Volume 58 | Number 4 Article 3

4-1-1980

# Caveat Creditor: The Consumer Debtor under the Bankruptcy Code

Marc S. Cohen

Kenneth N. Klee

# CAVEAT CREDITOR: THE CONSUMER DEBTOR UNDER THE BANKRUPTCY CODE

MARC S. COHEN†
KENNETH N. KLEE‡

## I. INTRODUCTION

One of the principal reforms attempted by the new bankruptcy law[1] was the invigoration of the fresh start for the consumer debtor.[2] Building upon recommendations[3] of the Commission on the Bankruptcy Laws of the United States,[4] Congress passed a law[5] that provides a consumer debtor[6] significant relief from his debts.[7]

In particular, the Code permits an honest[8] debtor to file[9] a liquida-

† B.A. 1971, Cornell University; J.D. 1974, New York University. Mr. Cohen practices bankruptcy and insolvency law with Sidley & Austin in Los Angeles, California.

‡ B.A. 1971, Stanford University; J.D. 1974, Harvard University. While serving as Associate Counsel for the House Judiciary Committee from 1974 through 1977, Mr. Klee, along with Richard Levin, was primarily responsible for drafting the Bankruptcy Reform Act of 1978. Mr. Klee practices bankruptcy and insolvency law with Stutman, Treister & Glatt, P.C. in Los Angeles, California. 

1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. The substantive law of bankruptcy is contained in Title I of Pub. L. No. 95-598 (codified at 11 U.S.C.A. (West 1979)) [hereinafter referred to as the Code].

2. *See* H.R. REP. No. 95-595, 95th Cong., 2d Sess. 4, 116-73 (1977) [hereinafter cited as HOUSE REPORT], *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6076-6134; S. Rep. No. 95-989, 95th Cong., 2d Sess. 2-3 (1978) [hereinafter cited as SENATE REPORT], *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5787-89.

3. H.R. DOC. NO. 93-137, 93d Cong., 1st Sess., pt. I, at 33-59 (1973).

4. Congress created the Commission on the Bankruptcy Laws of the United States [hereinafter referred to as the Commission] in 1970. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. On July 31, 1973, the Commission filed a two-part report with Congress. H.R. DOC. No. 93-137, 93d Cong., 1st Sess. (1973). The first part of the report contained recommendations relating to bankruptcy reform, and the second part was a proposed statute embodying the suggested reforms. *Id.*

5. Pub. L. No. 95-598, 92 Stat. 2549 (1978).

6. Under the Code, the term "bankrupt" is abolished in favor of the term "debtor." *See* 11 U.S.C.A. § 101(12) (West 1979).

7. *See, e.g., id.* §§ 522, 523, 524, 525, 722 & 727 [hereinafter citations to sections refer to sections of title 11 unless otherwise specified].

8. If a debtor commits an act proscribed by *id.* § 727(a), then the debtor's discharge may be denied. *See* text accompanying notes 200-33 *infra.*

9. Sections 109(a) and (b) specify who may be a debtor in a liquidation case under Chapter 7. 11 U.S.C.A. §§ 109(a), (b) (West 1979). Under § 301, a person who may be a debtor is authorized to file a voluntary petition commencing a liquidation case under Chapter 7. *Id.* § 301. Section 1930(a)(1) of title 28 of the United States Code requires that the petitioner pay a $60 filing fee to the clerk of the bankruptcy court. 28 U.S.C.A § 1930(a)(1) (West 1979).

tion case[10] and to be relieved[11] of his dischargeable[12] debts. To receive a discharge, all the debtor is required to do is to perform certain duties[13] and to surrender his nonexempt[14] property for distribution[15] to creditors.[16] The debtor is permitted to immunize exempt[17] property from distribution to creditors with dischargeable[18] unsecured[19] debts, and for the first time, Congress has provided a pervasive system of federal exemptions, which may[20] be elected as an alternative[21] to traditional state and federal nonbankruptcy exemptions.[22]

The Code also arms the debtor with new powers to avoid certain transfers,[23] to invalidate certain liens,[24] and to redeem tangible personal property from liens.[25] Thus, the Code may enable the debtor to achieve a fresh start by altering creditors' property interests.

Finally, the Code contains provisions that protect the discharge of

10. A liquidation case under Chapter 7 of the Code is the analogue of a straight bankruptcy case under the Bankruptcy Act.

11. The relief granted to a debtor who receives a discharge is described in §§ 524 & 525. 11 U.S.C.A. §§ 524 & 525 (West 1979). *See* text accompanying notes 337-372 and 392-399 *infra.*

12. Certain debts are excepted from discharge of an individual debtor in a Chapter 7 case under § 523(a). *See id.* § 523(a), text accompanying notes 257-317 *infra.*

13. *See, e.g., id.* §§ 521 & 727(a)(6). *See also* text accompanying notes 38-43 and 217-222 *infra.*

14. The filing of a voluntary petition under § 301 creates an estate comprised of all the debtor's interests in property. *Id.* §§ 301 & 541. All the debtor's property is property of the estate, excluding spendthrift trusts and property that is exempted subsequently under § 522(b). *See id.* § 522(b); text accompanying notes 74-152 *infra.*

15. Distribution in a liquidation case is provided for in *id.* §§ 725 & 726.

16. The term "creditor" is defined in § 101(9) as an

> entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor; . . . [or an] entity that has a claim against the estate of a kind specified in section 502(f), 502(g), 502(h), or 502(i) of this title; or . . . [an] entity that has a community claim.

*Id.* § 101(9).

17. Exempt property is property that may be excluded from the estate under *id.* § 522(b). *See* text accompanying notes 75-154 *infra.*

18. The effect of a discharge under § 524 of the Code applies only to those debts that are not excepted from discharge under § 523(a). *Id.* §§ 523(a) & 524. *See* text accompanying notes 258-317 and 337-372 *infra.*

19. The relief accorded to a debtor receiving a discharge under § 524 does not prevent the enforcement of a valid lien against exempt property. *Id.* § 522(c). *See* text accompanying notes 153-154 *infra.*

20. The federal exemptions may be elected unless the state of the debtor's residence passes a law forbidding that election. *Id.* § 522(b)(1). *See* text accompanying notes 89-90 *infra.*

21. The Code exemptions are mutually exclusive from traditional state and federal nonbankruptcy exemptions. *See id.* § 522(b) and text accompanying note 84 *infra.*

22. *See* text accompanying notes 81-90 *infra.*

23. *Id.* § 522(h); *see* text accompanying notes 169-173 *infra.*

24. *Id.* §§ 522(f) & 724(a); *see* text accompanying notes 158-163 *infra.*

25. *Id.* § 722; *see* text accompanying notes 179-194 *infra.*

the debtor[26] and that prohibit certain discrimination against the debtor based on bankruptcy.[27] Moreover, the bankruptcy court has jurisdiction[28] to enforce these provisions after the case is closed.[29]

## II. THE DEBTOR'S DUTIES, EXAMINATION, AND IMMUNITY

### *A. The Debtor's Duties*

Section 521 of the Code, entitled "debtor's duties," lists four duties of the debtor in a bankruptcy case. That section requires the debtor to: (1) file a list of creditors, a schedule of assets and liabilities, unless the court orders otherwise, and a statement of financial affairs;[30] (2) cooperate with the trustee as necessary to enable the trustee to perform duties under title 11;[31] (3) surrender to the trustee all property of the estate and any recorded information[32] relating to property of the estate;[33] and (4) appear at the discharge hearing.[34]

The list of duties set forth in section 521 is not exhaustive, however.[35] Other duties are listed elsewhere in the Code, as in section 343, which requires the debtor to appear and submit to examination under

26. *See id.* §§ 524(a)-(d) and text accompanying notes 337-386 *infra.*

27. *See id.* § 525 and text accompanying notes 392-399 *infra.*

28. *See* 28 U.S.C.A. §§ 1471(b) & (c) (West 1979), which confer original but not exclusive jurisdiction on the bankruptcy court with respect to proceedings related to a case under Title 11. *See also* HOUSE REPORT, *supra* note 2, at 445, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6400-6401; SENATE REPORT, *supra* note 2, at 154, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5940.

29. *See* 11 U.S.C.A. § 350 (West 1979).

30. *Id.* § 521(1). *See* FED. BANKR. R. 108(a). The Bankruptcy Rules should be consulted with regard to the debtor's duties. Section 405(d) of Pub. L. No. 95-598, 92 Stat. 2685 (1978), provides for the continued applicability of these Rules, to the extent they are not inconsistent with the Code, until new rules are promulgated.

31. 11 U.S.C.A. § 521(2) (West 1979). "This duty on the part of the debtor necessarily must be stated in general terms because section 521 is applicable to cases under Chapter 7, 11 or 13, each of which chapters set forth the duties of a trustee serving in a case under that particular chapter." 3 COLLIER ON BANKRUPTCY, ¶ 521.10 (15th ed. 1979). The duties of a trustee in Chapter 7 are set forth in 11 U.S.C.A. § 704 (West 1979); in Chapter 11 the duties are enumerated in *id.* § 1106(a); and in Chapter 13 the duties of a trustee are set forth in *id.* § 1302(b)(1).

32. "Recorded information" includes books, documents, records, and papers, *id.* § 521(3), as well as other forms of recorded information such as data in computer storage or in other machine readable forms. HOUSE REPORT, *supra* note 2, at 359-60, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6315.

33. 11 U.S.C.A. § 521(3) (West 1979). *See also id.* § 542(e), which provides that, subject to any applicable privilege, the court may order an attorney, accountant, or other person who holds recorded information relating to the debtor's property or financial affairs to disclose that information to the trustee.

34. *Id.* § 524(d). *See* text accompanying notes 384-386 *infra.*

35. HOUSE REPORT, *supra* note 2, at 360, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6316.

oath at the meeting of creditors,[36] or are found in the Rules of Bankruptcy Procedure, such as the debtor's duty to attend the hearing on any objection to discharge.[37]

Moreover, section 521 is intertwined with other provisions of the Code and related statutes. For example, the debtor will be denied a discharge if the debtor knowingly and fraudulently, in or in connection with the case, made a false oath or account,[38] or withheld from the trustee any recorded information relating to the debtor's property or financial affairs.[39] The same conduct could constitute the commission of a bankruptcy crime[40] or provide grounds for revocation of discharge.[41] Another example of the relationship between the duties set forth in the "debtor's duties" section and other provisions of the Code is a provision that excepts from discharge, under certain conditions,[42] debts that the debtor failed to list or schedule under section 521(1).[43]

### *B. Examination*

The Code requires the debtor to appear at a meeting of creditors[44] and submit to an examination under oath.[45] The examination may be conducted by creditors, by any indenture trustee, or by any trustee or examiner in the case.[46] In pilot districts the United States Trustee may examine the debtor as well.[47]

The requirement to appear and submit to examination by creditors[48] is derived from the Bankruptcy Act,[49] and the purpose of the examination "is to enable creditors and the trustee to determine if as-

36. 11 U.S.C.A. § 343 (West 1979).

37. FED. BANKR. R. 402(2). The trustee or creditor may object to the debtor's discharge under 11 U.S.C.A. § 727(c)(1) (West 1979).

38. 11 U.S.C.A. § 727(a)(4)(A) (West 1979).

39. *Id.* § 727(a)(4)(D).

40. 18 U.S.C. § 152 (West 1979). *See* HOUSE REPORT, *supra* note 2, at 384, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6340.

41. 11 U.S.C.A. § 727(d) (West 1979).

42. *See* text accompanying notes 281-287 *infra.*

43. 11 U.S.C.A. § 523(a)(3) (West 1979).

44. *Id.* §§ 341(a) & 343. The court is required to call a meeting of creditors to be held not less than 20 nor more than 40 days after the order for relief. FED. INTERIM BANKR. R. 2003. In a voluntary case, the date of the order for relief is the date of the filing of the petition. 11 U.S.C.A. § 301 (West 1979).

45. 11 U.S.C.A. § 343 (West 1979).

46. *Id.*

47. *Id.* § 15343.

48. *Id.* § 343.

49. Section 21a of the Bankruptcy Act provided that "[t]he court may, upon application of any officer, bankrupt, or creditor, by order require any designated persons, including the bankrupt

sets have been disposed of improperly or concealed or if there are grounds for objection to discharge."[50] The scope of examination continues to be governed by Bankruptcy Rule 205.[51]

### C. *Immunity*

The immunity section of the Code[52] provides that "[i]mmunity for persons required to submit to examination, to testify, or to provide information in a case under this title may be granted under part V of title 18." Part V of title 18 of the United States Code governs the granting of immunity to witnesses before federal tribunals.[53]

Prior law — section 7a(10) of the Bankruptcy Act — provided that "no testimony, or any evidence which is directly or indirectly derived from such testimony, given by [the bankrupt] . . . shall be offered in evidence against him in any criminal proceeding, except such testimony as may be given by him in the hearing upon objections to his

---

and his or her spouse, to appear before the court . . . to be examined concerning the acts, conduct, or property of the bankrupt." Bankruptcy Act § 21a, 11 U.S.C. § 44 (repealed 1978).

50. HOUSE REPORT, *supra* note 2, at 332, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6288.

51. *Id.* FED. BANKR. R. 205(d) provides: "The examination . . . may relate only to the acts, conduct, or property of the bankrupt, or to any matter which may affect the administration of the bankrupt's estate, or to his right to discharge."

