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THE REPORT OF THE BANKRUPTCY COMMISSION: THE FIRST FIVE CHAPTERS OF THE PROPOSED NEW BANKRUPTCY ACT*

FRANK R. KENNEDY†

The Commission on Bankruptcy Laws of the United States completed its work and went out of existence in accordance with the legislation creating it, as amended, on August 30 of last year.¹ The Commission was born on July 24, 1970, but there was a postnatal period of ten months during which the Commissioners were being chosen and the nucleus of a staff was being recruited. The work of the Commission and staff really commenced on June 1, 1971, and continued without interruption for the next 27 months.²

Notwithstanding incredible delays that dogged its duplication and distribution, the Commission's three-part Report has been completed.³ Whatever praise or criticism may be heaped on the Commission's Report

* This article is a revision of a paper presented at the Creditors' and Debtors' Rights Section program of the meeting of the Association of American Law Schools held in New Orleans, La., December 29, 1973.

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1. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970), *as amended*, Act of July 1, 1973, Pub. L. No. 93-56, 87 Stat. 140 (1973).

2. The Commission was created by Congress, but three of its nine members were appointed by the President, two by the Chief Justice, two by the President of the Senate, and two by the Speaker of the House. *Id.* § 2. The President appointed the chairman, Harold Marsh, Jr., who was for many years a member of the law faculty at the University of California at Los Angeles but now practices law in Los Angeles; Charles Seligson, who has been a member of the law faculty of New York University and the dean of the New York bankruptcy bar for many years; and J. Wilson Newman, chief financial officer of Dun & Bradstreet and its former president. The Chief Justice appointed two distinguished federal judges, Edward Weinfeld of the Southern District of New York, and Hubert L. Will of the Northern District of Illinois. The two Senators were Quentin Burdick of North Dakota, the father of the Commission, and Marlow Cook of Kentucky. The two Congressmen were Don Edwards and Charles Wiggins from California. The Congressmen and Senators were all members of the Judiciary Committees of their respective Houses of Congress through which all bankruptcy legislation must pass.

3. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, JULY 1973, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) [hereinafter cited as REPORT]. Part I of the report consists of twelve chapters setting forth in expository form the Commission's views of the problems that require congressional overhaul of the bankruptcy laws and their administration as well as the proposed solutions of the Commission. In addition, Part I includes chapters on the causes of bankruptcy and the basic philosophy of bankruptcy.

Part II includes the text of a proposed new Bankruptcy Act of 1973 and notes explaining the purposes, sources, and intended effects of the new legislation, as well as proposed amendments to the Internal Revenue Code and the Judicial Code.

Part III is a compilation of six reprints of reports, or summaries thereof, based on studies undertaken on behalf of the Commission.

—and it has been getting a good deal of the latter⁴ notwithstanding its limited exposure—I must emphasize that it is the Report of the Commission. The input of the Commissioners at all stages was substantial and significant, and, with one exception,⁵ it was a unanimous report.

The Bankruptcy Act proposed by the Commission⁶ has been introduced in both houses of the 93d Congress. In this article, I am going to focus primarily on the structure of the bankruptcy system proposed by the Commission, the proposed treatment of consumer debtors, and features of the provisions dealing with liquidation of estates. These aspects of the Report involve the first five chapters of the proposed Bankruptcy Act.

Structure

The present Bankruptcy Act⁷ is administered by courts of bankruptcy, which are federal district courts.⁸ However, most of the burden is carried by referees in bankruptcy who are regarded as arms, branches, or agents of the United States district courts for the purposes of handling bank-

