</td>
</tr>
<tr>
<td>1967</td>
<td>173,884</td>
<td>1,241</td>
<td>191,729</td>
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of section 321 of the present law, which describe the acts of bankruptcy, are complex, confusing, and poorly drafted. From these provisions, however, one can trace the general circumstances under which a debtor now may be adjudicated a bankrupt without his consent. Normally the debtor must be insolvent according to a balance sheet test under which his liabilities would exceed his assets. In addition, there must be some indication that creditors are beginning to divide the debtor’s assets and hence a need for the orderly collection and distribution of assets under the supervision of a federal bankruptcy court. Preferential transfers, fraudulent transfers, and liens are among the signals for involuntary bankruptcy. These are stern requirements, arguably designed to restrict the number of involuntary bankruptcies.

However, the present bankruptcy act is far from entirely debtor oriented. In addition to providing for debtor rehabilitation, the present law serves the purpose of providing an orderly method for collection and distribution of property to creditors. A number of provisions, including those concerning false financial statements, have a very harsh impact on debtors.22

The Bankruptcy Commission has expressed the opinion that it is too difficult to establish the grounds for an involuntary bankruptcy.23 As a result some involuntary petitions are filed too late in the collapse of a business to save assets for creditors.24 In response to this perceived problem, the Commission bill made the task of establishing the grounds for involuntary bankruptcy much easier. One may find the provisions governing the initiation of involuntary proceedings in Chapter IV,

\[
\begin{array}{ccc}
1968 & 164,592 & 1,001 & 181,266 \\
1969 & 154,054 & 946 & 169,500 \\
1970 & 161,366 & 1,085 & 178,202 \\
1971 & 187,149 & 1,215 & 182,249 \\
1972 & 152,840 & 1,094 & 164,737 \\
1973 & 144,929 & 985 & 155,707 \\
1974 & 156,962 & 1,009 & 168,767 \\
1975 & 208,064 & 1,266 & 224,354 \\
\end{array}
\]

*Includes Ch. 13, wage earners’ proceedings.
**Not Available.


22. See notes 150-158 and accompanying text infra.
24. Id.
Part 2 which is entitled "Commencement of Relief." Under its provisions one creditor with a claim of $2,500 may file a petition seeking involuntary straight bankruptcy.25 Under the Commission bill this would be a Chapter V proceeding.26 One creditor with a claim of $10,000 may file a petition for an involuntary corporate reorganization.27 Chapter VII of the Commission bill which would govern reorganizations is a merger of Chapters X, XI, and XII of the present law. Unlike the present law which requires allegation of an act of bankruptcy, an involuntary Chapter V or VII petition need only allege that "the debtor will be generally unable to pay his current liabilities as they become due"28 or that "the debtor has generally failed to pay his debts as they become due."29 The principal check on filing involuntary petitions against individuals or corporations is a requirement that the "petitioner shall have the burden of proving that relief is in the best interests of the debtor and its creditors."30 The court may require the petitioner to file a bond and in some instances upon dismissal of a case, the court may grant damages and attorney's fees to the debtor.31

The Commission substituted tests which generally resemble the common law liquidity concept of insolvency for the balance sheet (liabilities exceed assets) standard of the present bankruptcy act. In place of some indication that the debtor's assets are being dissipated the Commission has asked the bankruptcy judge in his discretion to determine whether bankruptcy is in the "best interests of the debtor and its creditors."32 A variety of considerations may be relevant in making that determination. Among them would be a comparison of the amount which creditors would realize in a bankruptcy liquidation with the likelihood of payment outside of bankruptcy,33 the

25. Commission Bill, supra note 6, § 4-205(a).
26. Id.
27. Id. § 4-205(b).
28. Id. § 4-205(c)(1).
29. Id. § 4-205(c)(2).
30. Id. § 4-208(a).
31. Id.
32. Id.
33. Under the present act, in arrangement proceedings under Chapters XI and XII, and in wage earners' plans under Chapter XIII, the court shall confirm a plan if it is satisfied that the plan "is for the best interests of the creditors and is feasible" in cases where one or more classes have dissented against the plan. See Bankruptcy Act of 1898, §§ 366(2), 472(2), 656(2), 11 U.S.C. §§ 766(2), 872(2), 1056(2) (1970). For example, where the dissenting creditors would fare better in liquidating the estate rather than in accepting the proposed arrangement, a court would likely find that the
probability that the debtor would be rehabilitated,\textsuperscript{34} and indications that the debtor’s estate is being dissipated or divided piecemeal among creditors.\textsuperscript{35} The weight given to any particular consideration appears to rest in the discretion of the bankruptcy judge. Indeed, the bankruptcy judge also is provided extensive leeway by the insolvency standards which are described as the “basis for relief.” In determining whether a debtor “will be generally unable to pay his current liabilities as they become due,” one could compare his flow of income and his liquid assets with his monthly bills; but one might ask whether it is as easy to determine when a debtor “has generally failed to pay his debts as they become due.”\textsuperscript{36} Questions such as what percentage of debts must remain unpaid and during what period of time appear relevant. The bankruptcy judges would provide the answers to these questions under the Commission bill. A major theme of these provisions is that the circumstances under which debtors may be adjudicated bankrupt without their consent is left to the discretion of the judge.

Recognizing that a single creditor owed $2,500 may appeal to the judge’s discretion, one must conclude that the number of involuntary bankruptcies would increase under the Commission bill.\textsuperscript{37} Whether, contrary to the compromise of 1898, invol-

\begin{footnotesize}

\textsuperscript{34} For example, in cases where there is no hope of rehabilitating the debtor because of his poor financial prospects for accumulating future wealth, \textit{i.e.}, for getting a job, the judge should not permit the involuntary proceeding to commence since this would seriously infringe the rehabilitation purpose of the bankruptcy act.

\textsuperscript{35} Under the present act, § 3 lists the “acts of bankruptcy” necessary to initiate an involuntary straight bankruptcy. These acts of bankruptcy are statutory indications of the presence of “grab law,” the dissipation of the debtor’s estate in a manner unfair to all the creditors. The bankruptcy judge, under the proposed law, would be advised to look to the old “acts of bankruptcy” as standards by which to determine the presence of grab law. If grab law is present, the judge would likely find that the involuntary bankruptcy is in the best interests of the debtor and its creditors.

\textsuperscript{36} “It would require the wisdom of Solomon, indeed, to determine upon an objective test to ascertain whether a debtor ‘will be generally unable to pay . . . .’” \textit{House Hearings, supra} note 5, at 1670 (statement of Richard Kaufman).

\textsuperscript{37} With respect to the initiation of involuntary bankruptcy proceedings whether for liquidation under Chapter V of either bill or for the reorganization of a business entity under Chapter VII of the Commission’s Bill and VII and VIII of the Judge’s bill, the ABA (American Bankers Association) believes that the filing of a petition has been made too easy by permitting one creditor holding a claim of $2,500 or more to file a petition seeking liquidation or by permitting one creditor with a claim of $10,000 or more to file a petition seeking business reorganization.

\end{footnotesize}
untary bankruptcy would become “a weapon in the hands of the creditor to press collections of debt harshly” if the Commission bill were adopted would depend initially upon the prevailing approach within the various circuits.

The House version in its Chapter 3 makes it somewhat more difficult to have a debtor adjudicated a bankrupt without his consent. If there are twelve or more creditors, then three who are owed at least $5,000 above the value of any security are required to file a petition for an involuntary case. When there are less than twelve creditors, one who is owed $5,000 may file an involuntary petition. The court may either dismiss a case or suspend all proceedings at any time if “the interests of creditors and the debtor would be better served by such dismissal or suspension.” The court may require the posting of a bond and in some circumstances, upon dismissing an involuntary petition, the court may award the debtor costs, reasonable attorney’s fees and damages.

The principal tools used by those who drafted the House version to make it more difficult to file an involuntary petition are the added number of creditors and the increased amount of debt owed over the value of any security. The change back to the requirement that three creditors file an involuntary petition will reduce the possibility that debtors will be harassed by one angry creditor with threats of involuntary bankruptcy.

Granting a single creditor the right to initiate proceeding gives to such creditor leverage that will often result either in preferential payments being made to such creditor or in a substantial increase in the number of bankruptcies. Three petitioning creditors should be required for either a liquidation or a reorganization petition.

House Hearings, supra note 5, at 1748 (statement of Robert J. Grimmig).

38. H.R. 6, supra note 6, § 303(i)(1).
39. House Bill, supra note 6, § 303(b)(1).
40. Id. § 303(b)(2).
41. Id. § 305(a)(1).
42. Id. § 303(c).
43. Id. § 303(i)(1).
44. The National Association of Credit Management recommends:

The National Association of Credit Management believes that a competitor might even go so far as to “acquire” a claim against a company which is troublesome competitively, even though insolvent, then use this claim to file an involuntary petition. Even if the petition were successfully defended by the alleged bankrupt, . . . irreparable damage may have been done to the company’s image among its suppliers and customers.

House Hearings, supra note 5, at 1670 (statement of Richard Kaufman).
However, it should not be difficult for the normal institutional creditors in a community to develop common policies in regard to bankruptcy. When those policies indicate that bankruptcy should be used as a collection device, it will be relatively easy to find the necessary number of creditors. In addition, one should note that consumer-debtors are more likely than other potential bankrupts to have less than twelve creditors. While the change to three creditors is very desirable, the increase in the amount of debt is more important to consumers. Large segments of poorer consumers will be insulated from threats of involuntary bankruptcy by this change. However, the House version will leave substantial numbers in the middle income class subject to involuntary bankruptcy. A normal line of credit for those in the middle income ranges is $5,000. The bank extending a line of credit, when joined by two credit card issuers, would be able to use involuntary bankruptcy regularly as a tool for policing their arrangements with debtors.

Under the House version the court normally may order relief in an involuntary case only when "the debtor is generally unable to pay such debtor's debts as such debts become due." This single liquidity test for insolvency restricts the court's discretion somewhat more than the dual test found in the Commission bill. The court still has considerable discretion in determining whether to dismiss a case when the interests of creditors and the debtor "would be better served by such dismissal." It is not clear that this standard differs from the one found in the Commission bill.

Congress could use a variety of tools short of return to the provisions of the present law to restrict the use of involuntary bankruptcy against consumer-debtors more strongly than either the Commission bill or the House version. An increase in the amount of debt required to be held by the filing creditors to $10,000 above the value of any security would protect most middle income consumers. This figure would be above the usual line of credit and accumulation of debts under credit cards. A middle income consumer who owed this amount and was insolvent under a liquidity test would be in severe financial difficulty. One who owed $5,000 might be a normal middle

45. House Bill, supra note 6, § 303(h)(1).
46. Id. § 305(a)(1). See also id. § 305(c). Section 305 provides that the decision to dismiss or not dismiss is unreviewable. Query what relationship a reviewing court would find between this provision and section 707 which provides that the court may dismiss a straight bankruptcy only for cause?
income consumer experiencing some temporary difficulties perhaps due to seasonal employment or a layoff caused by a natural gas shortage.

Using a second tool to restrict involuntary bankruptcy, Congress could exclude "individuals with regular income" as defined in section 1-102(28) of the Commission bill or section 101(23) of the House version from those subject to involuntary bankruptcy. This would include those whose principal income is from wages, salaries, commissions, and the like. An exemption such as this could be inserted in section 4-204 of the Commission bill or in section 303(a) of the House version.48 Such a provision would not be unprecedented since both bills now exempt farmers and the present law exempts wage earners who make less than $1,500 a year.49 In 1898, when the present law was first enacted, and in 1938, when it was substantially re-

47. "Individual with regular income" means an individual whose principal regular income is derived from wages, salary, commissions, retirement benefits, welfare payments, or any other similar source with sufficient regularity and stability that periodical payments of a fixed amount to his creditors pursuant to a plan under Chapter VI is feasible. Commission Bill, supra note 6, § 1-102(28).

An exemption such as this could be inserted in section 4-204 of the Commission bill or in section 303(a) of the House bill.

48. See Senate Hearings, supra note 4, at 851-52 (testimony of Samuel J. M. Donnelly). For example, section 4-204 could be amended to read:

Any person eligible to file a voluntary petition under Section 4-201 except an individual who earns more than half of his gross income from farming, an individual who owes $10,000 or less above the value of any property subject to a mortgage or security interest, or a corporation which owes $20,000 or less above the value of any property subject to a mortgage or security interest shall be subject to an involuntary petition under this chapter.

This amendment would prevent creditors from filing involuntary petitions against individuals and small businesses whose debts are not large. Restricting the availability of involuntary bankruptcy by such an amendment would also serve to protect the availability of credit, and thus, keep the cost of credit low, to those small corporations which are in their young, debt-producing years. Such an amendment may also protect these small corporations from a brutal form of tender offer from a larger corporation. Without this protection, large corporations could initiate involuntary bankruptcies on the corporations to which they plan to make tender offers. A small, young corporation faced with such a dilemma may easily succumb to such pressure and accept the tender offer as the only way out. Indeed, large corporations may not be the only threat to such young corporations. The Mafia and similar criminal underworld organizations may find involuntary bankruptcy an extremely persuasive tool with which to convince the defenseless corporation to seek their protection for a fee.