52. 11 U.S.C.A. § 344 (West 1979).

53. The relevant sections of part V state:

> "[O]ther information" includes any book, paper, document, record, recording or other material.

18 U.S.C. § 6001(2)(1976).

> Whenever a witness refuses, on the basis of his privilege against self-incrimination, to testify or provide other information in a proceeding before . . . a court . . . of the United States . . . and the person presiding . . . communicates to the witness an order issued under this part, the witness may not refuse to comply with the order on the basis of his privilege against self-incrimination; but no testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information) may be used against the witness in any criminal case.

*Id.* § 6002.

> (a) In the case of any individual who has been or may be called to testify or provide other information at any proceeding before . . . a court of the United States . . . the United States district court for the judicial district in which the proceeding is or may be held shall issue, in accordance with subsection (b) of this section, upon the request of the United States attorney for such district, an order requiring such individual to give testimony or provide other information which he refuses to give or provide on the basis of his privilege against self-incrimination, such order to become effective as provided in section 6002 of this part. (b) A United States attorney may, with the approval of the Attorney General, the Deputy Attorney General, or any designated Assistant Attorney General, request an order under subsection (a) of this section when in his judgment (1) the testimony or other information from such individual may be necessary to the public interest; and (2) such individual has refused or is likely to refuse to testify or provide other information on the basis of his privilege against self-incrimination.

*Id.* § 6003.

discharge."[54] The protection afforded under section 7a(10) arose, however, only when the bankrupt was required by statute to testify, as at the first meeting of creditors and at any other hearings that the court might direct.[55] Accordingly, the bankrupt's testimony was not immune at any hearings on objections to his discharge,[56] or in any proceeding in which the bankrupt, though called as a witness, was not under a duty to testify.[57] Moreover, the immunity granted under section 7a(10) pertained only to oral testimony given by the bankrupt.[58] The immunity generally did not protect the schedules required to be filed, nor did it protect the books and records of the bankrupt.[59]

Following the passage of the Organized Crime Control Act,[60] and the amendment of former section 7a(10) to provide that immunity applied not only to testimony, but also to any evidence directly or indirectly derived from testimony,[61] one court determined that section 7a(10) was sufficiently broad to constitute a grant of immunity coextensive with the protections of the fifth amendment.[62] Accordingly, a bankrupt could be compelled to testify in a bankruptcy case or risk a denial of discharge.[63] As noted, however, section 7a(10) did not cover books and records, nor did it protect testimony given at the discharge hearing.

In accordance with prior law, the immunity section of the Code[64] provides for the grant of "use and derivative use"[65] immunity by incorporating part V of title 18. To the extent immunity may be granted to witnesses other than the debtor, the effect of the Code's immunity section is not new; under prior law, immunity for witnesses in bankruptcy

54. Bankruptcy Act § 7a(10), 11 U.S.C. § 25(a)(10) (1976) (repealed 1978).

55. *Id.*

56. This testimony is specifically excluded from the immunity proviso of § 7a(10) of the Bankruptcy Act. *Id.*

57. *See* Goldstein v. United States, 11 F.2d 593, 594 (5th Cir. 1926).

58. *See* Ensign v. Pennsylvania, 227 U.S. 592, 599-601 (1913).

59. *See* 1A COLLIER ON BANKRUPTCY ¶ 7.21[4] (14th ed. 1978); Note, *Bankrupt's Immunity From The Use or Derivative Use of His Bankruptcy Testimony in a Subsequent Criminal Proceeding*, 25 DRAKE L. REV. 465, 478-81 (1975).

60. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 927 (codified at 18 U.S.C. § 6002 (1976)).

61. The amendment established a "use and derivative use" standard for § 7a(10). *See* Kastigar v. United States, 406 U.S. 441, 449-62 (1972).

62. Goldberg v. Weiner, 480 F.2d 1067 (9th Cir. 1973).

63. Bankruptcy Act § 14c(6), 11 U.S.C. § 32(c)(6) (1976) (repealed 1978). *See* 1A COLLIER ON BANKRUPTCY ¶¶ 14.56-14.58 (14th ed. 1978).

64. 11 U.S.C.A. § 344 (West 1979).

65. *See* Kastigar v. United States, 406 U.S. 441, 462 (1972).

cases was already governed by part V of title 18.[66]

In other respects, the Code's immunity section is a major departure from prior law. It provides that immunity may be granted under part V of title 18 to persons, including debtors, required to submit to examination, to testify, or to provide information in a bankruptcy case. Immunity is discretionary; part V of title 18 permits only the Attorney General or a United States attorney to request the grant of immunity, though it must be granted upon request.[67] If immunity is granted, the debtor-witness is required to testify or lose his discharge; if immunity is not granted, the debtor safely may claim the privilege against self-incrimination without risking loss of the discharge.[68]

Arguably, the Code extends the grant of immunity to the debtor's books and records through its conformity to title 18 immunity.[69] The Code does require the debtor, however, to "surrender all . . . books, documents, records, and papers, relating to the property of the estate,"[70] and it also provides for the surrender of the debtor's books and records by attorneys, accountants, and other third persons.[71] Since there is no constitutional immunity from the use of books and records once they are removed from the debtor's possession and control,[72] these provisions may negate any grant of immunity to books and records otherwise provided by the Code.

Also in contrast to prior law, the Code does not provide automatic protection for testimony freely given; the privilege against self-incrimination must be asserted initially by the debtor before immunity may be requested by the Attorney General or United States attorney and

66. HOUSE REPORT, *supra* note 2, at 332, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6288-89.

67. 18 U.S.C. § 6003 (1976).

68. HOUSE REPORT, *supra* note 2, at 332, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6289. *See* text accompanying notes 219-21 *infra*.

> Under section 727(a)(6) of the proposed title 11, a debtor is only denied a discharge if he refuses to testify after having been granted immunity. If the debtor claims the privilege and the United States attorney does not request immunity from the district courts, then the debtor may refuse to testify and still retain his right to a discharge. It removes the Scylla and Charibdis choice for debtors that exists under the Bankruptcy Act.

*Id.* at 333, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6289.

69. The grant of immunity under part V of title 18 extends to "testimony or other information." 18 U.S.C. § 6002 (1976). "Other information" is defined in *id.* § 6001 to include "any book, paper, document, record, recording or other material." *See generally* A. Kurland, *A Debtors Prism: Immunity For Bankrupts Under The Bankruptcy Reform Act of 1978* 55-63 (1979) (unpublished manuscript on file in the offices of the *UCLA Law Review*).

70. 11 U.S.C.A. § 521(3) (West 1979).

71. *Id.* § 542(e).

72. *See* 2 COLLIER ON BANKRUPTCY ¶ 344.03 (15th ed. 1979).

granted by the district court.[73] Finally, the grant of immunity does not prevent the use of the debtor's testimony in a civil proceeding or in the Chapter 7 case concerning the debtor.[74]

## III. EXEMPTIONS UNDER THE CODE

The filing of a voluntary petition under the Code creates an estate that includes all the debtor's interests in property.[75] The Code, however, permits an individual debtor[76] to exempt certain property of the estate.[77] The exemption section of the Code has three objectives: to make available for debtors a choice between state and federal nonbankruptcy law exemptions and Code exemptions;[78]to make available for debtors a substantial federal exemption;[79] and to make available to debtors a grant of certain powers to protect the "fresh start" encompassed by the discharge.[80]

### *A. The Choice of Exemptions*

Under the Bankruptcy Act, a bankrupt's exemptions varied from state to state, with the bankrupt enjoying exemptions under the state law of his domicile and federal nonbankruptcy law.[81] The state law exemptions were designed, in theory, to protect a debtor from his creditors by permitting him to retain the basic necessities of life so that after his creditors levied on all his nonexempt property, the debtor still would have enough property both to survive and to avert his becoming a public charge.[82] Many state law exemptions, however, have not been revised in this century, were designed for a more rural America, and essentially are inadequate to serve the needs of, and to effectuate a

73. 18 U.S.C. §§ 6002 & 6003 (1976).

74. *See* 2 COLLIER ON BANKRUPTCY ¶ 344.04 (15th ed. L. King ed. 1979).

75. 11 U.S.C.A. § 541 (West 1979).

76. *Id.* § 522(b).

77. *Id.* § 522. In addition, *id.* § 541(c)(2) preserves restrictions on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law. In effect, this provision creates an unlimited exemption for spendthrift trusts. Moreover, the exclusion of spendthrift trusts from the property of the estate does not have a limitation exempting the trust "to the extent reasonably necessary for the support of the debtor or his dependents." *See, e.g., id.* §§ 522(10)(E) & 522(11)(C) (exemptions so limited).

78. *Id.* § 522(b).

79. *Id.* § 522(d).

80. *Id.* §§ 522(e) to (i).

81. Bankruptcy Act § 6, 11 U.S.C. § 24 (1976) (repealed 1978).

82. HOUSE REPORT, *supra* note 2, at 126, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6087.

fresh start for, today's urban debtor.[83]

In an attempt to remedy the inadequacies in having exempt property largely defined by the vagaries of state law,[84] the Code permits an individual debtor to choose between a complete set of Code exemptions or the exemptions provided by state law and federal nonbankruptcy law. The choice between Code exemptions and state and federal nonbankruptcy exemptions is a mutually exclusive alternative — that is, the debtor may not mix or match items from the Code exemption list with exemptions available under state law and federal nonbankruptcy law.

The Code does not indicate how or when the debtor must make the election of exemptions, but in all likelihood the choice will be made in the debtor's schedules of assets and liabilities.[85] Under the present Rules of Bankruptcy Procedure,[86] the schedules must be filed with the petition initiating a liquidation case; either within ten days after the filing of the petition if the petition is accompanied by a list of the debtor's creditors and their addresses, or at such later time as the Bankruptcy Court may direct upon application.[87] Presumably, new Bankruptcy Rules will provide for the situation in which the debtor's choice of exemption is improvident and should be changed.[88]

There is one final caveat concerning the choice of exemptions available to the debtor. The Code contains a provision[89] permitting states to "opt out" of the Code exemption alternative. If a state passes a law forbidding use of the Code exemptions,[90] then a debtor domiciled

83. *Id.*

84. *See* text accompanying notes 91-101 *infra.*

85. FED. BANKR. R. 403(a), which requires exemptions to be claimed on the schedules filed pursuant to Bankruptcy Rule 108, should remain unaffected by the Code. 3 COLLIER ON BANKRUPTCY ¶ 522.02 (15th ed. 1979). Section 405(d) of Pub. L. No. 95-598, 92 Stat. 2685 (1978), provides for the continued applicability of the Bankruptcy Rules, to the extent they are not inconsistent with the statute, until new rules are promulgated.

86. Bankruptcy Rule 108 remains unaffected by the Code. 3 COLLIER ON BANKRUPTCY ¶ 522.02, at 522-12 n.10 (15th ed. L. King ed. 1979).

87. FED. BANKR. R. 108.

88. HOUSE REPORT, *supra* note 2, at 360, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6326-6327.

89. 11 U.S.C.A. § 522(b)(1) (West 1979).

90. To date eleven states have so "opted out." *See* ARIZ. REV. STAT. ANN. § 33-1133 (West Supp. 1980); FLA. STAT. ANN. § 222.20 (West Supp. 1979); GA. CODE ANN. § 51-1601 (West Supp. 1980); IND. CODE § 34-2-28-0.5 (West Supp. 1980); KAN. STAT. ANN. § 60-2301 (West Supp. 1980); LA. REV. STAT. ANN. § 13:3881(B) (West Supp. 1980); OHIO REV. CODE ANN. § 2329.66.2 (Page Supp. 1979); TENN. CODE ANN. § 26-901 et seq. (West Supp. 1980); S.D. CODIFIED LAW ANN. § 43-45-13 (West Supp. 1980); VA. CODE § 34-3.1 (Cum. Supp. 1979); WYO. STAT. § 1-20-109 (West Supp. 1980).

in that state may "elect" only the exemptions authorized by that state's law and the exemptions provided under federal nonbankruptcy law.

### *B. State Law and Federal Nonbankruptcy Law Exemptions*

If the debtor chooses the state law exemption alternative,[91] he also may exempt property from the bankruptcy estate that is exempt under non-Code federal law. Some of the more "common" federal exemptions are as follows:

(1) Foreign Service Retirement and Disability payments;[92]

(2) Social Security payments;[93]

(3) Injury or death compensation payments from war risk hazards;[94]

(4) Wages of fishermen, seamen, and apprentices;[95]

(5) Civil service retirement benefits;[96]

(6) Longshoremen's and Harbor Worker's Compensation Act death and disability benefits;[97]

(7) Railroad Retirement Act annuities and pensions;[98]

(8) Veterans' benefits;[99]

(9) Special pensions paid to winners of the Congressional Medal of Honor;[100] and

(10) Federal homestead lands on debts contracted before issuance of the patent.[101]

In addition, a debtor choosing the state law exemption alternative may also exempt entireties and joint tenancy interests to the extent that state law makes these interests unreachable by the debtor's creditors.[102] For example, in Pennsylvania, property held in tenancy by the entireties is immune from the creditors of only one spouse,[103] as opposed to

91. 11 U.S.C.A. § 522(b)(2) (West 1979).
92. 22 U.SC. § 1104 (1976).
93. 42 *id.* § 407.
94. *Id.* § 1717.
95. 46 *id.* § 601.
96. 5 *id.* § 8346.
97. 33 *id.* § 916.
98. 45 *id.* § 231m.
99. 38 *id.* § 3101.
100. *Id.*
101. 43 *id.* § 175.
102. 11 U.S.C.A. § 522(b)(2)(B) (West 1979).
103. *See In re* Dragon Heating & Air Conditioning, 15 C.B.C. 749 (E.D. Pa. 1978).

joint creditors of both spouses. In Pennsylvania and other states that similarly treat entireties property, the consequences of a joint filing by a husband and wife should be examined carefully. In these states, if only one spouse files a petition and claims the entireties exemption, the entireties property is protected, regardless of value, from those unsecured creditors of the petitioning party who do not have a judgment against the petitioning party's spouse on a joint debt. This exempt entireties property would not be available to creditors in the bankruptcy proceeding or after bankruptcy, since joint debts would be discharged as to the filing spouse. As a result, under Pennsylvania and other similar state laws, a creditor could not later obtain a judgment against both spouses that would enable it to execute against the entireties property.