4. See Bobier, *Proposed Revision of Bankruptcy Act: A Critique*, 28 PERS. FIN. L.Q. REP. 19 (1973); Cyr, *The Bankruptcy Act of 1973: Back to the Drafting Board*, 48 AM. BANKR. L.J. 45 (1974); Francis, *The Commercial Secured Creditor and the Bankruptcy Act of 1973*, 28 PERS. FIN. L.Q. REP. 55 (1974); Lavien, *Water a Myth and Watch It Grow!*, 79 COM. L.J. 116 (1974); Twinem, *Bankruptcy Report: Some Limitations on Creditors' Rights*, 29 BUS. LAWYER 353 (1974); Weintraub & Cramers, *Critique of Chapter VII and Related Sections of the Proposed Bankruptcy Act of 1973*, 48 AM. BANKR. L.J. 1 (1974); Weintraub & Levin, *Chapter VII (Reorganizations) as Proposed by the Bankruptcy Commission: The Widening Gap Between Theory and Reality*, 47 AM. BANKR. L.J. 323 (1973). But see Coogan, *The Proposed Bankruptcy Act of 1973: Questions for the Non-Bankruptcy Business Lawyer*, 29 BUS. LAWYER 729 (1974); King, *The Business Reorganization Chapter of the Proposed Bankruptcy Code—or Whatever Happened to Chapters X, XI and XII*, 78 COM. L.J. 429 (1973).

5. The exception was the separate statement by Judge Weinfeld respecting chapter II of the proposed Act. He was not in favor of the proposal to create new and independent bankruptcy courts. He would rather keep the referees just where they are in the federal judiciary, though he did acknowledge in the last paragraph of his statement that he approved of a longer term of twelve years for referees as well as adoption of the features of the improved retirement system favored by the Commission. REPORT, *supra* note 3, pt. I, at 299-301.

6. Proposed Bankruptcy Act of 1973, S. 2565, 93d Cong., 1st Sess. (1973); H.R. 10792, 93d Cong., 1st Sess. (1973) [hereinafter cited as Proposed Bankruptcy Act of 1973]. Some stylistic changes have been made in the House bill, and it does not include the proposed amendments of the Internal Revenue Code and the Judicial Code. The Senate bill includes the whole package as proposed by the Commission, but I do not think the Senate Finance Committee will let the Internal Revenue Code amendments get very far without claiming jurisdiction over them. The House bill was introduced by Congressmen Edwards and Wiggins and the Senate bill was introduced by Senators Burdick and Cook.

7. Bankruptcy Act §§ 1-703, 11 U.S.C. §§ 1-1103 (1970).

8. Bankruptcy Act §§ 1(10), 2, 11 U.S.C. §§ 1(10), 11 (1970); see J. MACLACHLAN, BANKRUPTCY §§ 75-76 (1956) [hereinafter cited as MACLACHLAN]; D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 147-172 (1971) [hereinafter cited as STANLEY].

ruptcy matters.⁹ The referees are appointed by the district judges and serve for six years each,¹⁰ although these terms are renewable. The referees perform both judicial and administrative functions under the present Act.¹¹ In addition, many of the administrative functions in bankruptcy are handled by receivers, who are ordinarily appointed by the referees,¹² and by trustees, who are sometimes elected by the creditors but more often appointed by the referees in bankruptcy¹³ or, in corporate reorganization cases and railroad reorganizations, by the district judges.¹⁴ All receivers and most trustees are appointed only for particular cases,¹⁵ although in some parts of the country there are what are known as professional trustees in bankruptcy, who serve in many cases and who make their principal livelihood serving as trustees.

The Commission believed that there are defects in the system. In the first place, referees are engaged in incompatible duties since they both supervise administration of estates in the bankruptcy courts and perform the judicial functions of deciding disputes between litigants, including the trustee whom they appoint and supervise. The referee's involvement in administration compromises his judicial independence or at least the appearance of such independence.¹⁶ Moreover, involvement in administration is a drain and an inefficient use of judicial manpower. The Commission believed that the answer to this problem is the separation of judicial and administrative functions. The judicial functions should be performed by bankruptcy judges free from responsibility for handling administrative details and elevated in stature so as to command the respect of the litigants who appear before them, both those who are adversaries of the trustees and the trustees in bankruptcy. The Commission recommended the creation of separate and independent bankruptcy courts staffed by bankruptcy judges appointed for fifteen year terms by the President with the consent of the Senate.¹⁷

9. See Note, *The Federal Magistrates Act—An Exercise in Article III Constitutionality*, 17 WAYNE L. REV. 1483, 1486-97 (1971).