49. Section 4 of the present bankruptcy act exempts both wage earners and farmers. 11 U.S.C. § 22 (1970). However, wage earner is defined under section 1(32) as "an individual who works for wages, salary, or hire, at a rate of compensation not exceeding $1,500 per year." Id. § 1(32) (1970).
vised, the exemption for wage earners was meaningful. But inflation since 1938 has made that exemption meaningless to almost all wage earners. To continue that exemption and insulate it against inflation with a cost of living escalator would be in accord with the original scheme of the bankruptcy law and would be the clearest indication that Congress does not intend to permit harassment of low and middle income consumer-debtors by threats of involuntary bankruptcy. If the new bankruptcy law is enacted without these changes and the number of involuntary consumer bankruptcies becomes undesirably large, then Congress should make the changes in subsequent years.

Further, Congress could restrict the court’s discretion by providing a more precise definition of the insolvency necessary for an involuntary bankruptcy.\footnote{Senate Hearings, supra note 4, at 851. Among the recommended changes to the Commission bill are deleting section 4-205(c)(1) and amending section 4-205(c)(2) to read, “if the debtor during the preceding 3 months has failed to pay a major part of his debts as they become due.” These changes would make the language of section 4-205(c) more specific and would restrict the discretion of bankruptcy judges. Furthermore, the 3 month period is parallel to periods stated in the avoidance and collection of the estate provisions. See, e.g., Commission Bill, supra note 6, § 4-607.} For example, in section 303(h)(1) of the House version, the words “the debtor is generally unable to pay such debtor’s debts as such debts become due” could be dropped in favor of such language as “the debtor during the preceding three months has failed to pay a major part of his debts as they became due.” This would substitute actual failure to pay for speculation regarding inability to pay. It would specify a large portion of the debts rather than allow the possibility that inability to pay some debts would be a ground for bankruptcy. It would also specify a period of time when the failure to pay would occur. However, this amendment, standing by itself without some explicit exemption for individuals earning regular income or for those owing less than some high fixed amount, would leave the number of involuntary consumer bankruptcies to the discretion of courts, because individual judges would still be left to determine when these would be in the best interests of the debtor and his creditors.

Section 303(h)(1) of the newly published Senate version of the bankruptcy bill offers an even more precise definition of insolvency than the House bill. A court may order involuntary relief against a debtor if “the debtor is generally unable to pay or has failed to pay a major portion of his debts as such debts
While it could be contended that the addition of the word "major" adds little to the word "generally," it appears to be designed to prevent courts from declaring debtors bankrupt without their consent, when only a small portion of their debts are generally not paid. Even under this standard, courts will be left to determine the time during which the failure to pay will lead to involuntary bankruptcy. Thus, though the Senate version takes a step towards protecting consumer-debtors from involuntary bankruptcy, it still leaves many questions to be settled by the courts.

The Impact of Exemption Provisions on the Number of Involuntary Bankruptcies

While some creditors would use any likely tool to harass those who owe them money, most creditors would use involuntary bankruptcy only if they perceive some monetary advantage from the proceedings themselves as opposed to their use as a threat. It is arguable that the exemption provisions of the Commission bill provide creditors in many instances with the monetary incentive to employ involuntary straight bankruptcy as a normal part of their collection process.

Unlike section 6 of the present law, which applies state exemptions in bankruptcy proceedings, the Commission bill provides for a number of specific exemptions in bankruptcy and would not refer to state law on this point. The Commission's exemption provisions appear to be a modernized restate-

51. Senate Bill, supra note 9, § 303(h)(1).
   This title shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the petition in the State wherein they have had their domicile for the 6 months immediately preceding the filing of the petition . . . .
53. Specific exemptions included in section 4-503 of the Commission bill are as follows: (1) an aggregate of $1,000 worth of livestock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles; (2) a burial plot of $2,500; (3) cash or its equivalent of $500 (including a tax refund); (4) alimony and support; (5) life insurance proceeds or benefits derived from insurance on the life of a spouse or provide; (6) retirement benefits under a plan qualified pursuant to Internal Revenue Code section 401(a) or established by statute and limited to what is reasonably necessary for support; (7) disability benefits; (8) personal injury or unemployment benefits; (9) health aids; and (10) cash surrender value in insurance up to $1,500. If the debtor dies, a family allowance of up to $1,000 per person is provided for in section 4-503(e). Senate Hearings, supra note 4, at 8 (statement of the Bankruptcy Commission).
54. Id. at 25 (statement of Frank Kennedy).
A principal exemption is for the homestead of the debtor in the amount of $5,000 plus $500 for each dependent of the debtor. Debtors without a homestead may use this sum to increase the amount of certain other property which may be retained. There are a number of other specific exemptions, including a list of "other property" such as livestock, wearing apparel, household furnishings, cash, se-

55. Much discussion in the Senate Hearings was devoted to whether there should be a federal floor for exemptions similar to federal limitations on garnishment, see 15 U.S.C. § 1671 (1970), and whether there should be a federal uniform exemption law or whether the diversity among state exemption statutes should be preserved. Mr. Charles Seligson, member of the Commission noted several inconsistencies among state exemption statutes: New York exempts 10% of wages in addition to whatever amount is necessary to maintain the bankrupt; Pennsylvania exempts all wages as does North Carolina and other states; similarly Texas exempts real estate with all improvements which conceivably could be worth "hundreds of thousands of dollars." Senate Hearings, supra note 4, at 29. Mr. Seligson further noted:

We recognized that if we . . . had the uniform exemption in bankruptcy, it might change the situation in regard to filing or nonfiling of petitions, depending upon the State where the debtor had his domicile.

I do believe, I think we have got to face up to the fact that when you talk about exemptions you are talking about something that seems to be very close to the hearts of those who administer State governments, states rights, and that does present a problem.

Senate Hearings, supra note 4, at 29-30. Although Mr. Seligson opposed a uniform exemption statute he felt favorable to imposing a federal floor above which states would grant more liberal exemptions. Id. at 30; see House Hearings, supra note 5, at 359 (statement of Prof. Countryman, Harvard Law School); accord, M. Girth & D. Stanley, Bankruptcy: Problem—Process—Reform 384 (1971). Mr. Walter W. Vaughn, speaking on behalf of the American Bankers Association echoed Mr. Seligson's view and noted: "Under the consumer protection acts passed by Congress in recent years there has always been provision for state laws providing the consumer with protection beyond that which was granted in the federal statute. We see no reason why this approach should not be taken in the case of exemptions." Senate Hearings, supra note 4, at 128; see id. at 309 (statement of Richard A. Hesse, consultant, Nat'l Consumer Law Center). But see House Hearings, supra note 5 at 1368-69 (statement of Alvin O. Wiese, Jr., Nat'l Consumer Fin. Ass'n).

Discussion in the House Hearings also pointed to the inconsistencies among states' exemption statutes. Mr. Richard A. Levine, representing the Department of Justice before the House Hearings, testified that:

We agree fully with the Commission on the bankruptcy laws that the archaic and widely varying state exemption laws for individual debtors should no longer be applied in bankruptcy proceedings. The exemption laws of some States make those States a debtor's paradise. Debtors should not be favored in bankruptcy depending upon their choice as such a State of residence or the accident of their residence there.

House Hearings, supra note 5, at 2140. But see id. at 1663-64 (statement of L.E. Creel III).

56. Commission Bill, supra note 6, § 4-503(b)(1). Mr. Richard A. Levine, representing the Department of Justice, stated that there was a need for a definition of "dependent" in the statute to promote certainty and avoid widely differing treatment in different jurisdictions." House Hearings, supra note 5, at 2117.
securities and income tax refunds. The amount of "other property" which may be retained is often subject to monetary limitations.

The homestead exemption found in the Commission bill provides the clearest incentive to creditors in some states to use involuntary bankruptcy as a normal means of collection. The amount of the exemption is considerably below that found in the homestead exemption laws of a number of states including, for example, California where it is currently fixed at $30,000 for a head of household and any person over sixty-five. Creditors in those states would have a strong incentive to use involuntary bankruptcy against debtors claiming homestead exemptions. If the Commission bill were enacted, some states might in response reduce their homestead exemptions to eliminate that incentive, but state legislatures perhaps would decide against this course or would have more pressing matters to consider.

In contrast, the amount of the exemption is lower than $5,000 in some states including New York where it is now set at $2,000 (recently increased to $10,000). In these states the Commission bill establishes a reason for creditors not to pursue involuntary bankruptcy. However, some debtors would have an additional reason for seeking the relief of bankruptcy.

One may find a similar but more limited impact for other exemption provisions in the Commission bill. If the amount of the exemption found in state law is higher or lower than the proposed federal provision there would be an incentive for using bankruptcy or a reason for avoiding it. If an exemption found in state law, such as the California exemption for fishing boats, is not repeated in federal law, some creditors would have a reason for using bankruptcy against some debtors.

While the present act is not uniform because it incorporates non-uniform state exemptions, the Commission bill, though adopting uniform exemptions, would still not achieve uniformity because the rate of involuntary and voluntary bankruptcies would fluctuate widely depending on whether state exemption laws favor or disfavor certain categories of debtors.

57. For other exemptions, see note 53 supra.
58. See Senate Hearings, supra note 4, at 309 (statement of Richard A. Hesse, consultant, Nat'l Consumer Law Center).
60. For examples of state exemptions statutes, see note 55 supra.
Whether the Commission bill favors consumer debtors or would be a weapon to press debt collections would depend upon the state in which the consumer lives.

A single provision in the House version corrects substantially the difficulties just described. Under section 522(b) a bankrupt debtor may choose between the federal exemption provisions and those of his state. The federal provisions then would become a floor but not a ceiling on the amount of property which a debtor could retain. The exemption provisions would provide little incentive to creditors to use involuntary bankruptcy although in some states debtors would have a reason for filing voluntary petitions.

The pattern of the specific exemption provisions of the House version resembles that of the Commission bill, although amounts and specific items differ. An important difference is found in the amount of the homestead exemption. A flat amount of $10,000 is found in the House version in contrast to the $5,000 plus $500 for each dependent listed in the Commission bill. In states with a lower homestead exemption such as New York some creditors will have to have a very substantial reason for using involuntary bankruptcy; some debtors in those states will have a strong reason for voluntary bankruptcy.

The amount of the homestead exemption must be considered in determining the class of debtors against whom involuntary bankruptcy would be used. Normally creditors would not use involuntary bankruptcy against debtors who have no significant assets which are not exempt. Since the principal asset of many consumer-debtors is a home, the amount of the homestead exemption must be considered in determining which debtors would be substantially immune from involuntary bankruptcy. Under the House version, those with less than $10,000 equity in their homes and no other significant nonexempt assets would be in this category. This would tend to limit the use of involuntary bankruptcy against middle income consumer-debtors. In states with high homestead exemptions

62. See note 55 supra. The new Senate version does away with the choice of exemptions available to the debtor. In it the debtor may only use his state exemptions and there is no longer a provision for a federal minimum exemption as under the House version. Senate Bill, supra note 9, §522(b). This will be detrimental to some consumer-debtors but will provide creditors with no incentive to use bankruptcy to avoid state exemption provisions.

63. House Bill, supra note 6, § 522(d)(1).

64. Commission Bill, supra note 6, § 4-503(b)(1).

65. See note 55 supra.
that limitation would be greater. However, elderly middle income consumer-debtors would tend to be more vulnerable to involuntary bankruptcy in all states than younger persons with the same income because of the likelihood that the equity in their homes is greater. The possibility of large debts due to illness and medical expenses would increase the probability that involuntary bankruptcy would be used against some elderly debtors. While the House version affords greater protection to consumer-debtors than the Commission bill, there is an incentive under it for some creditors to use involuntary bankruptcy as a "weapon... to press collections of debt harshly" against some debtors, including the elderly who own their homes.67

The Senate version, if enacted, would entirely eliminate the proposed federal minimum exemption provisions68 and retain the present reliance on state law regarding exemptions. For this reason, it would place fewer restraints on the use of involuntary bankruptcy against middle income consumer-debtors. In states with low homestead exemptions, for example, bankruptcy would afford a remedy against debtors with substantial equity in their homes.

*The Incentive to Use Involuntary Bankruptcy to Encourage Pursuit of Wage Earners' Proceedings*

While encouraging use of its proposed Chapter VI and making it more attractive to debtors than the present Chapter XIII, the Commission has rejected proposals for involuntary wage earner arrangement proceedings.69 However, the Commis-

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66. See 31 Cong. Rec. 1803 (1898).
67. Any household exemption which is limited to a certain equity value will leave the elderly more vulnerable since they are likely to have a higher equity in their home.
68. Senate Bill, supra note 9, § 522(b); see note 62 supra.
69. Professor Vern Countryman of Harvard Law School opposed involuntary wage earners' proceedings on three grounds:
(1) Compulsory wage earner plans would be inconsistent with the policy and traditions of a country which has abolished involuntary servitude by the Thirteenth Amendment to its federal Constitution, has abolished peonage, or debt slavery, by federal statute... and has abolished all but a few vestiges of imprisonment for debt by state constitutions and statutes.
(2) We expressed the view compulsory plans for wage earners only would discriminate against them since no similar proposals were made for individuals who were not wage earners or for corporations.
(3) As a practical matter, compulsory wage earners plans would not work.