### *C. Code Exemptions*[104]

Initially, the Code defines, for purposes of its exemption provisions, "dependent" as including the debtor's spouse, whether or not actually dependent,[105] and "value" as meaning the fair market value as of the date of the filing of the petition.[106] These definitions are important for the interpretation and application of the Code's exemption provisions.[107] For example, the Code permits an exemption for property used as a residence by the debtor or by a dependent of the debtor.[108] The inclusion of a debtor's spouse as a dependent may have a major effect on the determination of which property will be claimed exempt.[109] Furthermore, if the debtor fails to file the list of property that is claimed as exempt,[110] a dependent of the debtor may file such a list or may claim, on behalf of the debtor, property as exempt from property of the estate.[111] The definition of "value" is important because when exemptions are claimed, any change in the value of the property claimed by the debtor since the filing of the petition will not affect the amount of property that the debtor may exempt under the Code. The definition of "value" may, however, prove to be troublesome when the

104. 11 U.S.C.A. §§ 522(b)(1) & (d) (West 1979).

105. *Id.* § 522(a)(1).

106. *Id.* § 522(a)(2).

107. "Dependent" is used throughout § 522(d) in reference to property that may be exempted under the Code. *See id.* §§ 522(d)(1), (3), (4), (6), (8), (9), (10)(D), (10)(E), (11)(B), (11)(C), (11)(D) & (11)(E).

108. *Id.* § 522(d)(1).

109. 3 COLLIER ON BANKRUPTCY ¶ 522.03 (15th ed. 1979).

110. 11 U.S.C.A. § 522(*l*) (West 1979).

111. *Id.*

property exempted first becomes property of the estate after the date of the filing of the petition.

The Code exemptions are structured to permit the individual debtor to exempt the debtor's interest in specific property, or, in certain instances, to exempt an alternative dollar allowance of the debtor's interest in any property. For most kinds of property the "value" of the exemption is specifically limited. The Code exemptions, however, do permit a minimum exemption of at least $7,900 of the debtor's interest in any kind of property.[112]

The Code exemptions, in the order they appear in the statute, are as follows:

(1) Up to $7,500 of the debtor's interest in property, real or personal, that the debtor or a dependent of the debtor uses as a residence, or that is held as a burial plot for the debtor or a dependent of the debtor, may be exempted.[113] If a debtor's residence is subject to a mortgage that cannot be avoided under any of the trustee's or debtor's avoiding powers,[114] and the residence is sold, the debtor is entitled to his exemption in any surplus over the amount of the mortgage remaining from the sale.[115]

(2) Up to $1,200 of the debtor's interest in *one* motor vehicle may be exempted.[116] Again, the interest valued for this exemption, as for all others, is the debtor's equity in the property over and above unavoided security interests.[117]

(3) An unlimited exemption of the debtor's interest in household goods, wearing apparel, appliances, books, animals, crops, or musical instruments held for the personal, family or household use of the debtor or his dependents may be exempted, if no item is worth over $200 in value.[118]

(4) Up to $500 of the debtor's aggregate interest in jewelry held for the personal, family or household use of the debtor or his dependents may be exempted.[119]

---

112. *Id.* § 522(d)(5). This is the so-called "spillover" exemption. *See* text accompanying note 121 *infra.*

113. *Id.* § 522(d)(1).

114. *See* text accompanying notes 164-178 *infra.*

115. 3 COLLIER ON BANKRUPTCY ¶ 522.10 (15th ed. L. King ed. 1979).

116. 11 U.S.C.A. § 522(d)(2) (West 1979).

117. HOUSE REPORT, *supra* note 2, at 360, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6326.

118. 11 U.S.C.A. § 522(d)(3) (West 1979).

119. *Id.* § 522(d)(4).

(5) Up to $400 in *any* property in which the debtor has an interest, *plus* any unused amount of the residential property exemption described in paragraph (1) above may be exempted.[120] This is the unrestricted minimum exemption for $7,900. This spillover from the residence exemption[121] was included "in order not to discriminate against the non-homeowner."[122]

(6) The debtor's aggregate interest of up to $750 in value in any implements, professional books, or tools, of the trade of the debtor or the debtor's dependents may be exempted.[123]

(7) Any unmatured life insurance contract owned by the debtor may be exempted.[124] The exemption refers to the life insurance contract itself, such as a term life insurance policy, and does not encompass any other rights under the contract, such as the right to borrow the loan value of the policy.[125] Because of this provision, the trustee may not surrender a life insurance policy to the insurance company if the policy would remain property of the debtor should the debtor choose the Code exemptions.[126]

(8) The debtor's aggregate interest of up to $4,000 in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract may be exempted.[127] The value of any premium loan that is automatically transferred from the debtor's estate by the insurance company after the filing of the petition, however, is deducted from the $4,000 value of the exemption.[128] The life insurance contract exemption also covers the debtor's rights in a group insurance certificate, and the exemption may be claimed either if the insured is the debtor or

120. *Id.* § 522(d)(5).

121. *Id.* § 522(d)(1).

122. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327.

123. 11 U.S.C.A. § 522(d)(6) (West 1979).

124. *Id.* § 522(d)(7). The exemption is not applicable to credit life insurance contracts.

125. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327. The exemption for loan value is treated in § 522(d)(8), which is discussed in text accompanying note 127 *infra*.

126. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327.

127. 11 U.S.C.A. § 522(d)(8) (West 1979).

128. *Id.*; *see id.* § 542(d), which protects life insurance companies that are required by contract to make automatic premium loans from property of the estate. *See* HOUSE REPORT, *supra* note 2, at 369, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6325-6326. Section 542(d) permits a life insurance company to transfer property of the estate, or property of the debtor, to the company if such a transfer is to pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically under the life insurance contract. 11 U.S.C.A. § 542(d) (West 1979).

is an individual of whom the debtor is a dependent.[129] The exemption does not extend, however, to policies under which the insured is a dependent of the debtor unless the debtor is also a dependent of the insured.

(9) Professionally prescribed health aids for the debtor or a dependent also may be exempted.[130]

(10) The Code also permits the debtor to exempt a right to receive certain benefits akin to future earnings.[131] The entire amount of local assistance, veterans' disability, illness, social security, and unemployment compensation benefits are exempted.[132] In addition, the debtor's right to receive alimony, maintenance and support[133] is included as a Code exemption, but only to the extent reasonably necessary for the support of the debtor and the debtor's dependents.[134]

Similarly, the debtor's right to receive payments under a stock bonus, pension or profit–sharing plan is also exempt, but only to the extent necessary for the support of the debtor and the debtor's dependents.[135] If these payments are made on account of age or length of service, however, and the plan or contract was established by an insider[136] who employed the debtor at the time the debtor's rights under the plan or contract arose, then the payments are not exempt if the plan or contract does not qualify under certain provisions of the Internal Revenue Code relating to pension plans, profit-sharing plans, stock bonus plans, and annuities.[137]

(11) The debtor's right to receive, or property that is traceable to, an award under a crime victim's reparation law;[138] wrongful death payments to the extent reasonably necessary for the support of the debtor

129. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327-6328.

130. 11 U.S.C.A. § 522(d)(9) (West 1979).

131. HOUSE REPORT, *supra* note 2, at 362, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6328-6329.

132. 11 U.S.C. §§ 522(d)(10)(A), (B) & (C) (West 1979).

133. *Id.* § 522(d)(10)(D).

134. *Id.* The reason for the limitation on support and alimony "future earnings" benefits is that, in several jurisdictions, the supporting spouse's ability to pay is taken into account in determining support and alimony awards. In these jurisdictions the pre-separation standard of living is often a factor in the size of the award. On the other hand, benefits that fall within the "reasonably necessary" standard generally provide to the recipient the basics upon which to live and are prescribed by statute. *See* 3 COLLIER ON BANKRUPTCY ¶ 522.19 (15th ed. 1979).

135. 11 U.S.C.A. § 522(d)(10)(E) (West 1979).

136. *See* note 223 *infra.*

137. I.R.C. §§ 401(a), 403(a), 403(b), 408 & 409.

138. 11 U.S.C.A. § 522(d)(11)(A) (West 1979).

and the debtor's dependents;[139] payment under a life insurance contract that insured the life of a person upon whom the debtor was dependent to the extent reasonably necessary for the support of the debtor and the debtor's dependents;[140] and compensation for lost future earnings of the debtor or of a person upon whom the debtor was dependent to the extent reasonably necessary for the support of the debtor and the debtor's dependents may be exempted.[141]

The debtor may also exempt up to $7,500 of a personal injury award to the debtor or to an individual on whom the debtor is dependent to the extent reasonably necessary for the debtor's or a dependent's support.[142] The personal injury exemption excludes payments for pain and suffering or compensation for actual pecuniary loss;[143] it was designed to cover only payments compensating actual bodily injury, such as the loss of a limb.[144]

The choice of state law or Code exemptions applies to each debtor separately. Spouses who are joint debtors are *not* bound to choose the same alternative. Thus, a husband and wife filing together who choose the Code exemptions will be entitled to *twice* the stated amounts.[145] The court has no power to inquire into the exemptions claimed by the debtor unless a party in interest objects.[146] In the absence of objection, the property claimed as exempt is exempt.[147] As previously indicated,[148] a dependent may file the list of property claimed as exempt if the debtor fails to file such a list.[149] The dependent's right to claim the exemption if the debtor fails to do so exists regardless of which exemptions — state law or Code — are claimed.

As under the Bankruptcy Act,[150] a debtor may convert nonexempt

139. *Id.* § 522(d)(11)(B).
140. *Id.* § 522(d)(11)(C).
141. *Id.* § 522(d)(11)(E).
142. *Id.* § 522(d)(11)(D).
143. *Id.*
144. HOUSE REPORT, *supra* note 2, at 362, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6328-6329.
145. 11 U.S.C.A. § 522(m) (West 1979). A husband and a wife filing together may each claim their own Code exemptions, or one may claim state law and federal nonbankruptcy law exemptions, while the other chooses the Code exemptions. *Id.*
146. *Id.* § 522(*l*). Thus, FED. BANKR. R. 403(b) ("The trustee shall examine the bankrupt's claim for exemptions, set apart such as are lawfully claimed and allowable, and report to the court the items set apart") and (d) ("If no trustee has qualified, the bankruptcy judge shall file the report") are superseded.
147. 11 U.S.C.A. § 522(*l*) (West 1979).
148. *See* text accompanying note 111 *supra.*
149. 11 U.S.C.A. § 522(*l*) (West 1979).
150. *See, e.g.*, Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir. 1926).

property to exempt property on the eve of bankruptcy as part of "pre-bankruptcy planning."[151] Without more, "pre-bankruptcy planning" is not fraudulent.[152]

Finally, the Code provides that exempt property shall be insulated from pre-petition claims, with the exception of nondischargeable tax debts or secured dischargeable tax debts upon which a properly filed lien is avoided, and alimony, maintenance, or support claims that are excepted from discharge.[153] In addition, unavoided liens are enforceable against exempt property.[154]

### *D. Other Provisions Protecting Exemptions and Additional Powers Given the Individual Debtor to Protect the Discharge*

In contrast to the practice under the Bankruptcy Act,[155] and pursuant to the objective of protecting a debtor's exemptions, the Code provides that a debtor's waiver of state law or Code exemptions in favor of unsecured creditors is unenforceable.[156] Similarly, any waiver by a debtor of powers to avoid transfers of exempt property or to recover property also is unenforceable.[157]

Exempt property is protected further by a series of avoiding and recovery powers that the debtor may employ to avoid certain liens on exempt property and that permit the debtor, under certain conditions, to utilize the trustee's avoiding powers[158] to recover exempt property. Any recovered property that the debtor seeks to exempt, however, is subject to the value restrictions of the Code.[159]

---

151. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327-6328.

152. *See* Forsberg v. Security State Bank, 15 F.2d 499, 501-02 (8th Cir. 1926).

153. 11 U.S.C.A. § 522(c) (West 1979).

154. HOUSE REPORT, *supra* note 2, at 361, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6327-6328; Long v. Bullard, 117 U.S. 617 (1886). The express language in section 522(c) should prevail over any general language to the contrary in 11 U.S.C.A. § 524(a)(2) (West 1979).