10. Bankruptcy Act § 34(a), 11 U.S.C. § 62(a) (1970).

11. Bankruptcy Act §§ 38, 39(a), 11 U.S.C. §§ 66, 67(a) (1970); see MACLACHLAN, *supra* note 8, § 76.

12. Rule 201 of the Rules of Bankruptcy Procedure, promulgated October 1, 1973 [hereinafter cited as BANKR. R.].

13. BANKR. R. 209.

14. Bankruptcy Act §§ 156, 77(c), 11 U.S.C. §§ 556, 205(c) (1970). Under the latter section, the Interstate Commerce Commission must ratify the appointment before it becomes effective.

15. Standing trustees are authorized to be appointed for chapter XIII cases. Ch. XIII R. 13-205(a); see Ch. XIII R. 13-1.

16. REPORT, *supra* note 3, pt. I, at 85-98.

17. Proposed Bankruptcy Act of 1973, §§ 2-101, -102.

Under this recommendation, administrative functions would be carried out by an administrative agency of nationwide scope which the Commission designated as the United States Bankruptcy Administration.¹⁸ The Administration, or administrator as the chief executive officer is designated,¹⁹ would perform these functions by means of a permanent staff of accountants, attorneys, counselors, appraisers, auctioneers, and other persons required to discharge the duties of collecting estates, converting them to proceeds, and effecting their distribution.²⁰ It is believed that most cases involving consumers will generate little judicial business for the courts.²¹ These cases presently comprise over ninety percent of the approximately two-hundred thousand cases filed in the bankruptcy system each year.²² The Commission, however, did not foresee any substantial increase or decrease in the number of filings of bankruptcy cases as a result of its recommendations.

The present system of bankruptcy is supposed to be self-supporting. The theory is that fees paid by petitioners and charges against the estates and persons served by the system are to defray the costs of its operation. Ironically, however, the system is going bankrupt, a deficit having been incurred for each of the last six or seven years.²³ The referees' salaries and expenses therefore have been paid for, in part, by appropriated funds from the Treasury.²⁴ It is the Commission's recommendation that the bankruptcy judges, who will be performing essentially judicial functions, should be supported as other judges in our system are supported, *i.e.*, by the general revenues.²⁵ The Commission believed, however, that the number bankruptcy judges will be substantially fewer than the number of referees in bankruptcy now serving.²⁶

The United States Bankruptcy Administration would take over not only the administrative functions now performed by referees, but also most of the functions now performed by receivers and trustees. As previously indicated, these officers collect assets, reduce them to cash, and

18. The reasons for creating the agency, its structure, functions, and mode of financing are discussed in chapter 5 of part I of the Report. REPORT, *supra* note 3, pt. I, at 103-53.

19. Proposed Bankruptcy Act of 1973, §§ 1-102(3), 3-102(a).

20. *Id.* § 3-102(d).

21. REPORT, *supra* note 3, pt. I, at 86.

22. See 1972 ANN. REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 240 [hereinafter cited as 1972 ANN. REPORT].

23. REPORT, *supra* note 3, pt. I, at 127.

24. Bankruptcy Act § 40(c)(4), 11 U.S.C. § 68(c)(4) (1970).

25. Proposed Bankruptcy Act of 1973, § 2-107. See also REPORT, *supra* note 3, pt. I, at 149-50.

26. REPORT, *supra* note 3, pt. I, at 95. There are now approximately 220 referees in bankruptcy, including 30 part-time referees. 1972 ANN. REPORT, *supra* note 22, at 242.

distribute the proceeds to creditors and perform other ministerial functions subject to court supervision. The Commission contemplated that these functions will be replaced by a permanent staff of qualified people located in offices scattered throughout the United States at places where they can best carry out their functions, and be subject to managerial control that will insure efficiency and uniformity of action.²⁷ There would remain, however, an option for creditors to elect a trustee if a majority of creditors who participate in this matter in response to the first notice to creditors and who constitute holders of at least thirty-five percent in amount of all claims, vote to hold a meeting to elect a trustee.²⁸ At a meeting of creditors holding at least thirty-five percent in amount of all claims, a majority of the creditors voting may elect a trustee. If not displaced by an elected trustee, the administrator would thus combine the receiver's, the trustee's, and the referee's administrative functions.²⁹ If any dispute should arise or if the creditor or the debtor or other party in interest should wish to contest action taken by the administrator, however, he could take the matter by complaint to the bankruptcy court.³⁰ The premise of this recommendation regarding the displacement of appointed and elected trustees is that there is now a great deal of inefficiency in the system. Moreover, in many locales, the system has appeared to operate for the benefit of its functionaries rather than the debtor and creditors who are supposed to be served by it.³¹ There has been a great deal of maneuvering and competition by solicitors for proxies to control the selection of trustees in business bankruptcies. Under the system as it has operated, a holder of a few proxies, not infrequently a lawyer, will elect the trustee, who, in turn, will typically name the holder of the proxies to be his attorney. In a subsequent case the same holder of the proxies will be elected trustee by the holder of multiple proxies. He will then name as his attorney the person selected as trustee in the previous case. The repetition of this phenomenon in a number of cities has given rise to a widespread belief among lawyers not engaged in bankruptcy practice and in the commercial community that the system is manipulated and operated for the benefit of the lawyers, auctioneers, appraisers, and other members of a "bankruptcy ring."³² The Commission believed that the