House Hearings, supra note 5, at 1410.
sion bill would make it possible for creditors, with the cooperation of bankruptcy judges, to strongly influence wage earners to use Chapter VI arrangement proceedings.

A creditor would be able to accomplish this goal by filing a petition for involuntary bankruptcy alleging that the debtor has generally been or would generally be unable to pay his debts as they mature. A bankruptcy judge who is so inclined would then use his discretion to dismiss the petition as not "in the best interest of the debtor and its creditors" provided the debtor would file a Chapter VI petition. The court could then direct relief under Chapter VI rather than straight bankruptcy at the debtor's request. The great discretion given to bankruptcy judges by the general language of the involuntary bankruptcy provisions would allow those who favor Chapter VI proceedings to cooperate with creditors to force employment of these proceedings under threat of involuntary straight bankruptcy.

Under the present law, voluntary wage earners' proceedings are more frequently used in some parts of our country than others. For example, in 1974 there were 602 Chapter XIII proceedings in the Second Circuit (546 of which were in the western district of New York), 127 in the Third Circuit, 8,354 in the Fifth Circuit (over 5,000 of which were in Alabama),75,542 in the Sixth Circuit, 1,794 in the Eighth Circuit, and 5,142 in the Ninth Circuit.71 The attitude of the bankruptcy judges as well as the familiarity of lawyers in a jurisdiction with wage earners' proceedings would encourage or inhibit their use.72

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70. Bankruptcy Judge, Conrad K. Cyr, speaking on behalf of the National Conference of Bankruptcy Judges, testified before the Senate Hearings that the "consistent preference for Chapter XIII over straight bankruptcy" in Alabama is due to the fact that:

It was in Birmingham, Alabama, during the early years of the Great Depression, that Referee Valentine Nesbitt devised and implemented the first "wage earner program" from the 'whole cloth' of the former Section 74, which became the principal model on which Congress relied in fashioning Chapter XIII as part of the Chandler Act of 1938. The program at Birmingham has developed and consistently remained the largest Chapter XIII program in the nation, both because of its early beginnings and its widespread community acceptance.

Senate Hearings, supra note 4, at 73-74.

71. See Administrative Office of the United States Courts, Tables of Bankruptcy Statistics (1974). The figures for 1975 were 1,318 Chapter XIII proceedings in the Second Circuit (1,196 of which were in the Western District of New York), 215 in the Third Circuit, 10,588 in the Fifth Circuit (6,399 of which were in Alabama), 7,094 in the Sixth Circuit, 2,261 in the Eighth Circuit, and 6,532 in the Ninth Circuit. Id. (1975).

72. Judge Conrad K. Cyr, testifying before the Senate Hearings on behalf of the
It is possible that creditors and judges in some parts of our country would be sufficiently enthusiastic about Chapter VI proceedings to use the leverage available under the Commission's involuntary straight bankruptcy provisions to encourage large numbers of debtors in some financial difficulties to use these proceedings as a means of paying their creditors from future earnings. The incentive to do so would be greater in some states than in others. In states such as New York where creditors may garnish only ten percent of a debtor's wages, creditors may receive more than this from a wage earners' plan. This would be a less important reason for encouraging wage earners' proceedings in states such as California where the twenty-five percent limitation found in the Federal Anti-Garnishment Act is the principal restriction on access to the debtor's income. Even in such states, however, some creditors may be compelled to wait their turn for garnishment until creditors with prior garnishments are satisfied. Under a wage earners' plan there would probably be payments more closely resembling pro rata distributions. In California and other states with high garnishment rates, the homestead exemption

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National Conference of Bankruptcy Judges stated that the lack of uniformity among the districts' application of Chapter XIII was due to several reasons including "the lack of awareness on the part of debtors and attorneys of the existence of Chapter XIII in some areas; [and] differing social and creditor attitudes toward consumer insolvency and variations in the attitudes of bankruptcy judges in different parts of the country." Senate Hearings, supra note 4, at 52.

In the Southern District of New York, for instance, Judge Cyr indicated that few Chapter XI's are filed because bankruptcy judges have been preoccupied by the heavy volume of business cases, complex reorganizations, arrangements and the intricacies of business bankruptcy law. In the fiscal year 1973, one Chapter XIII was initiated among the 1,197 total cases filed. Said Judge Cyr, "These men are neither by training nor experience very likely to be promoting a Chapter XIII program in their area." Id.

In New Hampshire and Vermont there are few Chapter XIII cases because their judges are part time bankruptcy judges which contrasts with Maine where there are two full time bankruptcy judges and a heavy volume of Chapter XIII cases. In 1973, no Chapter XIII cases were initiated in 5 districts (Vt., Del., W. Pa., W. Wash. and E. Okla.).

Judge Cyr testified, however, that the major reason for the inconsistent use of Chapter XIII is "the lack of any functional consensus among lawyers and bankruptcy judges generally, district judges as well, as to what the true legislative purpose of Chapter XIII is." Id.

The fact that it is not economically feasible for some law firms or their clients to handle Chapter XIII proceedings may be another reason for their lack of widespread use. See House Hearings, supra note 5, at 1349-50 (statement of Paul L. Winkler).

73. See, e.g., CAL. CODE CIV. PROC. § 882.3(a)(4) (West 1976), which places a maximum limit of 90 days for garnishments giving other creditors a chance to obtain garnishments by waiting in line.
may be sufficiently high to cause creditors barred from access to wages by prior garnishments to think favorably of involuntary bankruptcy either for its own sake or as leverage for encouraging a wage earners’ proceeding.

Even under the present law there may be a rapid increase in the number of wage earner proceedings in a jurisdiction. In the western district of New York the number of wage earners’ proceedings rose in recent years from virtually none to 1,196 in 1975.\textsuperscript{74} If the leverage available in the Commission bill for encouraging such proceedings were to increase the frequency of their use to the 1974 level in Alabama, namely 5,000 a year,\textsuperscript{75} one could expect roughly fifty times that number to be commenced each year throughout the country. Since a wage earners’ proceeding would often last for three years, it would not be unreasonable to expect 750,000 (three times 250,000) cases to be pending during a given year.

Under the House version there would be fewer wage earners’ proceedings because involuntary bankruptcy would not be available against poorer consumer-debtors, who normally would not owe $5,000 in debts above the amount of any security. The requirement that three creditors file an involuntary petition when there are twelve or more creditors would prevent a single harsh creditor from using involuntary bankruptcy to encourage wage earners’ proceedings in communities where creditors are generally not inclined to do so. However, in parts of the country where wage earners’ proceedings are now popular or in areas where their popularity would increase, middle income debtors may be encouraged by their creditors to use these proceedings under threat of involuntary bankruptcy. If the credit community is generally agreeable to this course, banks, credit card issuers and other institutional creditors could readily establish among themselves standards for the cooperative use of involuntary bankruptcy as a lever for encouraging wage earners’ proceedings.

The variation in garnishment laws from state to state would be of some but lesser significance in regard to middle income debtors. In states where only ten percent of a debtor’s wages may be garnished, creditors nevertheless would recover

\textsuperscript{74} In 1965, there were 11 Chapter XIII proceedings in the Western District as opposed to 1,196 in 1975. Administrative Office of the United States Courts, Tables of Bankruptcy Statistics (1975).

\textsuperscript{75} This figure has increased to 6,399 cases in 1975. Id.
larger sums under state law from middle income debtors than from poor debtors. The incentive to use the leverage of involuntary bankruptcy if it were available against poor debtors with regular income would be greater than against middle income debtors. In states with high homestead exemptions there would be an incentive to encourage debtors, even those without a large equity in their homes, to use wage earners’ proceedings. Creditors would realize more by this means than by filing judgment liens against homes. The acceptance of state homestead exemptions by the House version would not remove this incentive. Creditors might be willing to risk a no-asset involuntary bankruptcy for the purpose of encouraging a wage earners’ proceeding. If the local bankruptcy judge is cooperative and the debtor poorly represented, the risk that the debtor would simply accept the involuntary and potentially no-asset straight bankruptcy rather than convert to a wage earners’ proceeding would be reduced.

Substantial arguments, then, support a prediction that under the Commission bill or the House version creditors would have strong incentives to use involuntary bankruptcy as a lever to encourage varying classes of consumer-debtors to file petitions in wage earners’ proceedings. It could be asserted, however, that such proceedings would be in the best interests of debtors in financial difficulty. Debtors who under any of several tests are unable to pay their debts as they mature may badly need the guidance of a federal court and the counseling and training which would enable them to conduct their affairs more carefully. The policy of rehabilitating debtors, which is one of the purposes of a bankruptcy law, would be served as well as the policy of affording creditors an orderly means for collecting debts.

However, the circumstances of these debtors would be changed substantially from those prevailing under present law. Involuntary bankruptcy now is not normally used against consumer-debtors nor is there any leverage in the present act to compel debtors to file petitions in wage earners’ proceedings. The proposed acts, then, would create varying classes of consumer-debtors. Opportunities for harassing and threatening these debtors which are not now available would be created. Under the present law, consumer-debtors have the opportunity to seek bankruptcy or a wage earners’ proceeding voluntarily. The proposed acts would provide the means for persuading those who have not chosen these routes to file petitions for wage earners’ proceedings. Debtors who would have chosen to suffer
state remedies or to work out their debts privately would be subjected to guidance and control. Some debtors who would be judgment proof or for other reasons substantially immune from state remedies would pay their creditors significant sums. Some debtors who would have recovered financial stability without the assistance of the bankruptcy courts would receive that assistance which may prolong the period of their recovery. While some debtors would benefit from the supervision and guidance thrust upon them, one must wonder whether these benefits outweigh the disadvantages of paternalistic control by a governmental institution. From the point of view of consumers as a class, one must ask whether the disadvantage of paternalistic control of a number of consumer-debtors, perhaps in the order of 750,000 in a given year, is outweighed by the advantage of this control for some of that number.

One could conclude, then, that the provisions of the Commission bill and of the House version which make it easier for creditors to have varying classes of consumer-debtors adjudicated bankrupts without their consent and easier to encourage these debtors to file petitions for wage earners’ proceedings have a greater adverse impact upon consumer interests than the present law. Nevertheless one should inquire whether these provisions serve more general public interests. That inquiry is the subject of a subsequent segment of this article.

Encouragement of Debtors to File Wage Earners’ Proceedings Instead of Voluntary Bankruptcy

Up to this point in the article the initiation of involuntary proceedings has been discussed. However, the Bankruptcy Commission has expressed its concern with the rising number of voluntary personal bankruptcies. From 1965 to 1975 the number of voluntary straight bankruptcies rose from 149,820 to 208,064. Many of the personal bankruptcies were no-asset cases. 7

As a partial remedy for the problem, the Commission has made it more attractive for debtors to use wage earners’ proceedings under Chapter VI of its bill than under Chapter XIII of the present law. 77 In addition, a debtor who files a voluntary

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76. Senate Hearings, supra note 4, at 8.
77. The Bankruptcy Commission noted that wage earners’ plans have been popular in more than a dozen districts but little used in other areas. Id. The Bankruptcy Commission suggested that Chapter XIII was not workable everywhere because "referees and lawyers and members of the credit community differ as to its virtues and
petition would be counseled as to the relief available under Chapter VI.\textsuperscript{78} This would appear sensible and unthreatening provided the debtor would also have access to adequate counseling and representation from an attorney independent of the bankruptcy administration established by the Commission bill.\textsuperscript{79} There is some reason to believe that debtors in parts of the country where wage earners' proceedings are now frequently used are subject to social pressure to choose these proceedings rather than straight bankruptcy. The counseling of debtors under the Commission bill may provide an opportunity for further social pressure in favor of wage earners' proceedings.\textsuperscript{80}

No similar provision appears in the House version. However, the court is given the power at anytime to dismiss a case or suspend all proceedings in it if "the interests of creditors and disadvantages." Id. The Bankruptcy Commission further stated that the mortality rate among extensions which require 100 percent repayments was high because they often overburden debtors and their families. Similarly, compositions were not widely used because the confirmed composition was a bar to further relief under the present act for 6 years, and creditor consent is often lacking. Creditors also vetoed Chapter XIII plans where prompt and full payment was unprovided for despite depreciation of their secured collateral. Id. See also note 70 supra; note 88 infra.

78. Counseling was seen by the Commission as improving the attractiveness and utility of plans for repayment by consumer-debtors out of future earnings. Consumer-debtors, who the Commission believed, were often uninformed about their options, would become aware of their alternatives through counseling. Senate Hearings, supra note 4, at 8.

Professor Frank Kennedy, Executive Director of the Commission on Bankruptcy Laws of the United States, testified before the Senate hearings that:

\textit{[o]ne of the reasons the Commission was convinced Chapter XIII has such a nonuniform use throughout the country is that debtors are not sufficiently informed about the options available to them. In districts where Chapter XIII is extensively used, there may be reason for doubt that debtors even know they have the option of straight bankruptcy.} Id. at 23.