155. *See* 1A COLLIER ON BANKRUPTCY ¶ 6.10 (14th ed. 1978).

156. 11 U.S.C.A. § 522(e) (West 1979).

157. *Id.* The avoiding and recovery powers are contained in *id.* §§ 522(f) to (i). *See* text accompanying notes 160-178 *infra*.

158. The Code permits a trustee to avoid certain liens. *See id.* § 544 (unperfected transfers), § 545 (statutory liens), § 547 (preferences), § 548 (fraudulent conveyances), § 549 (post-petition transfers), and § 724(a) (liens securing fines, penalties, or forfeitures that are not compensation for actual pecuniary loss).

159. *Id.* § 522(j). Thus the debtor, "though allowed to exempt such property pursuant to [§ 522(g) & (i)], may not exempt any amount pursuant to these subsections which, combined with other exemptions would make the total amount exempted greater than the amount allowed by federal or state exemptions, whichever the debtor chose under subsection (b)." 3 COLLIER ON BANKRUPTCY ¶ 522.30, at 522-71 (15th ed. 1979).

The debtor may avoid a judicial lien on any property that would be exempt but for the impairment by the lien.[160] The debtor also may avoid a nonpossessory, nonpurchase money "security interest"[161] in "household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor," and in "professional books, or tools, of the trade of the debtor" or the debtor's dependents, and in health aids prescribed for the debtor or the debtor's dependents.[162] The debtor may avoid a judicial lien or nonpossessory, nonpurchase money security interest only to the extent of the applicable exemption, however, and any amount by which the lien or security interest exceeds the exempted amount is still enforceable. These avoiding powers are available for the debtor's use notwithstanding any waiver of exemptions.[163]

Another power that the debtor may utilize to protect exemptions is the power to exempt property recovered by the trustee under certain of the trustee's powers[164] to the extent[165] the debtor could have exempted that property had it not been transferred.[166] Thus, unlike the Bank-

160. 11 U.S.C.A. § 522(f)(1) (West 1979). " '[J]udicial lien' means lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." *Id.* § 101(27). That definition does not include a mortgage. A mortgage is covered by the term "security interest," which means a lien created by an agreement. *Id.* § 101(37). *See* HOUSE REPORT, *supra* note 2, at 312 ("In general, the concept of lien is divided into three kinds of liens: judicial liens, security interests, and statutory liens. Those three categories are mutually exclusive and are exhaustive except for certain common law liens."), 314 (A security interest is one of the kinds of liens . . . . [T]he U.C.C. does not cover real property mortgages. Under this definition, such a mortgage is included.) Accordingly, while judicial liens against real property may be avoided to the extent that they impair an exemption to which the debtor may otherwise be entitled, mortgages cannot be so avoided.

161. Security interest is defined to mean a "lien created by an agreement." 11 U.S.C.A. § 101(37) (West 1979). The kind of security interest referred to in § 522(f)(2) is a consensual lien *other than* a purchase money or possessory lien. *Id.* § 522(f)(2).

162. *Id.* § 522(f)(2).

163. HOUSE REPORT, *supra* note 2, at 362, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6328-6329.

164. 11 U.S.C.A. §§ 510(c)(2), 542, 543, 550, 551, & 553 (West 1979). Section 510(c)(2) would allow the trustee to transfer to the estate a lien securing a claim subordinated by the court pursuant to § 510(c)(1). "In essence, the subordinated claim becomes unsecured and the property securing such claim becomes part of the debtor's estate." 3 COLLIER ON BANKRUPTCY ¶ 510.04, at 509-10 (15th ed. 1979). Section 542 permits recovery of property held by an entity other than a custodian. 11 U.S.C.A. § 542 (West 1979). Section 543 permits recovery of property held by an entity that is a custodian. *Id.* § 543. Section 550 permits the trustee to recover property if a transfer is avoided. *Id.* § 550. Pursuant to § 551, avoided transfers may be preserved for the benefit of the debtor. *Id.* § 551. Section 553 permits the trustee to recover offsets from creditors. *Id.* § 553.

165. The remaining recovered property would become property of the estate. 11 U.S.C.A. § 541(a)(3) (West 1979).

166. *Id.* § 522(g).

ruptcy Act,[167] the Code specifically permits exemptions in property transferred by the debtor that the trustee recovers. This exemption power, however, is available to the debtor only if the transfer was involuntary, and the debtor did not conceal the transferred property, or the debtor could have avoided the transfer as an avoidable judicial lien or an avoidable nonpossessory, nonpurchase money security interest.[168]

The Code also permits the debtor to avoid the transfer of property, or to recover a setoff, to the extent that the debtor could have exempted such property had it not been transferred, if the trustee does not pursue the transfer.[169] The debtor's avoidance power is available, however, only if the transfer was involuntary, the debtor has not concealed the property,[170] and the trustee could have avoided the transfer under certain avoiding powers.[171] If the trustee has commenced an action to avoid the transfer, the debtor must intervene.[172] If no action has been commenced by the trustee, the debtor must initiate it within the earlier of two years after the appointment of the trustee or the time the case is closed or dismissed.[173]

After a transfer is avoided or a setoff recovered, the debtor may recover the property from either the initial or subsequent transferee[174] and exempt the property recovered.[175] An avoided transfer may be preserved for the benefit of the debtor, but only to the extent that the debtor otherwise could exempt the property under the Code.[176]

---

167. Section 6 of the Bankruptcy Act disallowed exemptions from transferred property recovered by the trustee or the transfer of which was avoided for the benefit of the estate. Bankruptcy Act § 6, 11 U.S.C. § 24 (1976) (repealed 1978).

168. 11 U.S.C.A. § 522(g) (West 1979).

169. *Id.* § 522(h)(2).

170. *Id.* § 522(g)(1).

171. *Id.* § 544 (trustee as lien creditor), § 545 (statutory liens), § 547 (preferences), § 548 (fraudulent transfers), § 549 (post-petition transfers), § 724(a) (avoiding of liens securing fines, penalties, or forfeitures that are not compensation for actual pecuniary loss suffered), and § 553 (recovery of setoff).

172. HOUSE REPORT, *supra* note 2, at 362, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6328-29.

173. 11 U.S.C.A. § 546(a). Since § 522 basically is designed to make available to the debtor the same rights the trustee could have utilized, the debtor's exercise of those rights is subject to the same limitations the trustee would have faced. *See* HOUSE REPORT, *supra* note 2, at 363, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6328-6329.

174. 11 U.S.C.A. § 522(i)(1) (West 1979). Such recovery is subject, however, to the limitations of § 550, "the same as if the trustee had avoided such transfer." *Id.* § 522(i)(1). The limitations of § 550 are that property is not recoverable from a good faith subsequent transferee who takes for value and without knowledge of the voidability of the transfer avoided or any subsequent good faith transferee of the subsequent transferee. *Id.* § 550(b).

175. *Id.* § 552(i)(1).

176. *Id.* § 552(i)(2).

The debtor's powers under the Code are cumulative. As is the case with the trustee, the debtor may use more than one power to gain an exemption in any particular instance.[177] The liability of the debtor's exempt property to the estate is limited to the debtor's aliquot share of the administrative costs and expenses of recovery of property that the trustee recovers and the debtor later exempts, and any administrative costs and expenses of avoiding a transfer that the debtor has not already paid.[178]

## IV. REDEMPTION

In consumer cases under the Bankruptcy Act, a secured creditor with a security interest in all the debtor's property, including household and personal goods, could use the threat of foreclosure to obtain reaffirmation of a discharged debt. Though household goods generally have little if any realizable market value, in most instances the goods do have a high replacement cost. Consequently, the creditor could use the threat of repossession to obtain more value from the debtor than would be realized by foreclosure or repossession.[179] Together, the avoiding powers available to the debtor[180] and the redemption right[181] accorded him under the Code permit the debtor to ward off this threat.

The Code[182] allows an individual debtor[183] to redeem tangible personal property intended primarily for personal, family, or household use from a lien securing a dischargeable[184] consumer debt[185] if the consumer property is exempted by the debtor,[186] or has been aban-

177. HOUSE REPORT, *supra* note 2, at 363, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6329-6330.

178. *Id.*

179. In consumer cases, very often a secured creditor with a security interest in all of the debtor's property, including household and personal goods, uses the threat of foreclosure to obtain a reaffirmation of a debt. Otherwise, the secured creditor is able to deprive a debtor of even the most insignificant household effects, including furniture, cooking utensils, and clothing, even though the items have little, if any, realizable market value. HOUSE REPORT, *supra* note 2, at 127, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6087.

180. 11 U.S.C.A. § 522(f) (West 1979).

181. *Id.* § 722.

182. *Id.*

183. *Id.* Only an individual debtor in a liquidation case under Chapter 7 of the Code may utilize § 722. *See id.*

184. *See id.* § 523.

185. The term "consumer debt" is defined in *id.* § 101(7) as a "debt incurred by an individual primarily for a personal, family, or household purpose." *Collier* opines that a consumer debt does not include a debt to the extent that it is secured by real property. 4 COLLIER ON BANKRUPTCY ¶ 722.03 (15th ed. 1979).

186. *See* text accompanying notes 74-177 *supra.*

doned by the trustee,[187] by paying the lienholder the amount of its allowed secured claim.[188] This right of redemption is essentially a right of first refusal for the debtor in consumer goods that might otherwise be repossessed.[189] Moreover, the right of redemption is not waiveable.[190]

Liens that generally cannot be avoided by the debtor,[191] such as perfected security interests in cars or boats,[192] or perfected purchase money security interests in, or statutory liens on, household goods, furnishings, clothes, musical instruments, pets, health aids, and jewelry, may be affected by the debtor's right of redemption. Applicable property subject to a possessory security interest also may be the subject of redemption.

The right to redeem extends to the whole of the property and not merely to the debtor's exempt interest in it.[193] Thus, if a creditor has a claim in the amount of $3,000, which is secured against a car worth $2,000, the debtor can redeem the entire car for $2,000, and not just the exempt portion of $1,200. When the debtor has insufficient money to redeem, the policy behind redemption may be furthered by judicial approval of a reaffirmation agreement.[194]

## V. DISCHARGE AND NONDISCHARGEABLE DEBTS

One of the primary benefits to the consumer debtor in a Chapter 7

187. 11 U.S.C.A. § 554 (West 1979). Section 554 allows the trustee to abandon any property of the estate that is burdensome or of inconsequential value to the estate.

188. *Id.* § 722. Section 506(a) provides that an "allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property. . . ." In other words, "the amount of the allowed secured claim of an undersecured creditor is the value of his collateral." *Id.* § 506(a); *see* 91; 4 COLLIER ON BANKRUPTCY ¶ 722.05 (15th ed. 1979).

189. HOUSE REPORT, *supra* note 2, at 381, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6337.

190. 11 U.S.C.A. § 722 (West 1979).

191. Section 522(f) allows the debtor to avoid nonpossessory, nonpurchase money security interests in (1) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry held primarily for the personal, family, or household use of the debtor or his dependents; (2) professional books or tools of the trade of the debtor or his dependents; or (3) professionally prescribed health aids for the debtor or his dependents. *Id.* § 522(f).

192. Cars and boats are excluded from the items set forth in § 522(f) unless such items qualify as tools of the trade. *Id.*

193. HOUSE REPORT, *supra* note 2, at 380-81, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6335-6337.

194. *See* text accompanying notes 376-395 *infra.*

liquidation case is the discharge of debts.[195] In general, debtors receiving a discharge are released from debts that arose before the order for relief under Chapter 7[196] and from certain debts arising after commencement of the case that are treated as prepetition debts.[197] The discharge applies to a debt whether or not a proof of claim relating to the debt is filed and whether or not the claim is allowed.[198] Under certain circumstances, however, a debtor will not receive a discharge,[199] and in other circumstances a debtor's discharge may be revoked.[200]

### *A. Denial of Discharge*

An individual debtor[201] will receive a discharge in a liquidation case unless at least one of nine conditions exists.[202] If the debtor transfers,[203] removes, destroys, mutilates, or conceals property of the es-

195. 11 U.S.C.A. § 727 (West 1979). Debtors in cases under Chapters 11 or 13 may be discharged under §§ 1141 and 1328 respectively. *Id.* §§ 1141 & 1328.

196. The filing of a voluntary case or a joint case under Chapter 7 constitutes an order for relief under that chapter. *Id.* §§ 301 & 302(a). Similarly, an order for relief entered in an involuntary liquidation case constitutes the entry of an order for relief under Chapter 7. *Id.* § 303(h). If a voluntary, joint or involuntary case is commenced by or against a consumer debtor under Chapter 11 or 13, then the date of the entry of the order converting the case to a liquidation case constitutes the order for relief under Chapter 7. *Id.* §§ 102(6) & 348(b).

197. *Id.* § 727(b). Debts arising after commencement of the case that are treated as prepetition debts are specified in *id.* § 502(e)(2) (claims for reimbursement or contribution that become fixed after the filing of the petition); *id.* § 502(f) (claims that arise in the ordinary course of the debtor's business or financial affairs after the commencement of an involuntary case but before the appointment of a trustee or the entry of the order for relief); *id.* § 502(g) (claims arising from the rejection of an executory contract or unexpired lease that has not been assumed prior to rejection); *id.* § 502(h) (claims arising from the recovery of property under the avoiding powers); and *id.* § 502(i) (certain tax claims entitled to priority under *id.* § 507(a)(6) that arise after commencement of the case).