27. Proposed Bankruptcy Act of 1973, §§ 3-102, -103.

28. *Id.* § 5-101.

29. REPORT, *supra* note 3, pt. I, at 120-26.

30. Proposed Bankruptcy Act of 1973, § 4-101.

31. See REPORT, *supra* note 3, pt. I, at 4, 103-06, 109-10, 117.

32. The evils associated with solicitation and voting of proxies were the target of BANKR. R. 208, which became effective on October 1, 1973. Section 5-101(a) of the proposed Bankruptcy Act authorizes the administrator to promulgate a similar rule to gov-

establishment of an administrative agency subject to managerial, auditing, and accounting controls will achieve efficiency, economy, uniformity, and integrity of administration.³⁴

Administration of Consumers' Affairs

The resolution creating the Commission pointed out that the annual number of bankruptcies in the United States has increased more than one thousand percent annually in the last twenty years.³⁵ This increase has been attributed largely to the increased number of consumer bankruptcies.³⁶ Consumers can opt for straight bankruptcy—that is, for undelayed discharge from their dischargeable debts,³⁷ although their estates are typically insufficient to permit distribution of dividends to creditors. On the other hand, they may choose to pay their debts pursuant to a wage-earner plan under Chapter XIII,³⁸ typically over a three-year period.

Although wage-earner plans have been popular in a few areas, such plans are seldom used in many districts.³⁹ The Commission has sought to improve the attractiveness and utility of plans for payment by consumer debtors out of future earnings. An important recommendation in this

ern the solicitation of proxies and manner of voting. Proposed Bankruptcy Act of 1973, § 5-101(a).

33. Proposed Bankruptcy Act of 1973, §§ 3-401 to -403.

34. REPORT, *supra* note 3, pt. I, at 7-8, 117-20, 126; cf. MACLACHLAN, *supra* note 8, §§ 80-81.

35. The resolution was originally introduced by Senator Burdick in the first session of the 90th Congress, S.J. Res. 100, 90th Cong., 1st Sess. (1967), and the reference to the 1000% increase was probably based on a comparison of the 18,510 new cases filed in fiscal year 1948 with the 197,811 new cases filed in fiscal year 1968. See ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, TABLES OF BANKRUPTCY STATISTICS FOR THE FISCAL YEAR ENDING JUNE 30, 1968, at 169 (1969).

36. Consumer bankruptcies grew from 8,566 in 1946 to a peak of 191,729 in 1967, as the amount of personal debt outstanding climbed from 31.4 billion dollars to 338.2 billion dollars in the same span of years. STANLEY, *supra* note 8, at 25. The data on personal debt outstanding set out in this work were drawn from the ECONOMIC REPORT OF THE PRESIDENT, FEBRUARY 1971. Data as to bankruptcy filings by class during fiscal years 1939-67 inclusive were introduced by Judge Weinfeld, speaking as Chairman of the Committee of Bankruptcy Administration of the Judicial Conference of the United States, into the record of the *Hearings on S.J. Res. 100 Before the Subcomm. on Bankruptcy of the Senate Comm. on the Judiciary*, 90th Cong., 2d Sess. 60 (1968).

37. Proposed Bankruptcy Act of 1973, § 4-505.

38. *Id.* § 6-201.