79. Mr. Frank Kennedy also testified that:

\textit{the Commission contemplated that the nature of that counseling would be informational counseling that would tell the debtor what the options are under the act, what the features of straight bankruptcy are, what the features of a plan are, and the Commission proposed to make this kind of relief and this kind of counseling available only to persons with regular income on the assumption that only a debtor with a fairly regular and stable income can propose and realistically live up to a plan contemplating payment out of future earnings.} Id.

80. Professor Philip Schuchman believed that the very purpose of counseling was to encourage wage earners' proceedings. "From what I know of counselors and have seen and heard, I fear that they may very well encourage Chapter XIII or its equivalent in any new act. I can see no other reason why it is provided in the Commission bill . . . ." House Hearings, supra note 5, at 865.
the debtor would be better served by such dismissal or suspension." Indeed, under section 305(c) a decision to dismiss or not "is not reviewable on appeal or otherwise." Unlike the parallel provision in the Commission bill, the power is available in voluntary as well as involuntary cases. In the House version the provisions governing wage earners' proceedings are found in Chapter 13. Conceivably, a judge committed to wage earners' proceedings could in cases he deemed appropriate threaten to dismiss the voluntary straight bankruptcy unless it were converted to a Chapter 13 case. It is true that under section 706(c) the court may not itself convert a straight bankruptcy, or as the House version calls it, a liquidation case, to a wage earners' proceeding. One must also recognize that under section 1307(a) the debtor may convert a Chapter 13 proceeding to a liquidation case at any time. Nevertheless the bankruptcy judge arguably could dismiss a straight bankruptcy unless the debtor agreed to convert to Chapter 13. If the debtor then reconverted to straight bankruptcy, the judge could dismiss the case. Despite the prohibition on review in section 305(c), an appellate court should find such a maneuver contrary to the intent of the statute since it would be an effective denial of the right to convert a wage earners' proceeding to a straight bankruptcy. The proposed statute does not grant the bankruptcy judge unreviewable discretion to prevent such conversion. The Senate version would support this conclusion since it provides that "any waiver of the right to convert a case under this subsection is unenforceable." Nevertheless, both bills could provide a clearer basis for such a conclusion. Indeed, in the absence of such a clearer basis, some courts may conclude that the intent of the House version is to reduce the number of voluntary bankruptcies by the means just outlined. A conclusion such as this would prevent debtors from exercising their now historic option of seeking immediate rehabilitation by surrendering their property for distribution to creditors in return for a discharge from their debts.

Congress has shown no desire to make such a radical change. Undoubtedly, however, some debtors would benefit from paying their debts from future income over a period of

81. House Bill, supra note 6, § 305(a)(1). See also id. § 707. Query what the interrelation is of section 707's provision that dismissal shall be only for cause with section 305(a)?
82. Id. § 305(c).
83. Senate Bill, supra note 9, § 1307(a).
three years. Others need the financial training provided by a Chapter 13 proceeding. Nevertheless, the productivity of others or their likelihood of financial rehabilitation would be lessened by paternalistic control of their affairs during a three year period. The traditional option of voluntary bankruptcy, then, should remain fully available. A voluntary choice of Chapter 13 proceedings would provide assistance to those who would desire it or benefit from it. To compel others to choose it in place of voluntary bankruptcy would subtract seriously from the historical protection afforded consumer-debtors.

Finally, it should be pointed out that the provision in section 305(c) is ill considered even if used for other purposes than reducing straight bankruptcies by consumer-debtors. It gives

84. A substantial number of suggestions were made in an effort to aid this choice:

1. Require the Court to assume exclusive jurisdiction over all debts of the debtor, including priority, secured, and unsecured debts. Allow the Court to adjust the payments to the priority and secured creditors, as may be required, to achieve a reasonable and workable repayment plan that is not a material effect upon the priority and secured creditors.

2. Require any applicant for relief under the Act to acknowledge that his filing will result in either an outright bankruptcy or a repayment plan under Chapter XIII, as may be determined by the Court.

3. Require any consumer petitioner to show to the satisfaction of the Court that his debt problem is an unbearable, insurmountable problem that cannot be reasonably resolved by a repayment plan from future income.

4. Require the Court to rule whether a Chapter XIII repayment plan is a reasonable solution to the debt problem presented.

5. Allow the Court to rule on the form of relief available to the petitioner, regular bankruptcy or a repayment plan.

6. Allow any party of interest to file an application for reconsideration of the decision of the Court. This application will be based on new information which was not available to the Court at the time of the original decision.

7. Allow the District Court to review any decision made by the Bankruptcy Judge upon a reconsideration.

8. Require the debtor to pay not more than nor less than 10% of the money paid in under the Plan as his fee for the services of the trustee and the Court. A fee of 10% to the debtor is not excessive considering the average creditor charge is in excess of 10% and creditor charges are usually eliminated or drastically reduced. Debtors who can and desire to pay their debts do not object to this reasonable fee of 10%.

9. Require the trustee to take no more than 5% of the fees collected for his personal services, but not more than the salary presently being paid to the Bankruptcy Judge.

10. Require the trustee to limit his office expenses to no more than is actual and necessary as determined by the Bankruptcy Judge.

11. Require the trustee to remit, semi-annually, all fees collected in excess of the above limitations to an agency herein proposed, the Consumer Debt Relief Program.

House Hearings, supra note 5, at 1399 (statement of Duncan H. Kester).
the bankruptcy judge an uncontrolled power to determine when bankruptcy is appropriate or inappropriate. Thus, the availability of bankruptcy in any district will depend on the policies or prejudices of the bankruptcy judge. In view of this provision, it would be difficult to pretend that the House version offers a uniform law on the subject of bankruptcies.

The Impact on the Public Interest

The Commission bill and the House version, in somewhat different ways, would make it easier to obtain involuntary bankruptcy and would probably increase substantially the number of these proceedings. Under both proposed laws involuntary bankruptcy may be used as a lever against different but overlapping groups of consumer-debtors to encourage the filing of wage earners' proceedings. Under the House version and to some degree under the Commission bill voluntary bankruptcy may be discouraged or limited as a debtor's remedy. While these positions invade substantial interests of consumer-debtors, one must inquire nevertheless what their impact would be on the public interest.

To do so, one must propose some criteria for measuring the public interest. Bankruptcy law presents two considerations, namely the twin purposes of any modern bankruptcy law: first, providing an orderly process for the collection of the debtor's property and distribution of it to creditors; and second, rehabilitating the debtor. Since in regard to some proposed rules, analysis against these purposes would produce conflicting assessments, it would be desirable to find and use as additional criteria some common interests or collective goals of society which are not directly related to debtor or creditor interests but which would support or provide reasons for accepting the two purposes of bankruptcy law. One collective goal which would support the purpose of collecting property for creditors is the preservation of credit. The purpose of rehabilitating debtors

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85. See Lines v. Frederick, 400 U.S. 18 (1970); Segal v. Rochelle, 382 U.S. 375 (1965). The technique for evaluating legislative proposals suggested here is not dissimilar to the technique of statutory interpretation employed in the above cases, i.e., weighing the proposed changes against the dual purposes of the bankruptcy act.

may be supported by the societal goals of preserving productive economic units and encouraging debtors to support themselves in place of resort to the welfare roles. In addition, it is submitted that the traditional American concern for human dignity would support the purpose of rehabilitating debtors.

One could determine the impact of the proposals under discussion on the public interest by measuring each of them in turn against the criteria just outlined. In regard to each, then, one should ask whether its adoption would enhance significantly the availability of credit, whether it would tend to preserve or lessen the productivity of economic units, and what effect it would have on human dignity.

An increase in the number of involuntary bankruptcies could enable some creditors to obtain a larger repayment of the amount owed to them. However, given the large number of no-asset bankruptcies, this additional recovery should be comparatively small. It should not be significant when compared to outstanding consumer debt. It is unlikely that recovery of additional funds by involuntary bankruptcy would significantly enhance the availability of credit or decrease its cost. Nevertheless, some consumer-debtors who would have escaped involuntary bankruptcy would be thrust into it and it would become possible to harass consumers with threats of involuntary bankruptcy. For these reasons, there is some likelihood that the productivity of financially distressed consumer-debtors would be reduced and the protection afforded their human dignity lessened.

Creditors would probably recover more substantial sums through the increased number of wage earners' proceedings likely under the proposed bankruptcy laws. Nevertheless, when compared to the outstanding amount of consumer credit, these additional repayments probably would be too small to affect significantly the cost or the availability of credit. The productivity of some debtors would be enhanced by the experience of a wage earners' proceeding while it is likely that the productivity of others would be lessened. The human dignity of some would be enhanced by finding a way to pay their creditors while others would suffer a loss of human dignity by being subjected to the supervision of the federal court for a three year period. Completely voluntary proceedings coupled with an educational program\(^\text{87}\) could produce the beneficial results just described.

\(^{87}\) One such educational program was initiated by the National Association of Chapter XIII Trustees:
while avoiding those which are detrimental. One must also assess the impact of having as many as 750,000 debtors in wage earners' proceedings during a given year. Governmental paternalism on this scale resembles the social welfare system which has a pervasive and notoriously bad effect on the productivity and human dignity of the recipients of welfare.

To compel debtors to use wage earners' proceedings in place of voluntary bankruptcy would not make credit significantly more available or less costly. The number of involuntary bankruptcies today, although large, is insignificant when compared with the outstanding amount of consumer credit. Although there are now a large number of straight, voluntary, personal, no-asset bankruptcies, credit is readily available and not costly when compared with other eras or with the circumstances in other countries. Consumer credit is extraordinarily easy to obtain. Decreasing the availability of voluntary bankruptcy, then, probably would not affect significantly the ability to obtain credit or its cost. It would, however, prevent some debtors from using voluntary bankruptcy as a means of rapid financial rehabilitation. This would affect their productivity and their human dignity.

Arguably, then, the provisions of the Commission bill and the House version which are under discussion would not only invade substantial consumer interests but would have a deleterious effect on the public interest. Several simple changes, some of which have been discussed, would soften these adverse results of the proposed laws. Either consumer-debtors generally, or those who earn less than a fixed amount such as $20,000, or those who owe less than $10,000 over the amount of any security should be free from involuntary bankruptcy. The bankruptcy judge under the House version should be clearly denied the power to dismiss a voluntary petition be-

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Our association for a number of years has printed and distributed, by the thousands, a pamphlet . . . to Social Service and Welfare Departments, personnel offices, labor organizations, businesses, creditors and any worthwhile organization or group who are exposed to financially distressed individuals. These pamphlets are distributed for educational purposes, and in those areas where it is used the results always reflect an increase in filings.

*House Hearings*, supra note 5, at 1398 (statement of Duncan H. Kester).

88. Compare 208,064 voluntary straight bankruptcies in 1975 with 196.7 billion dollars of outstanding consumer credit. See generally DEP'T OF COMMERCE, BUREAU OF CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES (1976).

89. See *Senate Hearings*, supra note 4, at 851-52 (testimony of Samuel J.M. Donnelly). See also note 48 and accompanying text *supra*. 
cause of a refusal to convert to Chapter 13. If the House version is enacted without these changes and experience proves that the predicated results have occurred, then a basis would be present for Congress to make further changes.

THE COLLECTION OF THE ESTATE

In the evolution of a bankruptcy proceeding the institution of a voluntary or involuntary action is followed by collection and distribution of the debtor's estate to creditors and by the granting or denial of discharge. When discussing both collection of the estate and discharge, one should be aware that the debtor and his creditors are engaged in what could be described as a great game. The goal of the game for the debtor is to retain as much property as possible despite the bankruptcy proceeding. The exemption provisions of state and federal law are the most plainly relevant tools for achieving this goal. One should, however, recognize that a variety of other tools are useful, including the practice of reaffirming debts owed secured creditors in exchange for not reclaiming property and, in regard to exempt property, the assertion of the debtor's defenses or the avoiding of creditors' liens by the trustee. The choice of wage earners' proceedings, of course, would allow the debtor to retain a substantial amount of property. The creditors' goal in this great game is to have the debts owed to them survive the bankruptcy proceeding. A second goal is to be paid as much as possible. Because the creditors are often the aggressors in this game, they would attempt on occasion to take advantage of the debtor's desire to retain property to achieve their goals. Reaffirmation of debts is a tool readily used for the purposes of creditors as well as debtors. Principal tools for achieving the goal of having debts survive bankruptcy are the provisions concerning denial of and exceptions to discharge. Some of these tools have functions to perform in wage earners' proceedings as well as straight bankruptcy.