198. *Id.* § 727(b).

199. *Id.* §§ 727(a) & (c).

200. *Id.* §§ 727(d) & (e).

201. *Id.* § 727(a)(1) denies a discharge to a corporate or a partnership debtor. The objective of this provision is to prevent trafficking in corporate shells and bankrupt partnerships. HOUSE REPORT, *supra* note 2, at 384, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS. 5963, 6340. Although the term "individual" is not defined in the Code, Congress intended an individual who dies during a bankruptcy case to be eligible for a discharge, even though a decedent's estate is not eligible to commence a bankruptcy case. *Id.*

202. 11 U.S.C.A. §§ 727(a)(2)-(10) (West 1979). The Code is unclear as to whether the court may deny the discharge *sua sponte* or whether an objection must be made by the trustee or a creditor. *See id.* § 727(e). In a departure from the Bankruptcy Act, preparation of a business false financial statement (Bankruptcy Act § 14c(3), 11 U.S.C. § 32(c)(3)(1976) (repealed 1978)) and failure to pay filing fees (Bankruptcy Act § 14c(8), 11 U.S.C. § 32(c)(8)(1976) (repealed 1978)) are eliminated as grounds to deny the debtor a discharge. *But see* 11 U.S.C.A. § 523(a)(2) (West 1979) (relating to nondischargeable debts based on false financial statements) and *id.* § 707(2) (relating to dismissal for nonpayment of filing fees).

203. The term "transfer" is defined in § 101(40) in a very broad sense. *See* 11 U.S.C.A. § 101(40) (West 1979).

tate[204] within one year before or after the commencement of the case, then the discharge will be denied[205] if the debtor acted with intent[206] to hinder, delay, or defraud a creditor or the trustee.[207] A second basis for denying the debtor's discharge generally[208] is available if he does not supply[209] recorded information[210] from which his finances and business operations can be ascertained.[211] A third basis for a denial of discharge is the debtor's commission of a so-called bankruptcy crime.[212] The proscribed conduct consists of making a false oath or account, presenting or using a false claim, attempting to gain or gaining advantage by acting or forbearing to act in a bankruptcy case,[213] and withholding financial information from the trustee.[214] The conduct results in a denial of discharge if it is knowingly and fraudulently committed in or in connection with the debtor's case.[215] Each of the abovementioned causes for denying discharge was derived from section 14c of the Bankruptcy Act[216] and was intended to discourage misconduct in the bankruptcy case.

204. Technically property transferred within the year preceding the commencement of the case is actually property of the debtor. The commencement of a voluntary, joint, or involuntary case creates an estate that is comprised of all of the debtor's interests in property. *Id.* § 541.

205. *Id.* § 727(a)(2).

206. Although the Code does not define "intent," the legislative history indicates that the section is derived from § 14c of the Bankruptcy Act. HOUSE REPORT, *supra* note 2, at 384, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6340; SENATE REPORT, *supra* note 2, at 98, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5884. Presumably courts will follow cases construing the Bankruptcy Act, which required actual, as opposed to implied, intent. *See* 4 COLLIER ON BANKRUPTCY ¶ 727.02[3] (15th ed. 1979).

207. 11 U.S.C.A. § 727(a)(2) (West 1979). The trustee is the representative of the estate charged with custody of the estate's property. *Id.* §§ 323(a) & 704(1). The debtor's discharge would also be denied if the proscribed conduct were committed with intent to hinder, delay, or defraud an employee of the trustee charged with custody of property of the estate. *Id.* §§ 327(a) & 727(a)(2).

208. The Code requires a denial of discharge unless the debtor's failure to provide recorded information is justified under all the circumstances of the case. *Id.* § 727(a)(3).

209. Section 521(3) requires the debtor, and § 542(e) may require third parties, to turn over to the trustee recorded information relating to property of the estate. *See id.* §§ 521(3) & 542(e).

210. Recorded information that the debtor is required to produce includes books, documents, records, and papers. *Id.* § 727(a)(3).

211. The debtor's failure to provide recorded information ranges from failure to keep books and records to concealment, destruction, mutilation, or falsification of records. *Id.*

212. *Id.* § 727(a)(4). *See* 18 *id.* § 152 (corresponding criminal statute). The burden of proof standard is a preponderance of the evidence rather than beyond a reasonable doubt. HOUSE REPORT, *supra* note 2, at 384, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6340; SENATE REPORT, *supra* note 2, at 98, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5884.

213. Also proscribed is giving, offering, receiving, or attempting to obtain money or property or a promise of money or property for acting or forbearing to act in a bankruptcy case. 11 U.S.C.A. § 727(a)(4)(C) (West 1979).

214. *Id.* § 727(a)(4).

215. *Id.*

216. HOUSE REPORT, *supra* note 2, at 384, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS

The next two bases for denying the individual debtor a discharge focus on the scope of the debtor's duty to account for assets and to obey the court. The debtor is required to explain satisfactorily any loss of assets or deficiency of assets to meet liabilities,[217] and failure to do so will result in denial of discharge.[218] The debtor's discharge also will be refused if the debtor fails to obey any lawful order of the court other than an order to respond to a material question or to testify.[219] With respect to testimony, the discharge is denied if the debtor improperly invokes the privilege against self-incrimination,[220] or if the debtor is given immunity[221] and refuses to testify.[222]

The sixth basis for denying the debtor's discharge is designed to discourage or punish wrongdoing by the debtor in another bankruptcy case concerning an insider.[223] If the debtor commits any of the above-mentioned acts[224] in another bankruptcy[225]case concerning an insider within one year before or during the debtor's bankruptcy case, then the debtor's discharge will be denied.[226]

The next two bases for denying the debtor's discharge serve as limitations on the frequency with which the debtor may receive a discharge in a liquidation case.[227] If the debtor has been granted a discharge in a Chapter 7 or 11 case, or in a straight bankruptcy, Chap-

5963, 6340; SENATE REPORT, *supra* note 2, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5884.

217. 11 U.S.C.A. § 727(a)(5) (West 1979).

218. The debtor's discharge, however, will not be denied if the debtor fails to explain the loss or deficiency of assets after the court has granted the debtor a discharge. *Id.*

219. *Id.* § 727(a)(6)(A).

220. *Id.* § 727(a)(6)(C).

221. Immunity is governed by *id.* § 344. *See* 18 U.S.C. §§ 6001 to 6005 (1976); text accompanying notes 52-74 *supra.*

222. 11 U.S.C.A. § 727(a)(6)(B) (West 1979). *See* text accompanying notes 52-74 *supra.* Note that invocation of the privilege against self-incrimination will not prevent denial of discharge based on the debtor's failure to satisfactorily explain a loss of assets under *id.* § 727(a)(5).

223. The term "insider" is illustrated by relationships specified in *id.* § 101(25). With respect to a consumer debtor, relatives of the debtor or of a general partner of the debtor within the third degree are insiders. *Id. See id.* § 101(34). Also included as insiders are general partners of the debtor, partnerships in which the debtor is a general partner, and corporations of which the debtor is a director, officer, or person in control. Moreover, the court is free to specify other entities as "insiders" of the debtor. *Id.* §§ 101(25) & 102(3).

224. *Id.* §§ 727(a)(2)-(6).

225. Section 727(a)(7) does not specify that the insider's case be a bankruptcy case, but evidently that was Congress' intent. *See* HOUSE REPORT, *supra* note 2, at 385, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6341; SENATE REPORT, *supra* note 2, at 99, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5885-5886.

226. 11 U.S.C.A. § 727(a)(7) (West 1979).

227. The limitation only applies to discharges in liquidation cases and does not restrict the frequency of discharges in Chapter 11 or 13 cases. *Id.* § 103(b).

ter XI, or Chapter XII case under the Bankruptcy Act, the debtor will not be discharged in a subsequent Chapter 7 liquidation case commenced within six years after the commencement of the prior case.[228] If the debtor has been granted a discharge in a Chapter 13 case or in a case under Chapter XIII of the Bankruptcy Act, the debtor will not be discharged in a subsequent Chapter 7 case commenced within six years after the commencement of the prior case unless one of two conditions is met.[229] First, the debtor's discharge in the subsequent Chapter 7 case will not be barred if payments under the debtor's previous plan totaled at least 100 percent of allowed unsecured claims.[230] Second, the debtor's discharge will not be barred if payments under the previous plan totaled at least 70 percent of allowed unsecured claims, and the plan was proposed in good faith and was the debtor's best effort.[231] If either of these two conditions is met, the prior discharge will not bar the debtor's discharge in a subsequent Chapter 7 case.

The final basis for denying the debtor's discharge is court approval of a written waiver of discharge executed by the debtor after the order for relief under Chapter 7.[232] Presumably this provision will be used rarely, and court approval will be granted only when a waiver of discharge is in the debtor's best interest — for example, when all debts are paid in full[233] or when all debts are nondischargeable.[234]

### *B. Procedure to Object to Discharge*

Most of the procedure to be followed in objecting to the debtor's discharge is found in the Rules of Bankruptcy Procedure rather than in the Code. The Code merely specifies that the trustee[235] or a creditor

228. *Id.* § 727(a)(8). Note that the crucial date is the commencement of the prior case, not the date on which the debtor's discharge was granted.

229. *Id.* § 727(a)(9).

230. *Id.* § 727(a)(9)(A). The Code does not specify that holders of unsecured claims must receive full payment. Rather, the Code literally appears to provide that all payments under the plan to administrative claimants, secured creditors, and unsecured claimants must total at least 100% of the allowed unsecured claims in the case. *Id.*

231. *Id.* § 727(a)(9)(B). It is advisable that a debtor confirming a composition plan under Chapter 13 obtain a determination of good faith and best efforts at the time the plan is confirmed rather than at the time of a hearing on objection to the debtor's discharge in a subsequent liquidation case.

232. *Id.* § 727(a)(10).

233. If all debts are paid in full, the discharge will gain nothing for the debtor and may serve to bar discharge in a subsequent bankruptcy case. *See id.* § 727(a)(8).

234. *See id.* §§ 523 & 727(b).

235. *See also id.* § 151327(a)(1), which permits the United States trustee to object to a discharge in pilot districts described in § 1501 as follows: District of Maine; District of New Hampshire; District of Massachusetts; District of Rhode Island; Southern District of New York; District

may object to a debtor's discharge; the form of the request and the time within which the request must be filed are not specified in the Code.

Since the preexisting Rules of Bankruptcy Procedure continue in effect to the extent they are not inconsistent with the Code,[236] practice under Bankruptcy Rules 404 through 408 and 701 will continue to govern the procedure regarding objections to discharge.[237] Specifically, the objection must be initiated as an adversary proceeding by the filing of a complaint.[238] The complaint must be filed before expiration of the time fixed by the court to object to discharge, or the discharge usually will be granted.[239]

In general, the time fixed by the court must be not less than thirty nor more than ninety days after the first date set for the meeting of creditors,[240] but if notice of "no dividend" is given, the court may fix the time as early as the first date set for the meeting of creditors.[241] The court, on application of a party in interest or on its own initiative, may, however, extend the time for filing a complaint objecting to discharge.[242] Various notice provisions set forth in the Rules of Bankruptcy Procedure continue in effect under the Code.[243]

When creditors are unsure whether a basis exists for objecting to the debtor's discharge, they may request the court to order the trustee[244] to examine the acts and conduct of the debtor to determine

---

of Delaware; District of New Jersey; District of District of Columbia; Eastern District of Virginia; Northern District of Alabama; Northern District of Texas; Northern District of Illinois; District of Minnesota; District of North Dakota; District of South Dakota; Central District of California; District of Colorado; and District of Kansas.

236. *See* Pub. L. No. 95-598, § 405(d), 92 Stat. 2685 (1978).

237. To some extent Bankruptcy Rules 404(d)(2), 404(d)(4), 405, and 406 are inconsistent with the Code insofar as waivers of discharge are dealt with in § 727(a)(1) and failure to pay filing fees is not a basis to deny discharge. *See* FED. BANKR. R. 404(d)(2), 404(d)(4), 405, 406; 11 U.S.C.A. § 727(a)(1) (West 1979).

238. FED. BANKR. R. 404(e) & 701(4). An adversary proceeding involves a structured procedure governed by part 7 of the Bankruptcy Rules that is more formal than the procedure used in litigating other contested matters.

239. *Id.* 404(d). Under Rule 404(d), the court must grant a discharge forthwith unless a complaint has been filed, the bankrupt has waived discharge, the bankrupt has failed to submit to examination or the bankrupt has failed to pay his filing fees. *Id.* Under the Code, it seems that only a written waiver of discharge approved by the court will be retained as a valid basis for the court to deny discharge *sua sponte* if no objection to discharge is filed.

240. The first meeting of creditors referred to in Bankruptcy Rule 404(a) undoubtedly will be construed to be the meeting of creditors required under 11 U.S.C.A. § 341 (West 1979). *See* INTERIM BANKR. R. 2003.

241. FED. BANKR. R. 404(a).

242. *Id.* 404(c).

243. *Id.* 404(b) & (h).

244. In pilot districts, *see* note 235 *supra*, in lieu of the trustee, the United States trustee can be

whether a ground exists for the denial of discharge.[245] The court has discretion to grant or deny the request.

