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## Filing for Personal Bankruptcy: Adoption of a "Bona Fide Effort" Test Under Chapter 13

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**FILING FOR PERSONAL  
BANKRUPTCY: ADOPTION OF A  
"BONA FIDE EFFORT" TEST  
UNDER CHAPTER 13**

The number of debtors seeking relief in bankruptcy is one indication of the nation's economic health.<sup>1</sup> That number rose to 421,426 in 1980<sup>2</sup> — up more than eighty-five percent from 1979.<sup>3</sup>

<sup>1</sup> The number of bankruptcies in any given year rises as the economy slows down. The following statistics show this relationship:

	<i>Unemployment</i> <sup>(a)</sup> (%)	<i>Inflation</i> <sup>(b)</sup> (%)	<i>GNP</i> <sup>(c)</sup> (%)	<i>Bankruptcies</i> <sup>(d)</sup> (%)
1972	5.6	3.4	+5.7	- 9.2
1973	4.9	8.8	+5.8	- 5.3
1974	5.6	12.2	-0.6	+ 9.4
1975	8.5	7.0	-1.1	+34.3
1976	7.7	4.8	+5.4	- 3.1
1977	7.0	6.8	+5.5	-13.0
1978	6.0	9.0	+4.8	- 5.3 <sup>(e)</sup>
1979	5.8	13.3	+3.2	+11.5 <sup>(f)</sup>
1980	7.1	13.5 <sup>(h)</sup>	-0.2	+86.0 <sup>(g)</sup>

(a) OFFICE OF PRESIDENT, ECONOMIC REPORT (1981), Table B-29.

(b) *Id.*, Table B-53. Figures are December-to-December changes based on unadjusted indices.

(c) *Id.*, Table B-2. Figures represent the change in the Gross National Product from the preceding year, expressed in terms of 1972 dollars.

(d) [1978] ADMIN. OFC. OF THE U.S. COURTS, TABLES OF BANKRUPTCY STATISTICS 2 (petitions filed in fiscal 1977) [hereinafter cited as TABLES OF BANKRUPTCY STATISTICS]. Figures represent the change from the preceding year of the total number of filings in bankruptcy.

(e) [1979] TABLES OF BANKRUPTCY STATISTICS, (petitions filed in fiscal year 1978) Table F-1 (by computation).

(f) [1980] TABLES OF BANKRUPTCY STATISTICS, (petitions filed in fiscal year 1979) Table F-1 (by computation).

(g) [1981] TABLES OF BANKRUPTCY STATISTICS, (petitions filed in fiscal year 1980) Table F-1 (by computation).

(h) The Wall St. J., Jan. 16, 1981, at 4 (table).

<sup>2</sup> [1981] TABLES OF BANKRUPTCY STATISTICS, *supra* note 1, Table F-1. The previous record for the number of petitions filed in a single year was 254,484, set in 1975. [1976] TABLES OF BANKRUPTCY STATISTICS (petitions filed in fiscal year 1975) Table F-1.

<sup>3</sup> Compare [1981] TABLES OF BANKRUPTCY STATISTICS, Table F-1 with [1980] TABLES OF

Although most of these debtors filed for Chapter 7 liquidation<sup>4</sup>, twenty-three percent of those who filed voluntary petitions chose to take advantage of the wage earner relief chapter of the Bankruptcy Code, Chapter 13.<sup>5</sup>

The increased use of Chapter 13 underscores the need to resolve a recurrent problem: bankruptcy courts across the country are using different standards to determine the amount which a Chapter 13 debtor must pay to unsecured creditors. The problem arises from conflicting judicial interpretation of the "good faith" test in the Chapter 13 confirmation criteria. Specifically, the question is whether or not the test is applicable to the amount of payments the debtor proposes to make to such unsecured creditors.<sup>6</sup>

Last session, Congress debated a Technical Amendments Bill<sup>7</sup> which comprised a series of amendments to the Bankruptcy Reform Act of 1978.<sup>8</sup> Although that bill has not presently been reintroduced in the 97th Congress, the bill contained a provision that would have precluded confirmation of any Chapter 13 plan that did not represent a "bona fide effort" by the debtor to repay his creditors. This article recommends enactment of such an amendment to the Code, but also maintains that the "bona fide effort" test alone is too ambiguous for determining the amount a Chapter 13 debtor must pay to creditors with unsecured claims and sets forth a set of standard guidelines for bankruptcy courts to use in applying the test.