39. During fiscal year 1972 over seven hundred new chapter XIII cases were filed in the following districts: the Middle District of North Carolina, the Western District of Virginia, the three districts of Alabama, the Northern and Middle Districts of Georgia, the Southern District of Ohio, the Eastern and Western Districts of Tennessee, the Northern District of Illinois, the four districts of California, and the District of Kansas. There were eighteen districts in which fewer than five new chapter XIII cases were filed during the same year, including the Southern District of New York, the Middle and Western Districts of Pennsylvania, and the Eastern and Southern Districts of Texas. 1972 ANN. REPORT, *supra* note 22, table F2, at 412-17.

direction is that the administrator provide for counseling of all consumer debtors with regular income so that they may be fully informed as to their options under the Act.⁴⁰ The Commission had reason to believe that consumer debtors frequently are not fully informed about these options.⁴¹ After counseling, an individual debtor with regular income⁴² would retain his freedom of choice as to the mode of relief obtainable under the Act.⁴³ If he should choose straight bankruptcy, he would be able to claim his exemptions⁴⁴ and, unless he has been guilty of an act barring a discharge, he would be eligible for a discharge.⁴⁵

A significant reform advocated by the Commission is to eliminate the enormous diversity in exemptions that results from the present deference by the Bankruptcy Act to state exemption laws.⁴⁶ The Commission proposed a uniform exemption law for debtors under the Act⁴⁷ so that it would make no difference whether the debtor filed in Texas, where exemptions are exceedingly generous, or in New England, where they are skimpy.⁴⁸ Under this proposal, every debtor would be entitled to claim a homestead of up to five thousand dollars in value,⁴⁹ one thousand dollars in household furnishings and other personal property,⁵⁰ five hundred dollars in cash or its equivalent,⁵¹ one thousand five hundred dollars in cash surrender value of life insurance,⁵² and certain additional exemptions.⁵³

The Commission made a further recommendation regarding the use of false financial statements, given by a borrower to a lender at the time of obtaining a loan. Under the present act the use of a false financial

40. Proposed Bankruptcy Act of 1973, § 4-203(a).

41. REPORT, *supra* note 3, pt. I, at 159-60. See also STANLEY, *supra* note 8, at 53-56, 75-76, 80-81, 163-64.

42. An "[i]ndividual with regular income" as defined in § 1-102(28) of the proposed Act is one whose income has "sufficient regularity and stability that periodical payment of a fixed amount to his creditors pursuant to a plan under Chapter VI is feasible." Proposed Bankruptcy Act of 1973, § 1-102(28).

43. *Id.* § 4-203(b).

44. *Id.* § 4-503.

45. *Id.* § 4-505.

46. See Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678 (1960); Note, *Bankruptcy Exemptions: Critique and Suggestions*, 68 YALE L.J. 1459 (1959).

47. Proposed Bankruptcy Act of 1973, § 4-503.

48. REPORT, *supra* note 3, pt. I, at 10, 170-73.

49. Proposed Bankruptcy Act of 1973, § 4-503(b). If the debtor has no homestead or one of less value than five thousand dollars, he would be allowed additional exemptions in personal property of the kinds allowable under *id.* § 4-503(c)(1). The five thousand dollars limit would be increased by five hundred dollars for each dependent.

50. *Id.* § 4-503(c)(1).

51. *Id.* § 4-503(c)(3).

52. *Id.* § 4-503(d).

53. *Id.* § 4-503(c)(2), (4)-(9).

statement is a basis for denying a discharge or a basis for an exception to a discharge to such a debtor.⁵⁴ The falsity consists typically in the failure of the debtor to list all of his debts on the application for credit. It has been alleged by many that the principal function of a false financial statement is to provide the lender with a weapon or lever to enforce collection after a discharge or to coerce reaffirmation of a discharged debt. The Commission believed that the objectives of the legislation have not been fully achieved.⁵⁵ To deal with unresolved problems, the Commission recommended that a discharge extinguish a debt so that it cannot be reaffirmed,⁵⁶ and that a false financial statement no longer be available