While the provisions concerning discharge are part of the great game, discussion of them is appropriately located in the

90. See Senate Hearings, supra note 4, at 852 (testimony of Samuel J.M. Donnelly).

91. Another prevalent practice is the cosigning of loans made to the debtor. This allows the creditor recourse against the co-signor for any balance if the debtor defaults. However, the House version in certain circumstances would forbid the collection of the debt from the co-signor. This, of course, would restrict the availability of credit to those debtors. See House Bill, supra note 6, § 524(a)(3), (d).
Reaffirmations and Redemptions

Section 4-504 of the Commission bill allows the debtor to redeem exempt or abandoned property "from a lien securing a dischargeable consumer debt" by paying the fair market value of the property. 92 An agreement to redeem may be enforced against the bankrupt debtor under section 4-504(b) but under section 4-507, with one additional exception, no other debt extinguished by a discharge may be revived or reaffirmed. 93

These provisions of the Commission bill bring into the open and regulate a device frequently used in the great game described earlier. The trustee would often abandon property subject to a security interest. However, the debt supporting the security interest would be discharged. Rather than repossess or reclaim the collateral which may be worth less than the amount of the debt, a secured creditor may offer to allow the debtor to retain the property in exchange for reaffirming the debt and thereby reviving the personal obligation. 94 The past consideration would support the new post bankruptcy promise. The revival of the debt coupled with retention of the property by the bankrupt may serve the goals of both debtor and creditor. However, the debtor who is not well advised and is under pressure from his adverse circumstances may reaffirm debts foolishly. Possibly the amount of debts revived in this manner may be great enough to leave the debtor after bankruptcy in as difficult a financial condition as he was before. For several years he would be unable to obtain another discharge. In classic terms, then, his last state would be worse than his first. Testi-

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92. The provision does not apply to a debt secured by nonexempt property that is greater in value than the secured debt, because the trustee would not abandon the property but would sell it for the benefit of the estate. See Commission Bill, supra note 6, § 4-504.

93. See id. § 4-507(b). See also House Bill, supra note 6, §§ 524(b), 722; note 152 and accompanying text infra.

94. An investigation by the Federal Trade Commission found: "An endless variety of techniques was employed to secure these [reaffirmation] agreements, usually prior to the consumer's receipt of a discharge. The more common inducements were threats to property, threats to reputation and standing, and offers of additional cash."
fying on behalf of the National Consumer Law Center, Professor Richard Hesse stated:

In our informal survey of legal services lawyers, reaffirmation problems were found in 28% of the cases. The most frequent complaint was pressure by and fear of the creditor; 21 of 31 respondents cited that cause. Six respondents cited the debtor’s desire to retain the collateral (mainly household furnishings and automobiles) as the principal reason for reaffirmation. When asked what changes in the present law are needed to protect the debtor from unwanted reaffirmation, the responses include suggestions which evidenced great concern and fear that unsupervised reaffirmation of consumer debts would produce unconscionable results. Debtors should be able to make truly voluntary payments on discharged debts. Debtors should be given the option to redeem collateral and settle dischargeability disputes as long as the redemption or settlement is supervised and fair. But there is no sound reason to allow reaffirmation of discharged debts to be consideration for future advances or to permit creditors to obtain binding agreements to pay discharged debts.

The restrictions in the Commission bill on revivals or reaffirmations would control this problem. The provision of section 4-504 permitting the debtor to redeem for the fair market value of the collateral would keep the debtor from reaffirming debts in an amount greater than the value of the property retained and may discourage creditors from pressing for reaffirmations. This aspect of the bill could be improved by including a provision in section 4-504 similar to the requirement in section 4-506(b) that the agreement be “entered in good faith” and be “approved by the court.”

95. Senate Hearings, supra note 4, at 315 (statement of Richard A. Hesse).

96. The American Bankers Association and the Consumer Bankers Association favored reaffirmation if approved by the bankruptcy court within a reasonable time after the filing of the petition. Id. at 128 (statement of Walter W. Vaughn). The National Consumer Law Center took the position that “debtors should be given the option to redeem collateral and settle dischargeability disputes as long as the redemption or settlement is supervised and fair. But there is no sound reason to allow reaffirmation of discharged debts to be consideration for future advances or to permit creditors to obtain binding agreements to pay discharged debts.” Id. at 315 (statement of Richard A. Hesse).

Other witnesses before the Senate Hearings favored reaffirmations subsequent to a “cooling off” after the filing of the petition. Linn K. Twinem who testified on behalf of Beneficial Finance (which controls about 9.6% of the finance company market in the United States) favored a cooling off period, but was opposed to court approval for reaffirmations. Id. at 198-99. Mr. Benjamin L. Zelenko who accompanied Mr. Twinem
The provisions of the House version resemble substantially those of the Commission bill but are numbered differently. A key provision is section 722 which reads as follows:

An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title by the trustee, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.97

An agreement to redeem is enforceable despite a discharge. However, with one additional exception, no other revival or reaffirmation would be enforceable. Under section 524(b):

After the commencement of a case under this title, a creditor may not enter into an agreement with the debtor the consideration for which in whole or in part is based on a debt of the debtor that is dischargeable in a case under this title, whether or not discharge of such debt is waived.

Any such agreement is void.98

This wording has stronger rhetoric in it than an earlier House bill.99 It may be responsible for the rumor that the House version has eliminated reaffirmations.100 Actually it has not. Both the House version and the Commission bill leave intact the bulk of reasonable revivals of debt, those in settlement of objections to discharge which will be discussed below and those which are part of an agreement to redeem. Any other reaffirmation by a debtor would seriously interfere with the policy of rehabilitation.101 The House version has improved the Commis-

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97. House Bill, supra note 6, § 722.
98. Id. § 524(b).
99. H.R. 6, supra note 6, § 524(b) provided: "A debt is not enforceable to the extent that the consideration for such debt is based in whole or in part on a debt discharged in a case under this title, whether or not discharge of such debt is waived."
100. See, e.g., Minard, A Pound of Flesh?, FORBES, June 15, 1977, at 94.
101. However, for a debtor who wishes to keep his house after bankruptcy, this provision may work a hardship. If the homestead exemption is unable to cover the debtor's equity, the only escape left to the debtor and his mortgagee, who similarly
sion's approach by requiring in section 524(c) that both agreements settling objections to discharge and agreements for redemption be "entered into in good faith" and be approved by the court. Both the provisions in the Commission bill and the House version provoked considerable opposition from creditor interests. If these provisions were weakened, consumers would continue to be exposed to a problem which has caused concern in the administration of the present law.

Section 524(b) of the Senate version offers a substantially different scheme for controlling revivals and reaffirmation of debts. Any debt discharged in bankruptcy may be revived or reaffirmed. Rather than prohibiting the revival of some debts, the Senate bill puts a check on all revivals or reaffirmations by permitting the debtor to "rescind his revival or reaffirmation by written notice to all concerned creditors within 30 days."

Presumably, this would afford debtors greater protection than the House version in those instances when bankrupts revive debts in settlement of discharge or in order to redeem exempt or abandoned property. However, it does permit revivals in circumstances not allowable under the House bill. One such circumstance would be where new credit is extended on the condition that an old debt be reaffirmed. In this situation, it is questionable whether the opportunity to change his mind in thirty days will adequately protect the debtor. In fact, the troubled debtor will probably be poorly counseled and may not even know of his right to rescind.

Inappropriate revival of debts discharged in bankruptcy would tend to defeat both goals of a bankruptcy law: orderly collection and distribution of the debtor's property and rehabilitation of debtors. Revival would enable some particular creditors to collect a greater portion of the amount owed them and would take place ultimately after and outside of the bankruptcy proceeding. It would seem contrary to a second goal of a bankruptcy law to afford creditors an orderly process for col-

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102. House Bill, supra note 6, § 524(c). There is no "good faith" provision in the Senate version. See Senate Bill, supra note 9, § 524(b).

103. See Senate Hearings, supra note 4, at 190-91, 197-99 (testimony of Linn K. Twinem); id. at 203, 207-11 (testimony of Benjamin L. Zalenko); id. at 142-43, 181-83 (testimony of Alvin O. Wiese, Jr.); id. at 315 (testimony of Richard A. Hesse). See also note 97 supra; Minard, supra note 10.

104. Senate Bill, supra note 9, § 524(b).
lecting and distributing the debtor's property. For these reasons weakening of the proposed regulation of reaffirmation would be contrary to the public interest.105

Unconscionability and the Assertion by the Trustee of Debtor Defenses

The present law in section 70(c) states explicitly that the trustee shall have "all defenses available to the bankrupt" against third persons. This right could also be implied in section 70(a) which vests the trustee as of the date of bankruptcy with title to the bankrupt's property.106 The trustee's status as successor in title to the bankrupt would vest him with the defenses available to his predecessor.

In section 4-403(b) of the Commission bill one may find a list of claims which may not be allowed. Where "the debtor can defend against the enforcement of the claim" under any relevant law it may not be allowed. A provision interesting to consumers is found in section 4-403(b)(8) which prohibits the enforcement of an "unconscionable consumer claim."107 In section 4-403(c) unconscionability is defined more particularly108 and

105. But see statement of Alvin O. Wiese, Jr., predicting that: "most creditors would opt for immediate return of collateral or accelerate the payment of the value fixed in the bankruptcy proceeding. Down payments on depreciating collateral would be higher and the term of the obligation shorter." Senate Hearings, supra note 4, at 143.

107. Id. § 70(a).
108. Commission Bill, supra note 6, § 2-403(b)(1).
109. Id. § 4-403(b)(8).
110. Section 4-403(c) defines unconscionability as:
    (c) Unconscionability. Without limiting the scope of clause (8) of the subdivision (b), the following, among other things, may be considered as pertinent to the issue of unconscionability:
    (1) the degree to which unfair advantage was taken against the debtor in any aspect of the transaction from which the claim arises or in any aspect of any enforcement of the claim, because of his lack of knowledge, ability, experience, or physical or mental capacity;
    (2) substantial disparity between the price of goods or services and their value as measured by the price of the same or compara-
perhaps more favorably to the consumer than in section 2-302 of the Uniform Commercial Code.\footnote{I11}

If the trustee were to use such a provision aggressively it could serve as one tool for policing the market place to prevent unconscionable contracts. However, the provision is also relevant to the great game in which the bankrupt debtor's goal is to retain as much property as possible despite bankruptcy. The trustee could assert the debtor's defenses, including unconscionability, in regard to debts secured by exempt or abandoned property. Such property could then be set aside for the bankrupt debtor. The House version does not appear to contain a provision concerning unconscionable consumer claims.\footnote{I11} While it is arguable that this is a factor making it less desirable for the consumer than the Commission bill, one should note that under section 502(b)(1) a claim which is "unenforceable
against the debtor under any applicable law” may not be allowed.\footnote{13} The trustee, then, may assert the debtor's defenses under section 2-302 of the Uniform Commercial Code. What is lost is the more elaborate definition of unconscionability found in the Commission bill. While this loss is lamentable, the impact of the change on the interests of either the consumer or the public should be minimal.

\textit{Wage Earners' Proceedings and the Great Game}

The Commission placed the rules governing wage earners' proceedings in Chapter VI of its bill, while the House version changed the numbering back to the traditional Chapter 13. As noted earlier, the provisions of the Commission bill and House bill governing the initiation of bankruptcy offer considerable leverage to creditors. Creditors may use this leverage to achieve their goal of receiving higher payments through a wage earners' proceeding than they would in the absence of bankruptcy. However, debtors may also use wage earners' proceedings to further their goal of obtaining a discharge while retaining a maximum amount of property.

An important provision of the Commission bill, section 6-201(2), serves this goal of debtors. It has two significant aspects. The wage earners' plan may deal “with claims secured by personal property severally, on any terms” and secondly “may provide for the curing of defaults within a reasonable time.”\footnote{14}

Under the present law each secured creditor whose claim is dealt with by a wage earners' plan must consent to it. This provision makes it difficult to rehabilitate a debtor through a wage earners' proceeding when most of his property is subject to security interests. However, under section 6-204(b) of the Commission bill the court is directed to confirm a plan if it “provides for the preservation to each secured creditor affected by the plan of the value of his claim against the property of the debtor, is in the best interests of the creditors and is feasible.”\footnote{15} The consent of creditors to the plan is not required. Coupled with section 6-201(2), this provision allows the plan to deal adequately with secured claims. The value of the claims must be preserved but by virtue of section 4-402(b) the value

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\begin{itemize}
\item 113. House Bill, \textit{supra} note 6, § 602(b)(1).
\item 114. Commission Bill, \textit{supra} note 6, § 6-201(2).
\item 115. \textit{Id.} § 6-204(b).
\end{itemize}
of the claim may not exceed the value of the collateral. In addition to reducing or cramming down the claim of the secured creditor to the value of the collateral, the plan may also stretch out payments while still preserving the value of the claim.

The plan may provide for the curing of defaults when payments to a secured creditor have been skipped. A similar rule in regard to secured claims against the debtor's residence may be found in section 6-201(4). The debtor may also have the advantage of the rules discussed earlier on redemptions and reaffirmations. Under section 4-504, which is a rule applicable to all proceedings in bankruptcy, the debtor may redeem or make an enforceable agreement to redeem exempt or abandoned property subject to a security interest. He may do so by "paying the holder of the lien the fair market value of the property or, if less, the amount of the claim." This provision is remarkably similar to section 6-204(b)'s reference to the value of the secured creditor's claim. Taken together all of these provisions would provide the debtor with a full bag of tools for bringing property through a wage earners' proceeding.

The provisions of the House version may be used in a similar manner. Under section 1322(b)(2), (3), (4) and (5) of that bill the debtor's plan may modify the rights of holders of secured claims or provide for curing of a default. The court may confirm a plan under section 1325 provided:

(5) with respect to each allowed secured claim provided for by the plan—
(A) the holder of such claim has accepted the plan;
(B) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
(C) the debtor surrenders the property securing such claim to such holder.