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BANKRUPTCY STATISTICS, Table F-1, *supra* note 1.

<sup>4</sup> 11 U.S.C. §§ 701-66 (Supp. III 1979). For a discussion of Chapter 7 liquidation, see Rendleman, *Liquidation Bankruptcy Under the '78 Code*, 21 WM. & MARY L. REV. 575 (1980).

<sup>5</sup> Chapter 13 is codified at 11 U.S.C. §§ 1301-30 (Supp. III 1979). For a discussion of the operation of Chapter 13 and the major advantages of Chapter 13 over Chapter 7, see Epstein, *Chapter 13: Its Operation, Its Statutory Requirement as to Payment to and Classification of Unsecured Claims, and Its Advantages*, 20 WASHBURN L.J. 1 (1980). For a discussion of the theory and history of wage earner relief, see note 10 and accompanying text *infra*.

<sup>6</sup> The "good faith" controversy does not reach the handling of secured claims; the statute is unambiguous as to how secured claims are to be treated. See 11 U.S.C. § 1325 (a)(5) (Supp. III 1979); Reiley, *Secured Creditors and the Bankruptcy Act of 1978*, 14 U.S.F. L. REV. 341, 347-48 (1980).

<sup>7</sup> S. 658, 96th Cong., 1st Sess. (1979).

<sup>8</sup> Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-151326 (Supp. III 1979) and scattered sections of 28 U.S.C.). The Bankruptcy Reform Act of 1978 [hereinafter cited as the "Reform Act" or "Act"] is the first complete revision of the federal bankruptcy law since 1938. President Carter signed the Reform Act on November 6, 1978, and it became effective on October 1, 1979. The Act repealed the Bankruptcy Act of 1898 and replaced it with a new Bankruptcy Code, which is enacted as title 11 of the United States Code. For a discussion of the Act's legislative history, see Klee, *Legislative History of the New Bankruptcy Code*, 54 AM. BANKR. L.J. 275 (1980).

Part I discusses the history and current application of the Chapter 13 wage earner relief provisions, focusing on the present "good faith" controversy. Part II analyzes the "bona fide effort" test and examines its current congressional status. Part III suggests that more specific statutory guidance is necessary in order to effectively apply the "bona fide effort" test and recommends specific guidelines for its use. The article concludes that by following such a set of standard guidelines when applying the "bona fide effort" test, bankruptcy courts would promote uniform treatment of debtors, enhance judicial economy, and facilitate appellate review of Chapter 13 cases.

## I. THE CHAPTER 13 WAGE EARNER RELIEF PLAN

### A. *History of Wage Earner Relief*

Wage earner relief is an alternative to liquidation or "straight" bankruptcy. In straight bankruptcy the debtor's non-exempt assets are liquidated and the proceeds are distributed to the debtor's creditors. Once the proceeds are distributed, the debtor may or may not be entitled to a discharge of his pre-bankruptcy debts.<sup>9</sup>

Wage earner relief allows the debtor to keep his assets and still receive a discharge. The debtor promises to pay creditors a percentage, if not all, of their allowed claims out of the debtor's future earnings. The debtor makes periodic payments to a trustee who in turn distributes appropriate shares to creditors pursuant to a court-approved plan. Once payments are completed under the plan the debtor is discharged of all debts affected by the plan.<sup>10</sup>

Wage earner relief has been a part of the federal bankruptcy law since 1938 when Congress enacted Chapter XIII of the Bankruptcy Code.<sup>11</sup> Despite uniform support for its theory, debtor use of Chapter XIII was less than expected and geo-

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<sup>9</sup> See note 4 *supra*.

<sup>10</sup> For a thorough discussion of the theory and history of wage earner relief, see Merrick, *Chapter 13 of the Bankruptcy Reform Act of 1978*, 56 DEN. L.J. 585, 585-88 (1979).