54. Bankruptcy Act §§ 14(c) (3), 17(a) (2), 11 U.S.C. §§ 32(c) (3), 35(2) (1970).

55. REPORT, *supra* note 3, pt. I, at 11, 169, 177. A survey of 3101 applications for determination of dischargeability filed during the first four months of 1972 was conducted by the Administrative Office of the United States Courts, and the results were communicated to the Commission by transmittal of an Interoffice Memorandum on the subject dated August 31, 1972. The memorandum disclosed that although 837 decisions on the merits were rendered during the survey period, 489 applications were withdrawn before trial. The grounds for withdrawal most frequently mentioned were "Compromise, settlement or stipulation" (mentioned by 56% of the referees responding) and "Reaffirmation" (mentioned by 28% of the referees). Ninety-nine per cent of the applications (3062) were filed by creditors, and decisions on the merits favored the creditor in more than half the decided cases (438).

A post-amendment survey of practice in Connecticut and Virginia conducted under the direction of Professor Shuchman during the first nine months of 1971 showed the following results:

	Connecticut	Virginia
Total Applications Filed	75	105
Total Determinations Completed	15	39
Determinations for Creditors	0	14
Settlements	18	60

The average settlement in the Connecticut cases was \$760 on a \$1400 claim; the average settlement in Virginia was \$550 on a \$1021 claim. It is to be noted that 24% of the Connecticut applications and 57% of the Virginia applications were disposed of by settlement. Shuchman, *Impact Analysis of the 1970 Bankruptcy Discharge Amendments*, 51 N.C.L. REV. 233, 249-50 (1972) [hereinafter cited as Shuchman].

The Commission concluded from information it received that the inconvenience, expense, and trauma inflicted on a typical consumer debtor by the trial of a dischargeability application deter all but the hardiest from defending their claims to a discharge against creditors to a final termination of proceedings under § 17(c) of the Bankruptcy Act. 11 U.S.C. § 35 (1970). Information about the effect of the 1970 legislation on the rate of reaffirmations is sparse, but the Commission was satisfied that the rate has not decelerated. See Shuchman, *supra*, at 245-51. The Commission concluded that exploitation of the creditor's advantage in challenging the dischargeability of any consumer debt, when the creditor had required a financial statement in connection with the transaction, could be overcome only by eliminating the false financial statement exception for consumer debts. REPORT, *supra* note 3, pt. I, at 12. The enormous leverage that can be exerted by a creditor against a discharged debtor by threatening to file a complaint (as the initiating pleading is designated by BANKR. R. 409) pursuant to § 17(c) of the Bankruptcy Act or by threatening to repossess collateral seemed ample justification to the Commission for rendering reaffirmations of discharged debts unenforceable. Cf. Boshkoff, *The Bankrupt's Moral Obligation to Pay His Discharged Debts: A Conflict Between Contract Theory and Bankruptcy Policy*, 47 IND. L.J. 36 (1971).

56. Proposed Bankruptcy Act of 1973, § 4-507(a).

as a ground for denying a discharge, or for an exception from a discharge, as to any consumer debtor.⁵⁷ For a business debtor, the use of a false financial statement would be the basis for an exception of the debt from the effect of a discharge.⁵⁸ The Commission recommended the addition of two new exceptions from discharge: (1) debts for credit purchases made within ninety days of bankruptcy by one without intent to pay,⁵⁹ and (2) educational debts during the first five years after the first installment becomes due.⁶⁰

Business Bankruptcies

Business bankruptcies are typically asset bankruptcies. When the business is owned by a corporation, the discharge is unimportant, and the Commission recommended that no discharge be given to any corporation or partnership.⁶¹ Involuntary petitions, *i.e.*, petitions by creditors, are filed against debtors only when there is a reasonable prospect for some distribution to creditors. The Commission was impressed by testimony that both voluntary and involuntary petitions in business cases are postponed too long.⁶² As a result, assets are dissipated, and the debtor becomes hopelessly insolvent before administration is commenced. One reason involuntary proceedings are delayed is that creditors have difficulty finding and proving an act of bankruptcy, which the present law requires to be shown as a basis for an involuntary adjudication of a debtor as bankrupt.⁶³ An act of bankruptcy is typically a fraudulent transfer or preferential transfer by the debtor, and usually proof of insolvency is required as of the date of the commission of the act of bankruptcy. Insolvency is a deficiency of assets to pay liabilities,⁶⁴ but it is frequently a matter difficult to prove.⁶⁵ The Commission concluded that one answer to this problem is to allow an involuntary bankruptcy petition to be filed by one creditor having a claim of two thousand five hundred dollars,⁶⁶ if he can allege and prove simply that the debtor is unable