### C. *Revocation of Discharge*

The Code specifies three grounds for revoking the debtor's discharge.[246] First, if the discharge is obtained by fraud on the part of the debtor, the court must revoke the discharge on request of the trustee[247] or a creditor.[248] Specifically, the request must be made within one year after the debtor's discharge was granted,[249] and the requesting party must not have become aware of the fraud until after the discharge was granted.[250]

Second, the court must revoke the debtor's discharge if the debtor acquires or becomes entitled to acquire property of the estate[251] and knowingly and fraudulently fails to report the acquisition or entitlement to the trustee, or to surrender or deliver the property to the trustee.[252] The trustee or a creditor must request revocation of discharge on this ground within one year after the granting of the discharge or before the case is closed.[253]

The third basis for revoking discharge generally relates[254] to the debtor's refusal to obey a lawful order of the court.[255] The request of revocation of discharge on this ground also must be made within one year after the discharge is granted or before the case is closed.[256] In each of the abovementioned instances, the "request" to revoke discharge must be by complaint.[257]

---

ordered by the court to investigate the acts and conduct of the debtor. 11 U.S.C.A. § 15727(a)(2) (West 1979).

245. *Id.* § 727(c)(2).

246. *Id.* § 727(d).

247. In pilot districts, *see* note 235 *supra*, the United States trustee may request the court to revoke discharge. *Id.* § 15727(c).

248. *Id.* §§ 727(d)(1) & 15727(b)(1).

249. *Id.* §§ 727(e)(1) & 15727(c)(1).

250. *Id.* §§ 727(d)(1) & 15727(b)(1).

251. Property of the estate is defined in § 541 and includes certain property that the debtor acquires after the date of the filing of the petition. *Id.* § 541.

252. *Id.* §§ 727(d)(2) & 15727(b)(2).

253. 11 U.S.C.A. §§ 727(e)(2) & 15727 (c)(2) (West 1979).

254. *See* text accompanying notes 38-41 *supra.*

255. 11 U.S.C.A. §§ 727(d)(3) & 15727(b)(3) (West 1979).

256. *Id.* §§ 727(e)(2) & 15727(c)(2).

257. FED. BANKR. R. 701(4).

*D. Nondischargeable Debts*

Although the discharge sometimes releases the individual debtor from legal liability for all debts, certain kinds of debts are excepted from discharge[258] in a liquidation case under Chapter 7.[259] In particular, the Code provides that nine different kinds of debts are excepted from discharge or are "nondischargeable."[260]

The discharge does not apply to certain debts for taxes or customs duties entitled to priority in distribution, whether or not proofs of claim for the taxes are filed or allowed.[261] Priority debts for taxes or customs duties are nondischargeable if the debts arise in the ordinary course of a debtor's business or financial affairs before the appointment of a trustee or an order for relief in an involuntary case. These debts would include sales taxes, property taxes, employment taxes, and the like.[262] In addition, priority debts for taxes or customs duties are nondischargeable if the debts are unsecured claims for certain income, property, withholding, employment, or excise taxes or customs duties that generally arise within a specified period of time before the commencement of the case.[263] Also excepted from discharge are claims for taxes or customs duties with respect to which a required return was not filed or was filed late but within two years before the filing of the petition.[264] Finally, debts for taxes or customs duties that the debtor willfully attempts to evade or defeat or with respect to which he files a fraudulent return are nondischargeable.[265]

Debts incurred through fraud, false pretenses, or false representations are the second kind of debts excepted from discharge.[266] Specifically, if the debtor fraudulently incurs a debt for obtaining money, property, services, or an extension, renewal, or refinancing of credit, the

258. 11 U.S.C.A. § 523 (West 1979).

259. *Id.* § 727(b). Debts of a kind specified in § 523(a) will also be excepted from discharge in a Chapter 11 case concerning an individual, *id.* § 1141(d)(2), and from a "hardship" discharge in a case under Chapter 13, *id.* § 1328(c)(2).

260. *Id.* § 523(a). The reference to debts excepted from discharge as debts that are "nondischargeable" appears in the legislative history interpreting Pub. L. No. 95-598. *See, e.g.*, HOUSE REPORT, *supra* note 2, at 364, , *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6319-6320.

261. 11 U.S.C.A. § 523(a)(1)(A) (West 1979). Tax debts entitled to priority under §§ 507(a)(2) or 507(a)(6) are nondischargeable. *Id.* The ommission of reference to the filing of a claim for a customs duty was undoubtedly inadvertent and should be of no consequence.

262. *Id.* § 507(a)(2); *see id.* § 502(f).

263. *Id.* § 507(a)(6). *See generally* 3 COLLIER ON BANKRUPTCY ¶ 523.06 (15th ed. 1979).

264. 11 U.S.C.A. § 523(a)(1)(B) (West 1979).

265. *Id.* § 523(a)(1)(C).

266. *Id.* § 523(a)(2).

debt may be nondischargeable.[267] If the debtor's fraud is not based on an oral or written statement concerning the debtor's or an insider's[268] financial condition, then a creditor only need prove[269] false pretenses, false representations, or actual fraud in order to have the debt declared nondischargeable.[270]

On the other hand, if the debtor's fraud is based on a statement concerning the debtor's or an insider's financial condition, additional elements must be proven if the debt is to be nondischargeable.[271] In particular, the fraud must have been caused by a statement in writing[272] that is materially[273] false, on which the creditor reasonably relied,[274] and which the debtor caused to be made[275] or published with intent to deceive.[276]

If the debtor's false financial statement is given in the context of a refinancing of credit, a question arises whether the entire new obligation is nondischargeable or whether the exception to discharge is limited to the "new money" advanced. The Code specifies, however, that the debt is nondischargeable only if the creditor reasonably relied on the financial statement.[277] Thus, nondischargeability is limited to the "new money" advanced after the fraudulent statement is received unless the existing loan is in default or the creditor otherwise detrimentally relies on the false financial statement with respect to the original

267. *Id.* A debt based on fraud will be discharged unless the creditor to whom such debt is owed timely files a complaint to determine dischargeability. *Id.* § 523(c); FED. BANKR. R. 409. *See* text accompanying notes 324-329 *infra.*

268. The term "insider" is broadly defined in *id.* § 101(25). *See* note 223 *supra.*

269. The burden of proof is on the creditor to prove the elements of nondischargeability. *Cf.* FED. BANKR. R. 701(7) (nondischargeability proceedings are adversary in nature).

270. *See* 11 U.S.C.A. § 523(a)(2)(A) (West 1979). The Code requires actual fraud as opposed to fraud implied by law. *See* Neal v. Clark, 95 U.S. 704, 709 (1887) (construing similar provision in Bankruptcy Act of 1867).

271. 11 U.S.C.A. § 523(a)(2)(B) (West 1979).

272. A fraudulent oral statement concerning the financial condition of the debtor or an insider does not affect dischargeability. *See id.*

273. Minor irregularities in the debtor's financial statement will not bar dischargeability. The Code requires a statement that is materially false in order to render a debt nondischargeable. *See id.* § 523(a)(2)(B)(i).

274. Reliance on a written false financial statement will not affect dischargeability unless the reliance is reasonable. HOUSE REPORT, *supra* note 2, at 364, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6319-6320; SENATE REPORT, *supra* note 2, at 78, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5864.

275. The debt will be excepted from discharge if the debtor either publishes the statement or causes the statement to be published. "Publish" is used in a broad sense as under the law of defamation. *See* HOUSE REPORT, *supra* note 2, at 364, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6319-6320.

276. 11 U.S.C.A. § 523(a)(2)(B) (West 1979).

277. *Id.* § 523(a)(2)(B)(iii).

debt.[278] For example, if a loan is not in default and the creditor makes a new loan for an increased principal amount in place of the old loan in reliance on a false financial statement, only that portion of the new loan representing a fresh advance will be nondischargeable. On the other hand, if a loan is in default and the creditor makes a new loan in reliance on a false financial statement as part of a settlement, then the entire new loan is nondischargeable if the creditor has waived remedies with respect to the old loan.

The third kind of debt excepted from discharge is a debt that is neither listed nor scheduled[279] in a timely manner.[280] Moreover, if the debtor knows the creditor's name and fails to list the name, the debt generally is nondischargeable even if the debt is listed or scheduled.[281] Usually the requirement that a debt be timely scheduled is met if the debt is scheduled in time to permit timely filing[282] of a proof of claim.[283] With respect to timely scheduling of a debt based on fraud, a false financial statement, embezzlement, larceny, or willful and malicious injury, the creditor must be able to make a timely request[284] for a determination of dischargeability as well as to timely file a proof of claim.[285]

Generally, if the creditor has notice or actual knowledge of the case sufficient to file a timely proof of claim, the debt is not excepted from discharge on the basis that it was not scheduled.[286] If the unsecured debt, however, is based on fraud, false pretenses, a false financial statement, embezzlement, larceny, or for willful and malicious injury, then the creditor must have notice or actual knowledge of the case in time to file both a complaint to determine dischargeability as

278. HOUSE REPORT, *supra* note 2, at 129-30, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6090; 124 CONG. REC. H11,096 (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards); 124 CONG. REC. S17,412 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini). *See generally In re* Danns, 558 F.2d 114 (2d Cir. 1977).

279. The Act requires the debtor to file a list of creditors and a statement of financial affairs. 11 U.S.C.A. § 521(1) (West 1979). *See also id.* § 1106(a)(2).

280. *Id.* § 523(a)(3).

281. *Id.*

282. The Code does not specify the time period within which a proof of claim must be filed. That issue is determined by the Rules of Bankruptcy Procedure. *See* FED. BANKR. R. 302(e); FED. INTERIM BANKR. R. 3001 (reorganization case).

283. 11 U.S.C.A. § 523(a)(3)(A) (West 1979).

284. The Code does not specify whether the "request" is to be made by complaint, motion, or application. Bankruptcy Rules 701 and 703 specify that the request to determine dischargeability be made by filing a complaint commencing an adversary proceeding. FED. BANKR. R. 701 & 703. *Cf.* text accompanying notes 235-238 *supra.*

285. 11 U.S.C.A. § 523(a)(3)(B) (West 1979).

286. *Id.* § 523(a)(3).

well as a proof of claim, or the debt will be excepted from discharge.[287] Significantly, even though the creditor is barred from objecting to discharge, the debt nevertheless may be nondischargeable if not properly scheduled.[288]

The fourth kind of debt that may be excepted from discharge is a debt for fraud or defalcation while acting in a fiduciary capacity, or for embezzlement or larceny.[289] Congress intended "larceny" to include willful and malicious conversion in which injury occurs, even in the absence of intent to inflict injury.[290]

The fifth category of nondischargeable debts concerns debts for alimony, maintenance, or support.[291] This kind of debt is excepted from discharge, however, only if it is owed to a spouse, former spouse, or child of the debtor[292] and has not been assigned to another entity.[293] The determination whether a debt is for alimony, maintenance, or support is a federal question to be resolved by the bankruptcy court. As long as the debt is connected with a separation agreement, divorce decree, or property settlement agreement, the court may characterize it as alimony, maintenance, or support.[294] On the other hand, the bankruptcy court may decide that a debt is not actually for alimony, maintenance or support, even though the debt may be so denominated under state law.[295]

The sixth kind of nondischargeable debt is a debt for willful and malicious injury.[296] The injury must be caused by the debtor to another entity[297] or to the property of another entity.[298] Moreover, the

287. The Code refers to debts of a kind specified in paragraph (2), (4), or (6) of § 523(a). *Id.* § 523(a)(3)(B).

288. *Id.* The bar has no bearing on the dischargeability of the debt. *See id.* The express legislative intent was to overrule Birkett v. Columbia Bank, 195 U.S. 345 (1904) (construing § 17a of the Bankruptcy Act). 124 CONG. REC. H11,095 (daily ed. Sept. 28, 1978).

289. 11 U.S.C.A. § 523(a)(4) (West 1979).

290. 11 U.S.C.A. § 523(a)(5) (West 1979).

291. *See* HOUSE REPORT, *supra* note 2, at 364, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6323.

292. *Id.*

293. 11 U.S.C.A. § 523(a)(5)(A) (West 1979). Even if the debt is assigned to a third party, such as a state welfare agency, by operation of law, it will not be excepted from discharge. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 328, 92 Stat. 2679, which repeals § 456 of the Social Security Act, 42 U.S.C. § 656(b)(1976), relating to child support payments. *But see* § 221 of S. 658, 96th Cong., 1st Sess. (1979), as passed by the Senate on September 7, 1979, which proposes to reinstate § 456(b) of the Social Security Act for cases under the Bankruptcy Act and § 130(b) of that bill, which purports to do likewise for cases under the Code.

294. 11 U.S.C.A. § 523(a)(5) (West 1979).

295. *Id.* § 523(a)(5)(B).

296. *Id.* § 523(a)(6).