<sup>11</sup> Chandler Act, 52 Stat. 840, 930 (1938). Chapter XIII is codified at 11 U.S.C. §§ 1001-86 (1976). The Chandler Act added wage earner relief to the federal bankruptcy law. The Reform Act, *supra* note 8, amended Chapter XIII and redesignated it Chapter 13. In the remainder of this article "Chapter XIII" refers to wage earner relief provisions of the Bankruptcy Act of 1898; "Chapter 13" refers to the wage earner relief chapter of the Reform Act.

graphically imbalanced.<sup>12</sup> The vast majority of debtors continued to opt for liquidation where "both the debtor and his creditors are the losers."<sup>13</sup> The Bankruptcy Reform Act of 1978 amended Chapter 13 extensively,<sup>14</sup> making it more attractive to eligible<sup>15</sup> debtors by adding a number of incentives not present in Chapter XIII.<sup>16</sup>

Debtors responded quickly to these new incentives. Soon after the enactment of the Reform Act there was a drop in the rela-

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<sup>12</sup> S. REP. NO. 95-989, 95th Cong., 2d Sess. 12-13, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 5787, 5798; REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, Part I, 93d Cong., 1st Sess. 157 (1973)[hereinafter cited as COMMISSION REPORT]. To illustrate the geographical imbalance of Chapter XIII use, there were 8,806 voluntary petitions filed in the Third Circuit in 1977, of which 246 (2.8%) were in Chapter XIII. That same year there were 31,816 voluntary petitions filed in the Fifth Circuit, 7,353 (23.1%) of which were in Chapter XIII. [1978] TABLES OF BANKRUPTCY STATISTICS, *supra* note 1, at Table F-2.

<sup>13</sup> 123 CONG. REC. H11,699 (daily ed. Oct. 27, 1977)(remarks of Rep. Edwards). See H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 118, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 5963, 6079.

<sup>14</sup> These changes are discussed at length in Pickard, *The New Bankruptcy Code, Part I: A Review of Some of the Significant Changes in Bankruptcy Law*, 10 MEM. ST. U.L. REV. 177 (1980).

<sup>15</sup> The availability of Chapter 13 relief is restricted to individuals with regular income and noncontingent, liquidated unsecured debts of less than \$100,000 and noncontingent, liquidated, secured debts of less than \$350,000. 11 U.S.C. § 109(e) (Supp. III 1979).

<sup>16</sup> Among the many changes brought about by the Reform Act, four are particularly significant in making Chapter 13 more appealing to debtors. First, the discharge granted under Chapter 13 extinguishes certain kinds of debts that were nondischargeable under Chapter XIII. The discharge granted under Chapter XIII was limited to those types of debts which were dischargeable in liquidation. 11 U.S.C. § 1060 (1976). Under Chapter 7 (liquidation) nine types of debts are non-dischargeable, including, for example, fraud judgments, criminal fines, and liability arising from an act of theft or embezzlement. 11 U.S.C. § 727(a)(8) (Supp. III 1979). A Chapter 13 discharge is effective as against all types of debts except alimony, maintenance or support, and certain long-term obligations specially provided for under the plan. 11 U.S.C. § 1328 (Supp. III 1979).

Second, under certain circumstances the debtor may receive a "hardship discharge" despite his failure to complete his proposed payments under the plan. 11 U.S.C. § 1328(b) (Supp. III 1979) allows the court to grant the debtor a "hardship discharge" even though the terms of the plan have not been fully satisfied. The debtor must meet three requirements: a) the debtor's failure to complete the plan must not be due to the debtor's own fault, b) each unsecured creditor must have actually received an amount at least equal to the value of its claim under liquidation as of the effective date of the plan, and c) modification of the plan must be impractical.

Third, a previous discharge in liquidation within the preceding six years no longer bars the debtor from receiving a Chapter 13 discharge. Compare 11 U.S.C. § 32(c)(5) (1976) with 11 U.S.C. § 727(a)(8) (Supp. III 1979).