57. REPORT, *supra* note 3, pt. I, at 10-12, 175.

58. Proposed Bankruptcy Act of 1973, § 4-506(a)(2). See also REPORT, *supra* note 3, pt. I, at 176.

59. Proposed Bankruptcy Act of 1973, § 4-506(a)(3).

60. *Id.* § 4-506(a)(8). "Educational debt" is defined in *id.* § 1-102(23).

61. REPORT, *supra* note 3, pt. II, at 134.

62. See REPORT, *supra* note 3, pt. I, at 14, 186-89.

63. Bankruptcy Act § 3, 11 U.S.C. § 21 (1970).

64. See Bankruptcy Act § 1(19), 11 U.S.C. § 1(19) (1970); Proposed Bankruptcy Act of 1973, § 1-102(29). The proposed Act does not much change the traditional bankruptcy definition of insolvency but limits substantially its significance and use. See Levit, *The Archaic Concept of Balance Sheet Insolvency*, 47 AM. BANKR. L.J. 215 (1973) [hereinafter cited as Levit].

65. See Levit, *supra* note 64.

66. Proposed Bankruptcy Act of 1973, § 4-205(a).

generally to pay his debts or has failed to pay his current liabilities.⁶⁷ Three creditors are usually required for an involuntary petition under present law.⁶⁸ In order to protect the debtor against hasty or ill-founded petitions, the court would be required to hold a prompt preliminary hearing to determine whether it appears that the filing of the petition and proceeding thereon will be in the best interests of the debtor and creditors.⁶⁹ If the court determines that the case should proceed, no jury trial of any issue will be permitted.⁷⁰ This is contrary to present law, which provides for trial by jury on the demand of the debtor.⁷¹

Definition and Distribution of Assets

Under the proposed Act, the assets of the estate would be more generally defined, with less deference to the intricacies and diversities of state law.⁷² As mentioned earlier, the proposed Act does not recognize state exemptions;⁷³ likewise, there is no deference to the varieties of marital interests under state law—estates by the entirety, dower, curtesy, and the like.⁷⁴ Moreover, all future interests would be subject to administration unless a sale of such an interest would result in a sacrifice sale.⁷⁵ Spendthrift trusts would be recognized only to the extent income is necessary for the support of the debtor and his dependents.⁷⁶ There has also been some revision of the trustee's rights of recovery and avoidance, mostly of a technical nature which cannot be explored here.⁷⁷ The most significant change, perhaps, is the grant of jurisdiction to the bankruptcy courts over causes of action against the debtors of the estate and transferees of the debtor's property.⁷⁸ Under present law it is typically necessary for the trustee to sue such defendants in the state court or the federal district court.⁷⁹

67. *Id.* §§ 4-205(c) (1), (2). Another alternative available to a petitioning creditor seeking liquidation would be that within the last three months the debtor has made a general assignment for the benefit of creditors, or a general liquidation or rehabilitation proceeding outside the Bankruptcy Act has been initiated by or against the debtor. *Id.* § 4-205(c) (3).

68. Bankruptcy Act § 59(b), 11 U.S.C. § 95(b) (1970).

69. Proposed Bankruptcy Act of 1973, § 4-208(a).

70. *Id.* § 2-207(a).

71. Bankruptcy Act § 19(a), 11 U.S.C. § 42(a) (1970). See also BANKR. R. 115(b).

72. Compare Proposed Bankruptcy Act of 1973, § 4-601, with Bankruptcy Act § 70(a), 11 U.S.C. § 110(a) (1970). See also REPORT, *supra* note 3, pt. I, at 192-97.

73. See text accompanying notes 46 & 47 *supra*.

74. Proposed Bankruptcy Act of 1973, § 4-601(c).

75. *Id.* § 4-601(a) (5) (C).

76. *Id.* § 4-601(b).

77. The new recovery and avoidance sections are contained in *id.* §§ 4-604 to -608.

78. *Id.* § 2-201.