297. "Entity" is a term broadly described in § 101(14) to include a person, estate, trust, or

injury must be intentional in order for the debt to be nondischargeable; mere negligent injury or reckless disregard will not suffice.[299] Willful and malicious injury encompasses willful and malicious conversion in which injury is caused.[300]

The seventh kind of nondischargeable debt generally concerns a debt for a fine, penalty, or forfeiture.[301] To the extent[302] that such a debt is payable to and for the benefit[303] of a governmental unit,[304] and is not compensation for actual pecuniary loss, the debt is nondischargeable.[305] The debt nevertheless may be discharged if it is a tax penalty relating to a dischargeable tax[306] or to a taxable event that occurred more than three years before the date of the filing of the petition.[307]

The eighth category of debts excepted from discharge involves certain debts for educational loans.[308] If the debt is "for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution of higher education," then as a general rule the debt is nondischargeable.[309] If, however, the first payment on the loan became due more than five years before the date of the filing of the petition, exclusive of any suspension of repayment, then the entire debt is dischargeable.[310] Moreover, even if the loan was first due less

governmental unit. The term "person" is defined in § 101(30) to include an individual, partnership or corporation but does not include a governmental unit. The term "governmental unit" is defined in § 101(21) in a broad sense. *Id.* § 101(14), (21), (30). *See* note 306 *infra.*

298. *Id.* § 523(a)(6).

299. The express intent of Congress was to overrule Tinker v. Colwell, 193 U.S. 473 (1904) (implying that § 17a(8) of the Bankruptcy Act encompasses "reckless disregard"). HOUSE REPORT, *supra* note 2, at 365, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6324. *Cf. In re* Rambo, 5 BCD 800 (M.D. Tenn. 1979) (applying rationale in *House Report* to § 17a(8) of the Bankruptcy Act).

300. 124 CONG. REC. H11,096 (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards); 124 CONG. REC. S17,412 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini).

301. 11 U.S.C.A. § 523(a)(7) (West 1979).

302. The words "to the extent" mean that part of the debt may be nondischargeable if the terms of the Code only apply with respect to a portion of the debt.

303. In order to be nondischargeable, the debt must be owed both to the governmental unit and for its benefit—that is, not for the benefit of a third party.

304. "Governmental unit" is defined to mean the United States, a state, a commonwealth, a district, a territory and a municipality among others. The term "municipality" is defined to mean political subdivision or public agency or instrumentality of a state. 11 U.S.C.A. § 101(21), (29) (West 1979).

305. *Id.* § 523(a)(7).

306. *Id.* § 523(a)(7)(A).

307. *Id.* § 523(a)(7)(B).

308. *Id.* § 523(a)(8) (as amended by Act of Aug. 14, 1979, Pub. L. No. 96-56, 93 Stat. 387).

309. *Id.*; *see* note 304 *supra.*

310. *Id.* § 523(a)(8)(A) (as amended by Act of Aug. 14, 1979, Pub. L. No. 96-56, 93 Stat. 387).

than five years before the date of the filing of the petition, the debt is dischargeable if excepting the debt from discharge will impose an undue hardship on the debtor and the debtor's dependents.[311] Of course, if the educational loan is owed to an entity that is not a governmental unit or an institution of higher education, and the loan is not guaranteed, insured, or partially funded by such a unit or institution, the debt is dischargeable.[312]

The ninth category of nondischargeable debt is comprised of debts that were listed[313] or scheduled by the debtor in a prior bankruptcy case[314] in which the debtor's discharge was waived or denied.[315] If the debtor's discharge in the prior case was denied solely by virtue of the six year bar[316] or failure to pay filing fees,[317] then the exception to discharge based on denial of discharge does not apply.

As a general proposition, once a debt is excepted from discharge, the debt will never be discharged in a subsequent bankruptcy case. If the sole reason that the debt is excepted from discharge is based, however, on a time limitation or the failure to schedule the debt, then the debt may be dischargeable in a subsequent bankruptcy case. Thus, nondischargeable debts for taxes[318] or educational loans[319] may be discharged in a subsequent bankruptcy case.[320] If the debts are sufficiently stale so that they would not be excepted from discharge by a fresh application of the Code in the subsequent case, then the debts will be dischargeable. Likewise, if the debts are nondischargeable due solely to the debtor's failure to list the debts,[321] then the debts may be

311. 11 U.S.C.A. § 523(a)(8)(B) (West 1979).

312. Note that a debt for an educational loan owing to a private financial institution is nondischargeable if the debt is insured or guaranteed by a governmental unit. *Id.* § 523 (a)(8) (as amended by Act of Aug. 14, 1979, Pub. L. No. 96-56, 93 Stat. 387).

313. The statute also specifies that debts that could have been scheduled or listed by the debtor are excepted from discharge. 11 U.S.C.A. § 523(a)(9) (West 1979).

314. The prior case can be a case under the Code or the Bankruptcy Act. *Id.*

315. *Id.* Waiver of discharge under the Bankruptcy Act could be implied, but waiver under the Code is permitted only if approved by the court. *See* text accompanying notes 232-234 *supra.*

316. *See* Bankruptcy Act § 14c(5), 11 U.S.C. § 32(c)(5)(1976) (repealed 1978); 11 U.S.C.A. § 727(a)(8)-(9) (West 1979). *See also* text accompanying notes 227-231 *supra.*

317. *See* Bankruptcy Act § 14c(8), 11 U.S.C. § 32(c)(8)(1976) (repealed 1978).

318. Nondischargeable taxes or customs duties are specified in 11 U.S.C.A. § 523(a)(1) (West 1979). *See* text accompanying notes 261-265 *supra.* Also covered are debts for taxes that were nondischargeable under section 17a(1) of the Bankruptcy Act. *Id.*

319. Nondischargeable educational loans are specified in 11 U.S.C.A. § 523(a)(8) (West 1979). *See* text accompanying notes 308-312 *supra.*

320. *Id.* § 523(b).

321. The exception to discharge based on the debtor's failure to list or schedule debts is contained in *id.* § 523(a)(3). *See* text accompanying notes 279-288 *supra.*

discharged in a subsequent bankruptcy case. Debts for priority wages that were nondischargeable under the Bankruptcy Act[322] are subject to discharge in a subsequent case under the Code.[323]

The Code contains special provisions with respect to debts based on fraud, false financial statements,[324] embezzlement, larceny,[325] and willful and malicious injury.[326] The burden is on the creditor who holds the debt to litigate the issue of nondischargeability promptly before the bankruptcy court. Specifically, the creditor must timely request the bankruptcy court to determine the nondischargeability of the debt or the debt will be discharged.[327]

The Code does not specify the form of the request or the time limit within which the request must be made. The Rules of Bankruptcy Procedure, however, continue to be effective in this context.[328] In particular, Bankruptcy Rule 701(7) specifies that the request to determine dischargeability of a debt be made by filing a complaint. Moreover, Bankruptcy Rule 409 requires the complaint to be filed within the time fixed by the court. Therefore, if the debt is scheduled and the creditor fails to timely file a complaint, the debt will be discharged.[329]

The Code also contains a special provision designed to discourage creditors from filing complaints seeking to except from discharge consumer debts based on fraud or a false financial statement in order to pressure the debtor into settlement.[330] If a creditor files a complaint to determine that a consumer debt[331] is nondischargeable based on grounds of fraud, false pretenses, or a written false financial state-

322. Bankruptcy Act § 17a(5), 11 U.S.C. § 35(a)(5) (repealed 1978).

323. 11 U.S.C.A. § 523(b) (West 1979). Debts for priority wages are not excepted from discharge under the Code.

324. *Id.* § 523(a)(2).

325. *Id.* § 523(a)(4).

326. *Id.* § 523(a)(6).

327. *Id.* § 523(c). The debt will not be discharged, however, unless it was timely scheduled within *id.* § 523(a)(3)(B).

328. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 405(d), 92 Stat. 2549 (codified at note preceding 28 U.S.C.A. § 1471 (West 1979)); text accompanying notes 235-236 *supra.*

329. Complaints to determine nondischargeability of debts of the kind specified in ¶¶ (1), (3), (5), (7), (8), and (9) of § 523(a) need not be filed with the bankruptcy court. State courts have jurisdiction over those kinds of nondischargeability complaints subject to the paramount jurisdiction of the bankruptcy court. *See* 28 U.S.C.A. §§ 1471(b) & 1478(a) (West 1979).

330. 11 U.S.C.A. § 523(d) (West 1979). *See* HOUSE REPORT, *supra* note 2, at 131-32, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6028-6030 which concludes that 50% of the false financial statement cases settled by consumer debtors involved dischargeable debts.

331. The term "consumer debt" is defined to mean a debt incurred by an individual primarily for a personal, family, or household purpose. 11 U.S.C.A. § 101(7) (West 1979).

ment,[332] and the debt is nevertheless discharged,[333] the court will grant judgment[334] against the creditor for costs and attorneys' fees.[335] The judgment for costs and fees must be granted unless it clearly would be inequitable to do so.[336]

Thus, creditors should file complaints to determine dischargeability of consumer debts based on fraud or false financial statements only after considering the magnitude of the debtor's costs and attorneys' fees and the probability that the debts will be discharged. Similarly, the debtor's attorney should consider the probability that the debts will be discharged in determining whether to contest dischargeability litigation of this kind on a contingent fee basis.

## VI. EFFECT OF DISCHARGE

Once the debtor receives a discharge, the Code specifies several protections to aid his fresh start.[337] The discharge automatically voids any judgment[338] to the extent the judgment determines the personal liability of the debtor on a discharged[339] debt.[340] The judgment is void whether or not discharge of the debt is waived.[341] Also, the discharge automatically enjoins the commencement or continuation of an action, the employment of process, or any act to collect[342] a discharged debt.[343] The injunction prevents recovery of the debt, either as a personal liability of the debtor or from property of the debtor,[344] and operates as an

332. *Id.* § 523(a)(2).

333. The Code does not limit the reasons why the debt is discharged to the merits of the dischargeability complaint. Thus, if the complaint is settled and the debt is discharged, § 523(d) applies. *See id.* § 523(d).

334. The judgment against the creditor is granted in favor of the debtor. *Id.*

335. *Id.*

336. *Id.*

337. *Id.* § 524. The special protection afforded by § 524 applies whether the discharge is granted in a case under Chapter 7, 9, 11, or 13. *Id.*

338. *Id.* § 524(a)(1). The Code voids judgments whether obtained before, during, or after the bankruptcy case.

339. The kinds of debts discharged are specified in *id.* §§ 727(b), 1141(d), or 1328. *But see id.* § 523 (relating to nondischargeable debts).

340. *Id.* § 524(a)(1).

341. *Id.* Note, however, that waiver of the entire discharge will mean that § 524 does not apply. *See id.* § 727(a)(10).

342. The injunction also applies to prevent recovery or offset of the discharged debt.

343. 11 U.S.C.A. § 524(a)(2) (West 1979).

344. *Id.* The injunction is necessary since the automatic stay terminates when the discharge of an individual debtor is granted. *Id.* § 362(c)(2)(C). The injunction, however, does not affect the liability of an entity that is liable with, or that has guaranteed a debt of, the debtor. *Id.* § 524(e). Nor should the injunction apply to prevent enforcement against the debtor's property of a valid lien not avoided in the bankruptcy case. *Cf.* 11 U.S.C.A. § 522(c) (West 1979).

injunction whether or not discharge of the debt is waived.[345] Taken together, the invalidation of judgments and the injunction operate to shield the debtor from actions by creditors holding discharged debts.

If the debtor obtains community property after the commencement of the case,[346] the discharge may provide one additional protection. Generally, the discharge operates as an injunction against the commencement or continuation of an action, the employment of process, or any act to collect[347] a discharged community debt[348] from community property.[349] The injunction, however, does not apply to collection of a community claim that is excepted from discharge in the debtor's bankruptcy case.[350] The injunction also does not apply if the community claim would be excepted from discharge in a hypothetical case[351] concerning the debtor's spouse.[352] Moreover, the injunction applies whether or not discharge of the community claim is waived.[353]

In addition, there are some circumstances in which the community property injunction will not apply if the discharge of the debtor's spouse is denied or would be denied.[354] In particular, if the debtor's spouse is a debtor[355] in a case commenced within[356] six years of the

345. *See* note 341 *supra.*

346. Community property includes as property of the estate almost all interests of the debtor and the debtor's spouse as of the commencement of the case. 11 U.S.C.A. § 541(a)(2) (West 1979). The property, however, must either be under the sole, equal, or joint management and control of the debtor, or be liable for a claim against the debtor or for a claim against both the debtor and the debtor's spouse. *Id.*

347. *See* note 342 *supra.*

348. The term "community claim" is defined to mean a claim arising before the commencement of the case for which community property is liable. It is irrelevant that there is no community property in the estate when the case is filed. *See* 11 U.S.C.A. § 101(6) (West 1979). *See* note 346 *supra.*

349. *Id.* § 524(a)(3).

350. *Id.*

351. *Id.* The hypothetical case is commenced on the same date as the debtor's case.

352. In determining whether the debt would be excepted from discharge in the hypothetical case concerning the debtor's spouse, the court must apply the standards of §§ 523(c) and (d). *See id.* § 524(a)(3). Thus, a creditor must bring a complaint to determine dischargeability of a debt of the kind specified in ¶(2), (4), or (6) of § 523(a) in the bankruptcy court in a timely manner. *See* text accompanying notes 324-329 *supra.* If a creditor fails to prevail on a complaint to determine the nondischargeability of a consumer debt of the spouse under § 523(a)(2), then the court is virtually required to award judgment against the creditor for the debtor's costs and attorneys' fees. *See* text accompanying notes 330-36 *supra.*

353. *See* note 341 *supra.*

354. 11 U.S.C.A. § 524(b) (West 1979).