Finally, creditor approval is no longer a prerequisite to confirmation of a plan. Under Chapter 13, creditors with unsecured claims have no approval authority. See 11 U.S.C. § 1325 (Supp. III 1979). A bankruptcy court may confirm a Chapter 13 plan over the objections of secured creditors if: (1) the holder of each claim is to receive, under the plan, value of not less than the allowed amount of its secured claim, or (2) the debtor surrenders the property securing such claims to each secured creditor that does not accept the plan. 11 U.S.C. §§ 1325(a)(5)(B)-(C) (Supp. III 1979).

tive percentage of voluntary petitions in liquidation, matched by a corresponding increase in the relative percentage of voluntary petitions filed in Chapter 13.<sup>17</sup> Some debtors realized that the criteria for confirmation of a Chapter 13 plan might allow a debtor to receive a discharge of unsecured debts without making any payments to holders of unsecured claims.<sup>18</sup>

### B. Criteria for Confirmation of a Chapter 13 Plan

Section 1325 of the Code provides in pertinent part:

(a) The court shall confirm a plan if—

\* \* \*

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

\* \* \*

(6) the debtor will be able to make all payments under the plan and to comply with the plan.<sup>19</sup>

The statute does not expressly grant bankruptcy courts the dis-

<sup>17</sup> The change in the relative percentage of voluntary petitioners seeking wage earner relief is illustrated by the following statistics:

	Total Voluntary Filings	Chapter VII/7	Chapter XIII/13
1978 <sup>(a)</sup>	201,944	167,776 (83%)	30,185 (15%)
1979 <sup>(b)</sup>	225,549	182,344 (81%)	39,442 (17%)
1980 <sup>(c)</sup>	297,164	223,765 (75%)	67,825 (23%)

(a) [1979] TABLES OF BANKRUPTCY STATISTICS, *supra* note 2, at Table F-2 (covering the 12 month period ended June 30, 1978).

(b) [1980] TABLES OF BANKRUPTCY STATISTICS, *supra* note 2, at Table F-2 (covering the 12 month period ended June 30, 1979).

(c) [1981] TABLES OF BANKRUPTCY STATISTICS, *supra* note 2, at Table F-2A (covering the 12 month period ended September 30, 1980).

<sup>18</sup> See notes 21-23 and accompanying text *infra*.

<sup>19</sup> 11 U.S.C. § 1325 (Supp. III 1979).

cretion to consider the debtor's ability to pay in determining the minimum amount required for confirmation. Some courts, however, have found such discretion to be implicit in the "good faith" test of section 1325(a)(3).

1. *Section 1325(a)(4) and the debtor's ability to pay*— Section 1325(a)(6) establishes an upper limit on the amount the debtor may propose to pay: the plan may not call for payments that exceed the debtor's ability to pay. However, since the debtor is unlikely to propose payments which he or she cannot afford, this subsection is seldom at issue.<sup>20</sup> The difficulty lies in ascertaining the *minimum* amount the debtor is legally obligated to pay to holders of unsecured claims.

Section 1325(a)(4) is the only confirmation criterion expressly applicable to the minimum amount the debtor must pay. This section is referred to as the "best interest of creditors" test.<sup>21</sup> It requires only that creditors with unsecured claims receive an amount under the plan "not less than"<sup>22</sup> that which they would receive if the debtor's estate were liquidated under Chapter 7.<sup>23</sup> Thus, if liquidation would leave no assets to apply against unsecured claims, the debtor satisfies section 1325(a)(4) with a plan that proposes no payment to the holders of such claims.

A bankruptcy court, when making the section 1325(a)(4) calculation, has no discretion to take into account the debtor's ability to pay.<sup>24</sup> Moreover, confirmation of a plan is not discretionary with the court if all the criteria in section 1325 are

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<sup>20</sup> Occasionally, a debtor who is desperate to avoid liquidation will propose payments higher than he can reasonably be expected to maintain over the life of the plan. *See, e.g., In re Lucas*, 6 B.C.D. 82 (S.D. Cal. 1980) (debtor with disposable income of \$84 per month proposed payments of \$82 per month; confirmation denied).

<sup>21</sup> *See, e.g., In re Iacavoni*, 2 Bankr. Rep. 256, 262 (D. Utah 1980).