79. By virtue of Bankruptcy Act § 23, 11 U.S.C. § 46 (1970).

The law of preferences would be changed by reducing the period of vulnerability of preferential payments and transfers from four months to three months,⁸⁰ but making preferences to insiders vulnerable for a year;⁸¹ by presuming insolvency of the debtor during the three months before bankruptcy;⁸² by making only payments and transfers of more than one thousand dollars voidable;⁸³ by eliminating the requirement that the preferred creditor have reasonable cause to believe the debtor was insolvent at the time of the preferential payment;⁸⁴ and by reconciling the Bankruptcy Act and Uniform Commercial Code by validating a security interest in shifting accounts receivable and inventory during the three-month period preceding bankruptcy so long as the secured creditor did not improve his position.⁸⁵

With respect to distribution of estates, the Commission would make all claims against the debtor provable, including tort claims;⁸⁶ would invalidate unconscionable claims⁸⁷ and claims for excessive compensation to officers and insiders during the year before bankruptcy;⁸⁸ and would subordinate certain claims.⁸⁹ Most tax liens and other statutory liens would be invalidated unless they secure persons who have improved the property to which such liens attached⁹⁰ or provided valuable services respecting the property. Priorities for unsecured creditors would be modified by increasing wage priorities from six hundred to twelve hundred dollars per claimant and allowing up to three hundred dollars within the twelve hundred dollar maximum for pension-fund contributions by the employer.⁹¹ Tax priorities would be reduced to one year's taxes.⁹² Rent and nontax priorities of the United States would be abolished.⁹³

80. Proposed Bankruptcy Act of 1973, § 4-607(a)(1). The three-month period also applies to the avoidance of liens by judicial proceedings by virtue of the elimination of any counterpart of present Bankruptcy Act § 67(a), 11 U.S.C. § 107(a) (1970).

81. Proposed Bankruptcy Act of 1973, § 4-607(a)(2).

82. *Id.* § 4-607(f).

83. *Id.* § 4-607(b)(1).

84. *Id.* § 4-607(a).

85. *Id.* § 4-607(d). For a discussion of the background of this proposal, see REPORT, *supra* note 3, pt. I, at 206-10.

86. Proposed Bankruptcy Act of 1973, § 4-403(b). The proposed Act would eliminate the concept of provability as elaborated in Bankruptcy Act § 63, 11 U.S.C. § 103 (1970). Instead the concepts of provability and allowability become merged, and the fact that a claim is based on tort is no ground for denying allowance.

87. Proposed Bankruptcy Act of 1973, §§ 4-403(b)(8), (c).

88. *Id.* §§ 4-311(b), (c).

89. *Id.* § 4-406.

90. *Id.* § 4-606. The same standard of validity is applied to common law and statutory liens by § 4-406, but it is believed that most common law liens would survive under this test.

91. Proposed Bankruptcy Act of 1973, § 4-405(a)(4).

92. *Id.* § 4-405(a)(5). See also REPORT, *supra* note 3, pt. I, at 215-17.

93. REPORT, *supra* note 3, pt. I, at 217-18.

Conclusion

This article has attempted no more than a broad outline of the major changes proposed for dealing with the structure of the bankruptcy system and the substantive law and procedure for straight bankruptcy cases. These are the subjects of the first five chapters of the present Bankruptcy Act. The proposed changes would also affect the Bankruptcy Rules which went into effect on October 1, 1973, although to a substantial extent the new procedures established by these Rules would be entirely compatible with the proposed Act. The purpose and intended effect of technical and minor changes proposed by the Commission are explained in the Notes accompanying each section of the proposed new Bankruptcy Act, as set forth in Part II of the Report. The reasons for the more fundamental changes recommended by the Commission are discussed more fully in Part I of its Report. The Commission did not suppose that it could, and did not attempt to, propose legislation that would be noncontroversial. The Judiciary Committees of the Senate and House of Representatives plan to afford interested groups and persons an opportunity during 1974 to present their views as to the Commission's proposals. The publication of the Report and the Congressional hearings on its recommendations present the occasion for a thoroughgoing re-examination of the premises and the operation of the bankruptcy laws of the United States. On the need for such a re-examination the witnesses at the hearing on the proposal to establish the Commission were unanimous.

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