116. Id. § 6-201(4).
117. See notes 90-105 and accompanying text supra.
118. Commission Bill, supra note 6, § 4-504.
119. Id. § 4-504(a).
120. Compare Senate Bill, supra note 9, § 1322(b)(2), (3), (4), (5), which duplicates the House provisions except that the language relating to real property mortgages is inserted in subsection (b)(2) which now states that a plan may "modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or of holders of unsecured claims."
121. House Bill, supra note 6, § 1325(a)(5).
Upon examination these provisions resemble those in the Commission bill but are more flexible. To understand the provisions fully, one must relate section 1325(a)(5)(B) to section 506 concerning the determination of secured status. A creditor’s claim under section 506(a) is “a secured claim to the extent of the value of such creditor’s interest . . . in such property, and is an unsecured claim to the extent that such value is less than the amount of such allowed claim.”122 When this definition is read together with section 1325 (a)(5)(B) one can perceive an equivalent of the cram down provision in the Commission bill.

Both the Commission bill and the House version, then, provide the consumer with ample means to preserve his property while obtaining a discharge in a wage earners’ proceeding. Standing alone the greater attractiveness of these proceedings is both in the interest of the consumer and the public. However, when joined with the very large potential increase in wage earners’ proceedings described earlier, these provisions may fill in some portions of the emerging portrait of a new and undesirable paternalism in bankruptcy law.

Exemptions

The exemption provisions found in the Commission bill are designed to replace those of state law for the purpose of bankruptcy proceedings. In contrast, the House version gives the bankrupt a choice between its exemption provisions and those of state law.123 As explained earlier the choice allowed by the House version would reduce considerably the incentives for filing involuntary petitions.

Exemption provisions, however, also play a role in the great game. The debtor should use exemptions as a principal tool for retaining property despite a bankruptcy proceeding. While exemptions are tools for achieving this goal of the debtor, from the viewpoint of the public interest, they serve a major purpose of bankruptcy law, that of rehabilitating debtors. It would be worthwhile to recall some national goals which support the policy of rehabilitating debtors. Among these are the goals of promoting and preserving productive economic units, encouraging individuals and families to be self-supporting rather than seeking welfare assistance, and preserving human

122. Id. § 506(a).
123. House Bill, supra note 6, § 522(b).
dignity. Any particular strategy for rehabilitation may be evaluated by determining whether it furthers goals such as these.\textsuperscript{124}

A principal exemption in the Commission bill is for the homestead of the debtor. The aggregate value allowable as a homestead exemption is "$5,000 plus $500 for each dependent of the debtor."\textsuperscript{125} While this amount would protect only a very small house, it must be considered in relation to the amount of down payment which a purchaser would make in order to obtain a standard mortgage. If banks normally will advance seventy-five percent of the purchase price, then a $5,000 homestead exemption would support a $20,000 home. The $5,000 homestead exemption would seem a parsimonious protection of human dignity but at least a small step towards insulating a bankrupt debtor from the need for public assistance.

When the bankrupt does not exhaust the amount applicable to a homestead exemption he may select as exempt additional property of the type listed in section 4-503(c)(1) and (2) up to the amount of the unused homestead exemption. In any event under these clauses the following property would be exempt: "(1) livestock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles to the aggregate value of not more than $1,000; (2) a burial plot to the value of $2,500."\textsuperscript{126}

These exemptions could be described as a compilation and restatement of traditional state exemption laws. It could be argued that such laws, by exempting specific categories of

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\item \textsuperscript{124} L.E. Creel III, in his testimony at the House Hearings stated:
\begin{quote}
Since the determination of exemptions is based upon two not necessarily inconsistent, but certainly different philosophical purposes, to wit: (i) the minimum amount of properties which should be allowed to any individual in order for him to retain his dignity and to attempt self-rehabilitation and (ii) the maximum amount of properties which an individual should be permitted to retain before infringing upon the reasonable interests of creditors in property of the debtor, and since the former purpose (allowance of exemptions) is properly national in scope, while the latter (permission of exempt) is essentially local, any new bankruptcy act should properly address itself only to minimum exemptions, while leaving the definition of maximum exemptions to the states.
\end{quote}
\end{itemize}

The Committee, therefore, recommends that the new Bankruptcy Act provide only federal minimum exemptions consistent with the often stated federal policy goal of "fresh start" and "rehabilitation". The relative rights of parties other than the bankrupt, being outside the "fresh start" concept, are better determined by state law.

*House Hearings, supra* note 5, at 1658.

\begin{itemize}
\item \textsuperscript{125} Commission Bill, *supra* note 6, § 4-503(b)(1).
\item \textsuperscript{126} Id. § 4-503(c)(1), (2).
\end{itemize}
property, support the dignity of the debtor or his ability to earn a living. In contrast, a law allowing the debtor a lump sum exemption of $3,000, for example, in lieu of all other exemptions, might undermine the dignity of the debtor. A vivid example of the difficulties which such a solution would present can be seen in the possibility that a debtor, choosing the lump sum in cash, would be deprived completely of wearing apparel. A strong test would then be presented to a conscientious trustee who would be compelled to determine whether sufficient wearing apparel should be abandoned to protect the debtor's modesty. Arguably, the Commission fell into this trap in section 4-503(c)(1) under which a debtor so inclined could allocate his entire $1,000 to preservation of his motor vehicle. The Commission has avoided falling into this classic trap a second time by placing in subsection (c)(3) the exemption for cash and similar sources of funds to the aggregate value of not more than $500. Therefore, the debtor is not forced to choose between cash and clothes. With the exception of the problem noted in connection with section 4-503(c)(1), the Commission has adopted the better strategy of allocating minimum amounts to specific items of property deemed vital and important. Moreover, the problem posed by section 4-503(c)(1) is at least somewhat mitigated by the fact that an additional lump sum, the surplus from the homestead exemption, may then be applied to specified property above and beyond the minimum amounts.

Use of the surplus from the homestead exemption in this manner also avoids discrimination against those who rent or who, for other reasons, are unable to claim the full homestead exemption. However, a policy choice which may be discriminatory is hidden in these provisions. A debtor who rents may apply the amount of the homestead exemption to the tools of his trade or profession. It is not clear whether a debtor who owns his home may waive his homestead exemption and apply this amount to protecting his tools and hence his ability to earn a living. The policy grounds supporting this potential discrimination are also not clear. There is, of course, plain discrimina-

128. It was suggested that a figure of $500 would eliminate most nominal assets cases. Philip Schuchman stated: "[A]t the $500 level my guess is that of the present nominal asset cases, 90 percent or more would be eliminated. This would not affect creditors in any way. The only persons affected would be the trustees." House Hearings, supra note 5, at 864.
tion in favor of that more comprehensive group who own either houses or livestock, wearing apparel, jewelry or other items mentioned in section 4-503(c)(1) in amounts up to $6,000 plus $500 for each dependent, and against those who have other or fewer assets. Those with other assets could of course sell them and purchase section 4-503(c)(1) assets. Congress could avoid this discrimination to some degree by allowing the surplus from the homestead exemption to be applied to the property such as cash and securities listed in subsection (c)(3).

There are a variety of other exemptions in the Commission bill. The principal theme which runs through these additional provisions is protection of income or related property required for the future support of the debtor or his family. Exemptions for alimony,\textsuperscript{129} pension rights,\textsuperscript{130} disability benefits,\textsuperscript{131} and the like are akin to the basic exemption in straight bankruptcy of future income. These resources are directly related to the goal of promoting self maintenance by the debtor rather than reliance on public assistance.

Under the House version there is in most instances a larger homestead exemption than in the Commission bill.\textsuperscript{132} The debtor is allowed to protect his interest in real or personal property up to an amount of $10,000.\textsuperscript{133} The exemption for a burial plot is included in the homestead exemption.\textsuperscript{134} In other provisions the House version avoids presenting the debtor with some of the dilemma described above. For example, there are separate exemptions for a motor vehicle,\textsuperscript{135} for tools of the debtor's trade,\textsuperscript{136} for jewelry\textsuperscript{137} and for any other property up to $500 plus the unused excess of his homestead exemption.\textsuperscript{138} Each has a reasonable amount allocated to it which is in some

\textsuperscript{129} Commission Bill, \textit{supra} note 6, § 4-503(c)(4).
\textsuperscript{130} \textit{Id.} § 4-503(c)(6).
\textsuperscript{131} \textit{Id.} § 4-503(c)(7).
\textsuperscript{132} The Commission bill sets the exemption at $5,000 plus $500 per dependent.
\textsuperscript{133} The House version provides a flat $10,000 or the exemption allowed under state law.
\textsuperscript{134} \textit{Id.} § 522(d)(1).
\textsuperscript{135} \textit{Id.}
\textsuperscript{136} Section 522(d)(2) provides: "the following property may be exempted . . . [t]he debtor's interest, not to exceed $1,500 in value, in one motor vehicle." \textit{Id.} § 522(d)(2).
\textsuperscript{137} Section 522(d)(6) provides: "The following property may be exempted . . . [t]he debtor's aggregate interest, not to exceed $1,000 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor." \textit{Id.} § 522(d)(6).
\textsuperscript{138} \textit{Id.} § 522(d)(4) ($750 exemption).
\textsuperscript{138} \textit{Id.} § 522(d)(5).
instances larger than the aggregate amount allowed in section 4-503(c)(1) of the Commission bill which contains parallel provisions. The debtor is not put to a choice between his car and the tools of his trade. One provision of the House version at first sight may appear to repeat the Commission’s mistake of compelling a choice between necessary wearing apparel and other property, but on closer reading it avoids this problem. The language of section 522(d)(3) exempts the following property:

(3) The debtor's interest, not to exceed $300 in value in any particular item, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.\textsuperscript{139}

This provision does not compel the debtor to choose between the items listed up to an aggregate amount; rather, it exempts all such items with a ceiling of $300 on any individual item.

Following but expanding the pattern in the Commission bill, the House version allows the debtor to apply the unused amount of homestead exemption to “any particular item.”\textsuperscript{140} This property could include cash. Some discrimination found in the Commission bill between those who own favored property and those who do not is thereby avoided.

The House version includes but clarifies the exemptions found in the Commission bill for property related to the future support of the debtor and his family such as alimony,\textsuperscript{141} pensions, and disability payments.\textsuperscript{142} It specifically exempts the right to receive these and other payments which might be considered property on the date of bankruptcy. The Commission bill in some instances exempts the payments themselves which may cover accumulated and banked past payments.

For all the reasons stated, the exemption provisions of the House version seem to serve the interests of the consumer and the goals of bankruptcy better than those of the Commission bill. The most open-ended provision of the House version seems

\textsuperscript{139} Id. § 522(d)(3).
\textsuperscript{140} Id. § 522(d)(3). Under the Commission bill the unused portion of the homeowner's exemption may only be used on certain specified items. Under the House version it may be used to exempt anything.
\textsuperscript{141} House Bill, supra note 6, § 522(d)(10)(D).
\textsuperscript{142} Id. § 522(d)(10)(E), (C).
to be section 522(d)(3) which was quoted above. A determined
debtor conceivably could buy a large amount of household fur-
nishings and other items listed there in preparation for bank-
ruptcy. Allowing this would serve the debtor's interest but not
any identifiable public interest. It would seem to defeat the
policy of collecting property for the benefit of creditors. Some
total limitation should be placed on section 522(d)(3) property.
The Senate version of the bankruptcy law eliminates the mini-
mum federal exemptions found in the House bill. On this point,
it is less favorable to consumer-debtors. In states with less
satisfactory exemption provisions than those found in the
House version, consumer-debtors playing the great game would
retain less property under the Senate formula. Significantly, in
states where the exemptions are inadequate for rehabilitation,
reliance on them clearly impairs a primary goal of bankruptcy.

**Discharge**

A principal goal of the debtor in a bankruptcy proceeding
should be to obtain a discharge. When there are major obsta-
cles to discharge of large debts, an attorney should hesitate to
recommend bankruptcy to a debtor. This last part of a bank-
r uptcy is then closely related to the initiation and choice of a
proceeding. The rules concerning discharge may affect the per-
centage of debtors who choose voluntary straight bankruptcy
or as an alternative wage earners' proceedings. Discharge is
also related to the great game discussed in the second part of
this article in which debtors seek to retain a maximum amount
of property while creditors strive to have the debts owed them
survive the bankruptcy.

**Discharge and the Initiation of Bankruptcy Proceedings**

Section 4-505(7) of the Commission bill would deny a
debtor a discharge if he had been granted a discharge or had a
Chapter VII plan confirmed within five years of his petition. The
House version, like the present law, does not permit a
second discharge within six years. An earlier version of the

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143. Compare Senate Bill, supra note 9, § 522 with House Bill, supra note 6, § 522.
144. Commission Bill, supra note 6, § 4-505(7).
145. See Bankruptcy Act, § 14(c)(5), 11 U.S.C. § 32 (1970); House Bill, supra
note 6, § 727(a)(8). The 6 year limitation was retained unchanged in the Senate
version. See Senate Bill, supra note 9, § 727(a)(8).
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House bill, H.R. 6, set a seven year period in section 727(a)(8).