<sup>22</sup> Some debtors have argued that if Congress had intended to preclude confirmation of no-payment plans it would have phrased this section to read "more than," instead of "not less than." It appears more likely, however, that Congress had in mind the case in which a debtor would be able to satisfy one hundred percent of allowed unsecured claims under Chapter 7 liquidation. A requirement in Chapter 13 that he pay "more than" one hundred percent would be anomalous if not bizarre. *Id.* at 266.

<sup>23</sup> 11 U.S.C. § 1325(a)(4) (Supp. III 1979).

<sup>24</sup> *See* 11 U.S.C. § 1325(a)(4) (Supp. III 1979). The section requires the court to make and compare two determinations. First, the court is to determine the amount each unsecured creditor would receive if the debtor's estate were liquidated on the effective date of the plan. The court must then compare this amount to the amount that the debtor proposes to pay to each unsecured creditor under the plan. If the latter figure is equal to or greater than the former, the plan satisfies the test. No court has ever suggested that this section might be interpreted as allowing the court discretion to consider the debtor's ability to pay when making these determinations.

satisfied.<sup>25</sup> This lack of discretion may give rise to situations which Congress obviously did not foresee.<sup>26</sup>

2. *Judicial interpretation of "good faith"*— If section 1325(a)(4) gives the court no discretion to consider the debtor's ability to pay, the question arises whether such discretion may be found elsewhere in section 1325. Many creditors have argued that the answer lies in section 1325(a)(3), the "good faith" test. As the only other confirmation criterion that arguably affords the court discretion to consider the debtor's ability to pay,<sup>27</sup> the "good faith" test has become the source of a considerable volume of litigation.

Chapter 13 debtors have consistently argued that the minimum level of payments required for confirmation is to be determined solely by reference to section 1325(a)(4) and that section 1325(a)(3) only applies with respect to the debtor's reasons for filing.<sup>28</sup> On the other hand, creditors and trustees<sup>29</sup> opposing confirmation of a plan generally argue that a no-payment plan cannot be held to be submitted in good faith because such a plan does not promote the spirit or purpose of Chapter 13.<sup>30</sup> Nothing in the text or legislative history of the Reform Act ex-

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<sup>25</sup> 5 COLLIER ON BANKRUPTCY ¶ 1325.01[1] (15th ed. 1980).

<sup>26</sup> Consider, for example, the following hypothetical involving debtors H and W, a married couple. H has recently graduated from medical school and W from law school. They have one secured debt in the amount of \$500. Additionally, they have ten unsecured debts which total \$100,000. They have no nonexempt assets. H and W submit a Chapter 13 plan which provides for full payment of the secured claim and one dollar to each of the ten creditors with unsecured claims. Since they have no assets to liquidate, their plan satisfies § 1325(a)(4). Thus if § 1325(a)(4) is held to be the sole criterion governing the amount H and W must pay to unsecured creditors, the court must confirm the plan, despite the fact that H and W's starting salaries are expected to exceed \$75,000. Although Congress, in enacting Chapter 13, did not intend such a result, it is a possibility if the courts have no discretion to take into account the debtor's ability to pay.

<sup>27</sup> With the exception of § 1325(a)(6), which has no application to the minimum amount of payments, the remaining criteria in § 1325 are straightforward; that is, the plan either satisfies them or it does not. There is no subjective element to their application. See 11 U.S.C. § 1325 (Supp. III 1979).

<sup>28</sup> See, e.g., *In re Beaver*, 2 Bankr. Rep. 337, 340 (S.D. Cal. 1980).

<sup>29</sup> In *In re Terry*, 3 Bankr. Rep. 63 (W.D. Ark. 1980), the trustee objected to the confirmation of a "zero" (no-payment) plan because he, just as the rest of the creditors, would receive nothing for his services. The court brushed aside this argument, stating, "[a] wag might suggest that poetic justice has been achieved and, indeed, that it might be therapeutic for trustees to join the ranks of unpaid creditors." *Id.* at 66.