355. The limitation applies whether the debtor's spouse is a debtor under title 11 or under the Bankruptcy Act. *Id.* § 524(b)(1)(A).

356. The spouse's case may be commenced within six years before or after the debtor's case. *Id.*

debtor's case, and the spouse is not granted[357] a discharge, the community property injunction will not apply to protect the debtor.[358] Alternatively, if the court would not grant the debtor's spouse a discharge in a hypothetical Chapter 7 case commenced at the same time as the debtor's case, then the community property injunction will not apply in the debtor's case.[359]

Procedurally, the objection to discharge of the debtor's spouse must be made in the same manner as an objection to the debtor's discharge.[360] Thus, Bankruptcy Rule 701(7) requires the creditor to file a complaint objecting to the spouse's hypothetical discharge within the guidelines of Bankruptcy Rule 404 and Interim Rule 4003.[361]

The complex series of rules governing the community property injunction commonly is referred to as the "split discharge."[362] In general, the effect of the injunction is to restrain holders of allowable community claims from collecting upon or recovering from after-acquired, exempt, or abandoned community property to satisfy discharged community debts. To the extent creditors of the nondebtor spouse have claims against community property that could[363] be property of the estate, their community claims[364] usually are dischargeable in the debtor's bankruptcy.[365] This protects the debtor's discharge by insulating after-acquired community property, such as earnings, from creditors with claims against the debtor's spouse. Otherwise, creditors with claims against the debtor and the debtor's spouse could subvert the debtor's discharge by asserting their claims against the nondebtor spouse with the result that the debtor's after-acquired community property would be liable.

Since creditors of the nondebtor spouse may have their community claims discharged, they are given an opportunity to file proofs of

357. The spouse should be denied a discharge for this provision to apply. If the discharge is not granted because the case is dismissed, the injunction in the debtor's case should not be affected. *See id.* § 349(a).

358. *Id.* § 524(b)(1).

359. *Id.* § 524(b)(2).

360. *Id.* § 524(b)(2)(B); *see* text accompanying notes 235-243 *supra.*

361. *Id.* The creditor has the burden of proof in proving the facts essential to sustaining an objection to discharge. FED. BANKR. R. 408.

362. *See* HOUSE REPORT, *supra* note 2, at 366, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6321-6322.

363. A "community claim" is defined as a prepetition claim for which community property of the estate is liable whether or not the estate contains any such property as of the commencement of the case. 11 U.S.C.A. §§ 101(6) & 541(a)(2) (West 1979).

364. *See* notes 346 & 348 *supra.*

365. 11 U.S.C.A. § 524(a)(3) (West 1979).

claim and to participate as creditors[366] in the debtor's bankruptcy case.[367] Special distribution rules are designed to provide that community creditors of the debtor and community creditors of the debtor's spouse share equitably in various kinds of property that may comprise the debtor's estate.[368] Unless a proof of claim is filed by or on behalf of the community creditor, however, there will be no distribution on account of the creditor's community claim.[369]

Whether or not the creditor files a proof of claim, the community claim will be dischargeable.[370] Thus, community creditors of the nondebtor spouse are encouraged to participate in the debtor's bankruptcy case as the last opportunity[371] to recover their community debts from the debtor's community property.[372]

## VII. REAFFIRMATION

### *A. In General*

Unlike prior law and practice,[373] the Code severely limits the effectiveness of reaffirmation of discharged debts.[374] To give further effect to the discharge,[375] the Code prohibits the enforceability of agreements providing for reaffirmation of debts dischargeable under title 11 unless several conditions are met.[376] This general prohibition against the enforceability of such an agreement applies whether or not discharge of

366. The term "creditor" is defined as an entity that has a community claim. *Id.* § 101(9)(c).

367. *See id.* § 501(a).

368. *See id.* § 726(c). *See also* HOUSE REPORT, *supra* note 2, at 383-84, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3963, 6338-6340.

369. *See* 11 U.S.C.A. §§ 501, 502, & 726 (West 1979).

370. *See id.* §§ 727(b) & 1141(d)(1)(A).

371. A community creditor may have another opportunity to reach the debtor's community property if the debtor is denied a discharge or the creditor's community debt is nondischargeable.

372. The debtor is required to list community creditors who subsequently will receive notice of the debtor's bankruptcy case. 11 U.S.C.A. §§ 101(9) & 521(1) (West 1979). *See* FED. BANKR. R. 203.

373. Under the Bankruptcy Act, there was no prohibition against reaffirmation. Governing state law generally provided that the bar of a discharge could be waived by the making of a new promise after the commencement of the bankruptcy case. *See In re* Thompson, 416 F. Supp. 991, 996 (S.D. Tex. 1976); 1A COLLIER ON BANKRUPTCY ¶¶17.33, 17.34 (14th ed. 1978).

374. 11 U.S.C.A. §§ 524(c) & (d) (West 1979).

375. HOUSE REPORT, *supra* note 2, at 366, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6321-6322.

376. 11 U.S.C.A. § 524 (West 1979). In the absence of compliance with § 524(c), the *entire* agreement is unenforceable and not just to the extent that the agreement is based upon a dischargeable debt. The prohibitions of § 524(c) do not extend to reaffirmation of debts discharged under the former Bankruptcy Act. *See* HOUSE REPORT, *supra* note 2, at 366, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6321. ("It will only apply to discharges granted if commenced under the new title 11 Bankruptcy Code.")

the debt that is the subject of the reaffirmation has been waived.[377]

Section 524(c) enumerates the requisite conditions for the enforceability of reaffirmation agreements. First, the reaffirmation agreement otherwise must be enforceable under applicable nonbankruptcy law. Second, the reaffirmation agreement must have been made before the granting of the discharge.[378] Third, the agreement must not have been rescinded by the debtor within thirty days after the agreement became enforceable.[379] For an individual debtor,[380] with respect to a consumer debt not secured by the debtor's real property,[381] the reaffirmation agreement only becomes enforceable after the court has determined at a discharge hearing either that the agreement does not impose an undue hardship on the debtor or the debtor's dependents and is in the debtor's best interest, or that the agreement was entered into in good faith and in settlement of nondischargeability litigation or in connection with the redemption of collateral.[382] Since the reaffirmation agreement for such a debtor is unenforceable until after the court makes the requisite determination at the discharge hearing, the individual debtor has at least thirty days from the discharge hearing to rescind the reaffirmation agreement.

Last, in order for a reaffirmation agreement by an individual debtor to be effective, the court must hold a discharge hearing that complies with certain enumerated requirements.[383] In a case involving an individual, the court must hold a hearing at which the debtor is required to appear in person. At the hearing, "the court shall inform the debtor that a discharge has been granted or the reason why a discharge has not been granted."[384] If the debtor whose discharge has been entered desires to enter into an agreement reaffirming a dischargeable debt,[385] the court must advise the debtor that reaffirmation is not required by any applicable law, Code or nonbankruptcy, and must inform the debtor of the legal consequences and effects of a reaffirmation agreement and of a default under the agreement.[386]

377. 11 U.S.C.A. § 524(c) (West 1979).
378. *Id.* § 524(c)(1).
379. *Id.* § 524(c)(2).
380. *Id.* § 524(d).
381. *Id.* § 524(d)(2).
382. *Id.* §§ 524(c)(3) & 4; *see* text accompanying notes 383-391 *infra.*
383. *Id.* § 524(d).
384. *Id.*
385. *Id.*
386. *Id.* § 524(d)(1).

### B. *Special Requirements For Consumer Debts Not Secured By The Debtor's Real Property*

In the instance in which the debtor wishes to reaffirm a consumer debt[387] not secured by the debtor's real property, the court must not only hold the discharge hearing and give the required warnings,[388] but must also approve the agreement to render it enforceable.[389] The reaffirmation agreement may be approved on two alternative grounds: Either the agreement will not impose an undue hardship on the debtor or the debtor's dependents and is in the debtor's best interest, or the agreement must be entered into in good faith and in settlement of dischargeability litigation[390] or provide for redemption of collateral.[391]

## VIII. PROTECTION AGAINST DISCRIMINATORY TREATMENT

The Code further protects the debtor's discharge by codifying[392] and expanding the Supreme Court's decision in *Perez v. Campbell*,[393] which voided an Arizona law that permitted suspension of a driver's license for failure to pay a personal injury judgment, even though that judgment had been discharged in bankruptcy.

The Code[394] prohibits a governmental unit[395] from denying, re-

387. *See* note 185 *supra*.

388. 11 U.S.C.A. § 524(d)(1) (West 1979).

389. *Id.* § 524(d)(2).

390. *See id.* § 523. Reaffirmation is permitted only if the agreement was made prior to the granting of discharge. *Id.* § 524(c)(1). Entry of discharge forthwith could preclude settlement of dischargeability litigation by reaffirmation under § 524(c)(4)(B). Accordingly, Interim Rule 4002 provides that "the court, on application of the debtor, shall defer entry of an order granting discharge for 45 days and, on application within the 45-day period, the court may for cause further delay entry of the order to a date certain." INTERIM BANKR. R. 4002.

391. 11 U.S.C.A. § 722 (West 1979). Because the debtor may not have the present ability to redeem, § 524(c) permits reaffirmation of the allowed amount of the secured creditor's claim to give effect to the redemption right of § 722. *See id.* §§ 524(c)(4)(B)(ii) & 722.

392. *Id.* § 525. One purpose of § 525 is "to strengthen the anti-reaffirmation policy" of § 524. HOUSE REPORT, *supra* note 2, at 367, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6321-6322.

393. 402 U.S. 637 (1971).

394. 11 U.S.C.A. § 525 (West 1979).

395. "Governmental Unit" means "United States; State; Commonwealth, District; Territory; municipality, foreign state . . . or other foreign or domestic government" or a department, agency, or instrumentality thereof. *Id.* § 101(21). "Municipality" means "political subdivision or public agency or instrumentality of a State." *Id.* § 101(29). It is unlikely that a state chartered bank or a national bank would fall within either definition. *See* HOUSE REPORT, *supra* note 2, at 311 (" 'Department, agency or instrumentality' does not include entities that owe their existence to State action such as the granting of a charter or a license but that have no other connection with a State or local government or the Federal Government. The relationship must be an active one in which the department, agency, or instrumentality is actually carrying out some governmental function.") The following laws are excepted from the prohibition of § 525: Perishable Agricul-

voking, suspending or refusing to renew a license, permit, charter, franchise or other similar grant to the debtor; from conditioning such a grant to the debtor; from discrimination against the debtor with respect to such a grant; from denying employment to the debtor; from terminating the employment of the debtor; or from discriminating with respect to employment against a person that is or has been a debtor under title 11, or a debtor or bankrupt under the Bankruptcy Act, or that is or has been associated with a debtor.[396] The prohibition extends only to discrimination or other action based solely on the ground of bankruptcy, whether under the Code or under the Bankruptcy Act; on the ground of insolvency, before or during bankruptcy prior to a determination of discharge; or on the ground of nonpayment of a debt discharged in the bankruptcy case, whether under the Code or under the Bankruptcy Act. Thus, the prohibition against discriminatory treatment by a governmental unit should prevent state-funded schools from withholding transcripts from students who have had their loans discharged.[397]

The prohibition is neither preemptive nor exhaustive. According to the House Report:[398]

> The enumeration of various forms of discrimination against former bankrupts is not intended to permit other forms of discrimination . . . . This section permits further development to prohibit actions by governmental or quasi-governmental organizations that perform licensing functions, such as a State bar association or a medical society, or by other organizations that can seriously affect the debtors' livelihood or fresh start, such as exclusion from a union on the basis of discharge of a debt to the union's credit union.

The Code, however, "does not prohibit consideration of other factors, such as future financial responsibility or ability, and does not prohibit imposition of requirements such as net capital rules, if applied nondiscriminatorily."[399]

---

tural Commodities Act, 7 U.S.C. §§ 499a-499s (1976), Packers & Stockyards Act, 7 U.S.C. §§ 181-229 (1976), and section 1 of 17 U.S.C. § 204 (1976).

396. 11 U.S.C.A. § 525 (West 1979); HOUSE REPORT, *supra* note 2, at 366-67, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6320-6322.

397. *See, e.g.*, Handsome v. Rutgers University, 445 F. Supp. 1362 (D.N.J. 1978). *But see* Girardier v. Webster College, 563 F.2d 1267 (8th Cir. 1977) (private college entitled to withhold transcripts).

398. HOUSE REPORT, *supra* note 2, at 367.

399. *Id.*

## IX. CONCLUSION

Without question, the Code assembles the most potent arsenal of weapons ever granted to a consumer debtor. The debtor may immunize exempt property from distribution to creditors with dischargeable unsecured debts. Moreover, the debtor may choose between state and federal nonbankruptcy law exemptions and uniform Code exemptions. In addition, under certain conditions, the debtor may avoid certain liens on exempt property and may utilize the trustee's avoiding powers to recover exempt property. In addition, consumer debtors may redeem certain essential tangible personal property.

The Code also relieves the consumer debtor of nondischargeable debts unless a specific basis exists to deny the debtor's discharge. The Code protects the discharge by invalidating judgments based upon discharged debts and enjoining certain actions by creditors holding discharged debts. Finally, the Code prohibits discrimination against the debtor based on bankruptcy.