A lawyer for a debtor in financial distress should recommend bankruptcy only at the most advantageous moment since a discharge would not be again available for five, six, or seven years. Under present law a debtor may have a plan confirmed in a Chapter XIII wage earners' proceeding within six years of a previous discharge provided the plan is for an extension rather than a composition of debt. The Commission in section 4-505(a)(7) removes all obstacles to wage earners' proceedings by extension, composition or both within their five year period. In section 727(a)(8) of the House version there is a provision similar to the one just described which refers, however, to the six year period. Under both proposed acts, then, a debtor may have a fair opportunity for relief in a wage earners' proceeding despite a recent bankruptcy.

The purpose of the House version in affording this new relief between bankruptcies may be seen in a different perspective, however, when the provisions just noted are juxtaposed to section 305(a) which was discussed earlier. Under that provision the court may dismiss either a voluntary or involuntary petition as not in the better "interests of creditors and the debtor." It was suggested earlier that this provision was designed to encourage use of wage earners' proceedings in preference to straight bankruptcy. The six year period established by the House version in section 727(a)(8), when joined with the permission to use wage earners' proceedings between bankruptcies, would serve the same policy. The provisions may portray a paternalistic design to push debtors seeking relief in federal bankruptcy court into proceedings in which they can be guided, counseled, and controlled for a three year period.

The provisions of the Commission bill which shorten the period between bankruptcies from six years to five and which allow confirmation of wage earners' plans by extension, composition or both within that period are plainly in the interest of consumer debtors. However, when the provisions for wage earn-

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146. Perry v. Commerce Loan Co., 383 U.S. 392 (1966). A composition is an agreement with creditors for some consideration, such as immediate payment, whereby they agree to discharge their claims upon receipt. The payment is actually a lesser amount than is actually owing on the claim. An extension is a prolongation of a period previously fixed for payment of a creditor's debts, however, it does not involve a discharge.

147. Commission Bill, supra note 6, § 4-505(a)(7).

148. House Bill, supra note 6, § 727(a)(8).
ers' proceedings within the five year period are seen in a different context, such as that of the House version just discussed, one may wonder whether they have acquired a sinister cast.

A yet more sinister possibility may emerge from the discharge provisions of either the House version or the Commission bill. During a five, six, or seven year period following a discharge a debtor would not be entitled to a second discharge in straight bankruptcy. For that period of time the debtor would be in effect on financial probation. When further debts are accumulated, creditors would be able to threaten the debtor with an involuntary bankruptcy in which the debtor would lose his property but would not receive a discharge. The debtor's principal defense would be conversion of the involuntary bankruptcy to a wage earner's proceeding. The prospect of such conversion, however, may be the creditor's principal incentive for filing an involuntary petition. The proposed laws, then, would create a new class of debtors on probation who would be peculiarly vulnerable to involuntary bankruptcy, to what amounts to involuntary wage earners' proceedings, and to creditor threats and harassment. This class does not exist under the present law because it is difficult to have a debtor adjudicated a bankrupt without his consent. The provisions in the proposed laws which would increase the number of involuntary bankruptcies would create this new class of debtors on probation.

The creation of this class of debtors would not appear to be deliberate. Yet one may ask whether it is in the public interest. Policing debtors who have received discharges in the recent past would not appear necessary to the preservation of credit in view of the absence of policing and rather high availability of credit under current law. It may enhance the productivity of some while it would decrease the productivity of others. Ordinarily such policing would have a serious adverse impact on the human dignity of the debtor. A principal means of avoiding creation of a class of debtors on probation would be adoption of the earlier suggestion that those with regular income be exempt from involuntary bankruptcy.

Discharge and the Great Game

A series of provisions in the Commission bill related to discharge would affect the conduct of that great game played by the debtor and his creditors. Creditors have often employed
the allegation of a false financial statement as an important move in that game. Under section 17(a)(2) of the present law a debt for "obtaining an extension or renewal of credit in reliance upon a materially false statement in writing" concerning the debtor's financial condition is not dischargeable.\[149\] Creditors may either challenge the dischargeability of a debt under section 17(c)(2) or settle with the debtor in exchange for a reaffirmation of the debt. When the debt is secured by property which the bankrupt wants to retain, both debtor and creditor would achieve their respective goals of retaining property and bringing the debt through bankruptcy by means of the reaffirmation. The Commission made a statement concerning this portion of the great game which is worth reproducing at length. It reads as follows:

In 1970, Congress became convinced that the discharge obtained by a bankrupt was often frustrated by creditors who had taken a financial statement listing the bankrupt's debts at the time that credit was extended. If the bankrupt made less than a complete disclosure of all his debts in the statement, the creditor could, prior to 1971, sue the discharged debtor on the debt arising out of the loan or other extension of credit by relying on an exception in the section defining the scope of the discharge. The exception was for any debt arising out of an extension of credit by a creditor who relied on a false financial statement, but Congress was informed that often the false financial statement was not relied on by the creditor, that indeed it was often obtained merely for the purpose of being used as a basis for negotiation for a reaffirmation after bankruptcy or for obtaining a default judgment against a debtor unwilling to reaffirm.

Congress by the amendment of 1970 to section 17 of the present Act required creditors wishing to rely on this and certain other exceptions from discharge to seek a determination of the issue of dischargeability before the bankruptcy court within a time prescribed by the bankruptcy court. The Commission has been informed that the legislation has achieved its objective in part, but creditors continue to make advantageous use of the financial statements obtained at the time of extending credit by filing or threatening to file applications for determination of non-dischargeability against bankrupts and accepting a reaffir-

mation in settlement of the litigation or threatened litigation.¹⁵⁰

In view of the continuation of this problem despite the attempt by Congress to control it, the Commission proposed that "the use of a false financial statement be eliminated as a basis for an exception to discharge for a consumer debt."¹⁵¹ In section 4-506(2) the Commission stated that proposal in statutory language.

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¹⁵⁰ See COMMISSION REPORT, supra note 6, at 10-11.
¹⁵¹ Id. at 12. It is also interesting to note the testimony of Los Angeles attorney Bernard Shapiro, before the House: "This has caused considerable debate and controversy; it is, to some, a serious moral issue. I think to all it is a moral issue, yet, there has been such abuse concerning consumer false financial statements and so much vexing litigation over it, and it consumes so much time in the bankruptcy courts, that the Commission felt it should be eliminated as a ground for nondischargeability in consumer cases." House Hearings, supra note 5, at 973.

The Bankruptcy Commission, in its prepared statement before the Senate Hearings stated: "It has been alleged and believed by many that the principal function of a false financial statement is to provide the lender with a weapon or lever to enforce collection after a discharge, typically by obtaining a default judgment, or to coerce reaffirmation of a discharged debt." Senate Hearings, supra note 4, at 9.

The Commission's proposal, however, is not universally accepted. Also speaking at the Senate Hearings, Bankruptcy Judge Conrad K. Cyr, (on behalf of the National Conference of Bankruptcy Judges) testified that the Commission’s proposal “is not in accord with the standards which prevail in the credit marketplace,” and represents a "retreat from the commitment of assuring ready access to a fair and impartial judicial forum for consumer credit grantors and borrowers alike." Id. at 62. Opponents to the Commission proposal generally express concern that dishonest debtors may willfully make a false financial statement but nonetheless be discharged from the debt. See, e.g., id. at 129 (statement of Walter C. Vaughn, American Bankers Ass’n & Consumers Bankers Ass’n); id. at 143-44 (statement of Alvin O. Wiese, Jr., Chairman of the Subcomm. on Bankruptcy of the Law Forum of the Nat'l Consumer Fin. Ass'n); id. at 196-97 (statement of Linn K. Twinem, Beneficial Fin. System).

Mr. Twinem's testimony indicated that creditors generally believe that the 1970 amendments offer debtors adequate protection with regard to false financial statements. Under those amendments a bankruptcy judge must determine: (1) whether the statement is materially false; (2) whether the statement was made with the intent to deceive; and (3) whether the creditor relied upon the statement. Id. at 196.

The Bankruptcy Commission and the National Consumer Law Center, however, both disagreed with this creditor argument. Professor Richard A. Hesse, consultant to the National Law Center, described an informal survey conducted by the National Consumer Law Center of legal service attorneys that involved over 3,000 cases since the implementation of the 1970 amendments. The survey disclosed that false financial statement problems still occur in 14% of the cases. Id. at 328. Professor Hesse goes on to say that

[T]he same problems to which the 1970 amendments presented themselves are still present; that is, the debtor is encouraged not to list everything on the financial statement, and the bankruptcy court is willing to draw the conclusion that the failure to list other creditors on the financial statement was done with the intent to deceive.

Id. at 328.
The Commission also included several provisions regulating the great game. One has not been discussed. Under section 4-506(b), which in some respects resembles the present section 17(c)(1), either the debtor or a creditor may request the bankruptcy court to determine the dischargeability of a debt. The concluding sentence of this subsection would bring a portion of the great game under public scrutiny. It reads as follows: "An agreement entered in good faith and approved by the court settling litigation to determine the dischargeability of a debt may be enforced against the debtor."^152

The related provision in section 4-504(b) which allows enforcement of an agreement to redeem property was discussed earlier. The rule in section 4-507 prohibiting a reaffirmation of debts provides an exception for section 4-504(b) and section 4-506(b) agreements.

Neither the House nor the Senate version adopts the Commission's proposal regarding false financial statements. Both contain an exception to discharge resembling very closely the provision of the present law found in section 17(a)(2). In section 523(a)(2)(B) of the House version a discharge does not cover a debt

for obtaining money, property, services, or an extension or renewal of credit by . . . use of a statement in writing (i) that is materially false; (ii) respecting the debtor's financial condition; (iii) on which the creditor to whom the debtor is liable for obtaining such money, property, services, or credit reasonably relied; and (iv) that the debtor made or published with intent to deceive.\(^153\) That provision presents a formidable list of obstacles to a creditor using it as a basis for objecting to discharge of the debt owed to him. However, a similar set of obstacles appears in the present law and does not deter creditors who, as the Commission noted, would continue to harass debtors seeking the relief of bankruptcy with charges of false financial statements. Arguably, debtors in bankruptcy are less well represented than creditors and are not prepared to meet these allegations. The House version in section 523(d) directs the court to "award to the debtor the costs of, and a reasonable attorney's fee for, the proceeding to determine dischargeability" when it decides in a consumer-debtor's favor on a false financial statement allega-

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152. Commission Bill, supra note 6, § 4-506(b).
The court would also award the debtor any damages resulting from the proceeding. The Senate version would permit attorney's fees only when the court found that "the proceeding was frivolous and not brought by the creditors in good faith." The prospective attorney's fees would give debtors' counsel an incentive to contest these challenges to dischargeability more vigorously. Whether creditors would be deterred from routinely alleging a false financial statement would depend on how vigorously debtors' attorneys respond. The House version contains in section 524(c)(1) the provision for settlement of litigation concerning dischargeability which was noted in the Commission bill. In view of the provision for attorney's fees one must ask whether such a settlement could include a fee for the debtor's attorney. If such a fee becomes a routine part of settlement agreements, the debtor's attorney would always have an incentive to settle rather than contest the creditor's challenge to dischargeability at the risk of losing his fee. In that event creditors would continue to routinely allege false financial statements.

As noted earlier, the Senate version contains a general permission to revive or reaffirm debts. Thus, it does not need a separate provision for revival in settlement of an objection to discharge. The principal check on revival is found in section 524(b) which permits a debtor to rescind or reaffirm within thirty days. When the debtor is represented by an attorney whose fee may be related to the revival or reaffirmation in settlement of or an objection to discharge, one may question whether he will advise the debtor to rescind within thirty days.

The Commission bill in section 4-506(a)(3) excepts from discharge any debt incurred within ninety days before bankruptcy "without the intention . . . to pay the debt and in contemplation of the filing of a petition." The House version

154. Id. § 523(d).
155. Senate Bill, supra note 9, § 523(d).
156. Since the Senate bill allows for revival and reaffirmation, id. § 524(b), section 524(c)(1) of the House version became unnecessary and was not carried over.
157. House Bill, supra note 6, § 523(d).
158. Commission Bill, supra note 6, § 4-506(a)(3).

Both bills cover the question of "loading up," that is the practice of certain debtors of running up substantial debts in the period immediately prior to the filing of the petition at a time when they were so hopelessly insolvent that it is obvious there was no ability or intent to repay. There has been an attempt made in both bills to meet this problem, by providing that debts incurred within ninety days of filing without intention to
does not contain a similar provision. Arguably, the provision in the Commission bill was an exchange for agreement on abolishing the false financial statement exception to discharge in consumer cases. When this exception was restored in the House version there no longer was a need for the exchange.