<sup>30</sup> Creditors argue that the purpose of Chapter 13 is to allow debtors to pay their debts over a period of time rather than liquidate; debtors, on the other hand, argue that the purpose of Chapter 13 is to give the debtor a "fresh start." See, e.g., *id.* at 65-66. Numerous citations can be gleaned from the text and legislative history of the Reform Act to support either view. This topic is examined at great length in *In re Hurd*, 4 Bankr. Rep. 551, 554-60 (W.D. Mich. 1980).



pressly addresses the meaning of "good faith."<sup>31</sup> Yet three distinct trends have emerged as bankruptcy courts continue to decide the "good faith" issue on a case-by-case basis.

A small minority of courts have held that a Chapter 13 plan cannot satisfy section 1325(a)(3) unless it proposes repayment of at least seventy percent of the debtor's allowed unsecured debts *and* represents the debtor's best effort to repay all creditors in full.<sup>32</sup> Other courts have held that section 1325(a)(3) does not pertain to the amount of payments proposed by the plan<sup>33</sup> and

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<sup>31</sup> See 5 COLLIER ON BANKRUPTCY ¶ 1325.01[2][C] (15th ed. 1980). Furthermore, there is not a single reported case construing a similar good-faith requirement in Chapter XIII. There are two probable explanations for the lack of case law under Chapter XIII. First, the creditors had no need to challenge the plan for lack of good faith, since they could block confirmation of a plan simply by withholding their approval. See note 16 *supra*. Second, the majority of plans confirmed proposed a very high percentage of repayment. [1969] TABLES OF BANKRUPTCY STATISTICS, *supra* note 1. For example, in 1968 there were 10,341 Chapter XIII plans confirmed. These plans covered debts totalling \$22,358,939. The amount to be paid under these plans totalled \$21,262,098—95.1% of all debts owed. *Id.* at Table F-11. At this level of proposed repayment, the creditors could not credibly argue bad faith.

<sup>32</sup> *In re Burrell*, 2 Bankr. Rep. 650 (N.D. Cal. 1980), *rev'd*, 6 Bankr. Rep. 361 (N.D. Cal. 1980) (payments must be substantial, but not necessarily 70% of allowed unsecured claims or debtor's best effort); *In re Raburn*, 4 Bankr. Rep. 624 (M.D. Ga. 1980). The bankruptcy court in *Burrell*, although later reversed by the district court, decided that Congress could not have intended to grant a debtor all the benefits of Chapter 13 without creating a reciprocal obligation on the debtor's part to repay creditors in full or at least in substantial part. The court extrapolated its definition of "substantial" from § 727(a)(9) of the Code. That section governs the availability of a discharge under Chapter 7 in the case of a debtor who has received a Chapter 13 "hardship discharge" within the preceding six years. The previous Chapter 13 discharge does not bar the debtor from receiving a Chapter 7 discharge provided that the payments the debtor proposed under his Chapter 13 plan totalled at least 70% of allowed unsecured claims and represented the debtor's best effort. 11 U.S.C. § 727(a)(9) (Supp. II 1979). The bankruptcy court was undaunted by the conspicuous absence of any such requirement in the Chapter 13 confirmation criteria, dismissing it as a simple oversight by Congress. *Burrell*, 2 Bankr. Rep. at 653.

The bankruptcy court in *Burrell* apparently overlooked a part of the Reform Act's legislative history that dispels the court's "oversight" theory. The "best effort" proviso to § 727(a)(9) was explained to the House and Senate in this manner:

It is expected that the Rules of Bankruptcy Procedure will contain a provision permitting the debtor to request a determination of whether a plan is the debtor's "best effort" prior to confirmation of [his plan].

124 CONG. REC. H11,098 (daily ed. Sept. 28, 1978)(remarks of Rep. Edwards); 124 CONG. REC. S17,415 (daily ed. Oct. 6, 1978)(remarks of Sen. DeConcini). The statement anticipates the confirmation of some Chapter 13 plans that do not represent the debtor's best effort. If a plan had to represent the debtor's best effort in order to be confirmed, the debtor would have no reason to request the determination referred to in the statement. Thus, it is inappropriate to infer a "best effort" requirement in § 1325(a)(3).