If one leaves aside this compromise found in section 4-506(a)(3), the Commission’s elimination in consumer cases of the false financial statement exception to discharge is preferable from the consumer’s view to the related provisions of the House and Senate versions. Arguably, neither the false financial statement exception nor the provision in section 4-506(a)(3) is necessary to protect creditors in consumer cases. Alert use of modern credit checking should prevent most flagrant abuses of credit by consumers. Those who extend credit as part of their business can easily absorb the odd occasional instance of flagrant abuse which escapes normal precautions. Creditors can determine whether it is in their interest to tighten credit checking to reduce minor abuses. If these provisions are not necessary to protect creditors then their elimination would have no significant impact on the availability or cost of credit.

Retaining either the false financial statement exception, as the House and Senate versions do, or the provision found in section 4-506(a)(3) of the Commission bill would adversely affect other public interests. Both provisions interfere with the debtor’s rehabilitation by burdening him with debts after bankruptcy. Rehabilitation of debtors is a purpose of modern bankruptcy supported by the public interest in promoting the productivity of economic units and preserving human dignity. In view of the long continued abuse by creditors of the false financial statement exception in consumer cases it would make sense to eliminate this exception to discharge and leave creditors to the other resources and tools noted above to protect against abuse of consumer credit. To continue the false financial statement exception would be to continue a sporting theory of discharge, that is, to allow the creditors a fair chance to catch their quarry before letting him escape forever. The image of the great game may provide insight into how bankruptcy is repay and in contemplation of the filing can be excepted from the discharge. It is our [American Bankers Association] belief that this attempt has been rendered almost completely ineffectual by the requirement of a showing of intent to file a bankruptcy proceeding [sic].

House Hearings, supra note 5, at 1026 (statement of Walter W. Vaughn).
actually played but it is not in the public interest to concentrate on promoting the sporting aspects of bankruptcy.

Some may contend that the false financial statement exception should be continued for the purpose of punishing debtors who employ such statements or to deter others from using them. The deterrent effect is probably nonexistent; very few debtors, particularly consumer-debtors, would be aware of this provision of bankruptcy law at the relevant moment for deterrence. It is not in the public interest to use bankruptcy as a punitive law. If any law should serve that function it should be the criminal law. Bankruptcy should promote human dignity, the productivity of economic units and the proper functioning of the credit system.

For these reasons, the Commission's position in regard to the false financial statement exception to discharge should be adopted without its provision in section 4-506(a)(3). If the position found in the House version prevails, some care should be taken regarding attorney's fees in agreements settling litigation concerning discharge. If there is a greater incentive to settle than litigate, the provision of attorney's fees for successful litigation would not reduce creditor abuse of the false financial statement exception to discharge. Continuation of these abuses after enactment of the House version should provide a basis for future change in its discharge provisions.

CONCLUSION

Hopefully the reader has seen a portrait emerging during this article of a new bankruptcy law now being born through the law-making process whose characteristic features are becoming fixed. The final moments of birth may be imminent, or hopefully, in the interest of consumer-debtors or for other purposes, may be postponed. Our vision of the choices available in the enacting process is still fresh. At this vantage point in time one can review the likely provisions of the new law and compare the choices taken with those not taken. Perhaps one can locate provisions worth watching to see how they work in practice. The provisions selected for comment in this article are those which affect consumer-debtors. Arguably these provi-

159. See id. at 898-902 (statement of Linn K. Twinem).
160. See Senate Hearings, supra note 4, at 865 (testimony of Samuel J.M. Donnelly). See also Senate Hearings, supra note 4, at 315, 329-30 (testimony of Richard A. Hesse).
sions are among those most worth watching. Since consumer-debtors were the least able to protect their interests in the enactment process, the provisions affecting them may be among those producing intriguing results which should be followed with close scrutiny accompanied by empirical research.

A methodology has been offered for locating and evaluating the provisions which would most seriously affect the interests of consumer-debtors and which would determine for them the characteristic features of the new law. One should examine the provisions in any proposal which are related to the structural features of modern bankruptcy law to determine how the suggested provisions would affect the consumer-debtor's ability to avoid bankruptcy or to choose the appropriate form of proceeding voluntarily, to bring a reasonable amount of property through bankruptcy, and to obtain a discharge covering most of his debts. Arguably, provisions are peripheral which are not related to these fundamental concerns which the structure of bankruptcy law creates for the consumer-debtor. When one has described the impact of a provision on the basic interests of a consumer-debtor, one can then evaluate it in view of the public interest. By using this methodology, one can assess the impact of the proposal on the twin purposes of modern bankruptcy law, to rehabilitate the debtor and to provide an orderly process for collection and distribution of his estate, and on the more fundamental national concerns which logically support these purposes. Arguably, the fundamental national interests which support a bankruptcy law are concern for the preservation of credit, for promotion of human dignity and for increasing the productivity of economic units.

Using this method, we have found in the Commission bill and in the House and Senate versions a number of provisions, sometimes in alternate form, which would promote or detract from the interests of consumer-debtors.

One set of provisions, including some discussed under discharge, relate to the initiation and choice of bankruptcy proceedings. There appears to be a trend towards increasing the

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161. See notes 4-6 and accompanying text supra.

162. Compare the purpose behind analyzing the impacts of the proposed bankruptcy laws on the consumer-debtor as the "least advantaged class," with the discussion of the difference principle in J. Rawls, supra note 11, at 75.

163. See Commission Bill, supra note 6, §§ 4-201, 4-204, 4-205, 4-505(7); House Bill, supra note 6, §§ 301, 302, 303, 305, 727(a)(8). See also notes 25-47, 144-145 and accompanying text supra.
number of involuntary bankruptcies for consumer-debtors, hindering voluntary bankruptcy, and emphasizing wage earners’ proceedings either as a substitute for voluntary or as an escape from involuntary bankruptcy.

All three proposed bills make it easier for a creditor to have a debtor adjudicated a bankrupt without his consent. The Commission bill offers a creditor a range of incentives for employing an involuntary petition. Among these are the ability to reach assets exempt under state law but not in bankruptcy (particularly in states with large homestead exemptions),\(^{164}\) to collect during the five year period following a bankruptcy any nonexempt property without allowing the debtor a discharge unless he converts to a wage earners’ proceeding,\(^{165}\) and to forcefully persuade a debtor to initiate a wage earners’ proceeding which would give the creditors access to future income in an amount larger than permitted by the garnishment laws of many states.\(^{166}\) An important provision in the House version allows the debtor to choose the state exemptions rather than the uniform exemptions in the bankruptcy law.\(^{167}\) This removes some incentives for using involuntary petitions. Such incentives are also removed by the Senate’s elimination of federal exemptions. In states whose homestead exemptions equal or are less than the federal exemption ($10,000), creditors under the House version may use bankruptcy as a device for collecting from debtors, such as the elderly, who have substantially paid for homes. This incentive will be more generally present if the Senate’s removal of federal minimums is accepted. The other incentives for filing an involuntary petition continue under the House version and in some instances are stronger. A debtor under the House version must wait six rather than five years between discharges, which would increase the incentive for using an involuntary petition in the interim.\(^{168}\) A creditor filing an involuntary petition may be influenced by a number of overlapping incentives. He may desire, for example, either

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164. This would be the case where the state homestead exemption is greater than $5,000. See Commission Bill, supra note 6, § 4-503(b)(1); notes 56-60 and accompanying text supra.
165. See Commission Bill, supra note 6, § 4-505(7).
166. See generally Commission Bill, supra note 6, ch. VI; notes 72-75 and accompanying text supra.
167. See House Bill, supra note 6, § 522(b)(2)(A); note 123 and accompanying text supra.
168. See House Bill, supra note 6, § 727(a)(8); notes 145-148 and accompanying text supra.
an elderly person's home or access in substantial amounts to that person's future income from a pension or other sources. It would be harder for a creditor to thrust a debtor into involuntary bankruptcy under the House version than under the Commission bill. Nevertheless, it would often be easy for three institutional creditors to cooperate in the filing of involuntary petitions against pre-established types of consumer-debtors. Despite the higher debt required ($5,000) and the higher exemptions available, the incentive for filing involuntary petitions would be present in many instances.

The probably proper elimination of the acts of bankruptcy as the basis for an involuntary petition is the step which would make possible the list of undesirable consequences just enumerated. The most effective tool for guarding against these consequences would be an exemption from involuntary bankruptcy for those with regular income or, in the alternative, for those who earn less than some specified amount such as $20,000 or $30,000. Arguably, this would continue the design of the present law where the provision exempting wage earners with incomes of $1,500 or less has become obsolete due to inflation.169

The Commission bill requires counseling concerning wage earners' proceedings for those filing voluntary petitions.170 Despite the Commission's finding that the number of voluntary petitions is not excessive, the House and Senate versions place a more substantial obstacle before those seeking voluntary relief. The bankruptcy judge has the power to abstain in a voluntary or involuntary proceeding unless the bankruptcy would be in the better interest of the debtor and his creditors.171 Unless the judge's power to abstain is restricted to involuntary bankruptcies, consumer-debtors would be deprived of the free access to relief from debts which has been available since 1898. In view of the Commission's finding, restriction of that free access would not appear necessary to the preservation of credit and would often reduce productivity by compelling a debtor to struggle with the weight of his debts either privately or through a wage earners' proceeding. Arguably, free access to relief from debts is important for the preservation of human dignity.

169. The Senate insertion of the words "major portion" in the insolvency test of section 303(h)(1) would contribute to controlling these undesirable consequences.
170. Commission Bill, supra note 6, § 4-203(a); see notes 78-80 and accompanying text supra.
171. House Bill, supra note 5, § 305(a)(1); see notes 41-46 and accompanying text supra.
The provisions which encourage involuntary while restricting voluntary bankruptcy fit into a pattern in which there is an emphasis upon wage earners' proceedings and upon the financial counseling and education of consumer-debtors. Involuntary bankruptcy would provide the leverage to encourage debtors to file petitions in wage earners' proceedings. Debtors would be persuaded or compelled to use wage earners' proceedings when they seek voluntary relief. While it is desirable to make these proceedings more attractive and useful to debtors, it would seem overly paternalistic to compel debtors by the pressures described in this article to file petitions in wage earners' proceedings. Unless Congress intends to have a very substantial number of debtors (perhaps 750,000 during any given year) under the supervision of the federal bankruptcy courts, consumer-debtors should be allowed to file voluntary petitions without hindrance and should be exempt from involuntary bankruptcy.

There are provisions attractive to consumers in both the Commission bill and the House version. A number of these relate to the great game in which debtors seek to preserve property while obtaining a discharge and creditors seek either payment or the survival of debts despite the discharge. The increased attractiveness of wage earners' proceedings would allow some consumers to arrange their affairs sensibly. Hopefully consumers would not have to pay the price just described in exchange for this improvement. Both the House version and the Commission bill bring the problem of reaffirmations and agreements settling objections to the dischargeability of debts under public scrutiny. The Senate version contains an intriguing but perhaps ineffective provision on this point. Creditors, however, achieved a significant victory when the drafters of the House version were persuaded to restore the false financial statement exception to discharge of a consumer debt. This victory could provide a basis for substantial interference with the rehabilitation of debtors, especially if debtors' attor-

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172. See Commission Bill, supra note 6, §§ 4-403(b)(8), 4-503, 4-506, 4-507(a); House Bill, supra note 6, §§ 522, 523. See also notes 144-160 and accompanying text supra.
173. See Commission Bill, supra note 6, § 4-507(a); House Bill, supra note 6, §§ 524(b), 722. See also notes 92-106 and accompanying text supra.
174. Senate Bill, supra note 9, § 524(b).
175. See House Bill, supra note 6, § 523(a)(2)(B); text accompanying note 153 supra.
neys have an incentive to settle disputes concerning dischargeability. The Commission's position on false financial statements in consumer transactions should be accepted. If creditor pressure forces rejection of the exception for consumer debts from this bar to dischargeability, then debtors' attorneys should not receive a fee in settlement agreements but should be compensated for successful litigation of dischargeability.

A number of other provisions favorable to consumer-debtors were discussed. For example, the exemption provisions in the House version are a substantial improvement from the consumer's view over those in the Commission bill. The exemption provisions and others affect the basic interests of the consumer-debtor. Some provisions favorable to the consumer such as the unconscionability sections of the Commission bill do not seriously affect these basic interests and could be described as window dressing.

The House version, which has been highly influenced by the continuing concern and effort of California Congressman Don Edwards, will probably become law, hopefully with some of the changes recommended in this article and some of the better provisions found in the Senate version. Such continuing dedication to revision of a major segment of federal law deserves the type of scrutiny which law reviews provide for important court decisions. The impact of important legislation should be reviewed during the enactment process for the purpose of evaluating its provisions, suggesting changes in them, and providing a basis for a post-enactment audit. If experience shows that some provisions produce undesirable results, further change should follow. Hopefully, those concerned with protecting consumer-debtors will follow, as well as predict, the impact on consumer interests of the structural provisions of the emerging bankruptcy law and will urge the necessary changes on Congress.

176. See note 158 and accompanying text supra.
177. See notes 123-142 and accompanying text supra. Compare House Bill, supra note 6, § 522(b)(2)(A), (d)(1)-(12) with Commission Bill, supra note 6, § 4-503(b)(1), (C)(1)-(9).
178. Commission Bill, supra note 6, § 4-403(b)(8), (c); see notes 106-113 and accompanying text supra.