<sup>33</sup> See *In re Berry*, 5 Bankr. Rep. 515, 517 (S. D. Ohio 1980); *In re Bellgraph*, 4 Bankr. Rep. 421, 423 (W.D.N.Y. 1980); *In re Harland*, 3 Bankr. Rep. 597, 599 (D. Neb. 1980); *In re Cloutier*, 3 Bankr. Rep. 584, 586 (D. Colo. 1980); *In re Thebeau*, 3 Bankr. Rep. 537, 538 (E.D. Ark. 1980); *In re Sadler*, 3 Bankr. Rep. 536, 538 (E.D. Ark. 1980); *In re Terry*, 3 Bankr. Rep. 63, 65 (W.D. Ark. 1980). These courts based their decisions on a finding

will confirm a no-payment plan provided it satisfies section 1325(a)(4).

Most bankruptcy courts, however, have taken a position somewhere between these two extremes. The majority of courts have held that section 1325(a)(3) pertains to the amount of the proposed payments: unless there are exceptional circumstances, "good faith" requires that at least *some* payments be proposed. Additionally, to satisfy the "good faith" test, the proposed payments must be "meaningful" or "substantial."<sup>34</sup>

The Bankruptcy Code is intended to be a uniform law on the subject of bankruptcy.<sup>35</sup> The treatment of debtors who file in Chapter 13, however, has been far from uniform. The standards for confirmation of a Chapter 13 plan vary widely from state to state and even among the districts within a single state.<sup>36</sup> Some type of corrective action, either by Congress or the courts, must be taken if the Act is to be applied equally to similarly situated debtors.

## II. THE "BONA FIDE EFFORT" TEST

### A. *Legislative History of the Technical Amendments Bill and Current Congressional Status*

Congress hurriedly passed the Bankruptcy Reform Act in the

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that there is no statutory basis for reading a minimum payment requirement into § 1325(a)(3). See also Epstein, *supra* note 5, at 13.

<sup>34</sup> See, e.g., *In re Hurd*, 4 Bankr. Rep. 551, 558 (W.D. Mich. 1980); *In re Iacavoni*, 2 Bankr. Rep. 256, 265-68 (D. Utah 1980). These courts have determined that the legislative history of Chapter 13 implies an obligation on the part of a Chapter 13 debtor to make at least a meaningful attempt to repay creditors with unsecured claims.

<sup>35</sup> Although the Reform Act has no official title, the heading of Title 11, U.S.C. reads: "An Act to establish a uniform Law on the Subject of Bankruptcies." 92 Stat. 2549. Moreover, the U.S. Constitution expressly grants Congress the power to establish "uniform Laws on the Subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4.

<sup>36</sup> Compare *In re Raburn*, 4 Bankr. Rep. 624 (M.D. Ga. 1980)(§ 1325(a)(3) requires 70% payment of unsecured claims and plan must represent debtor's best effort) with *In re Terry*, 3 Bankr. Rep. 63, 66 (W.D. Ark. 1980) (§1325(a)(3) is inapplicable to amount of proposed payments) and *In re Cook*, 6 B.C.D. 219 (S.D. W. Va. 1980)(§ 1325(a)(3) requires payments commensurate with the extent to which the debtor is invoking the special relief afforded by Chapter 13). See also *In re Beaver*, 2 Bankr. Rep. 337 (S.D. Cal. 1980)(§ 1325(a)(3) requires "meaningful attempt" to repay or adjust debts); *In re Goeb*, 6 BCD 628, 630 (S.D. Cal. 1980)(§ 1325(a)(3) requires the debtor to deal fairly and equitably with all creditors); *In re Howard*, 5 B.C.D. 1375, 1376 (S.D. Cal. 1980)(§ 1325(a)(3) requires a plan calling for substantial payments to creditors).

closing sessions of the 95th Congress.<sup>37</sup> As a result, the Act contains many technical and substantive errors.<sup>38</sup> The Technical Amendments Bill, debated but not enacted by the 96th Congress, was intended to correct these errors.<sup>39</sup> The following discussion examines how the Bill addressed the "good faith" issue, why Congress chose this particular solution, and, most importantly, the extent to which the amendment should actually have resolved the controversy.

Section 127(b) of the Bill would have amended section 1325(a)(4) of the Reform Act to read as follows:

(a) The court shall confirm a plan if—

\* \* \*

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date, *and such plan represents the debtor's bona fide effort.* . . .<sup>40</sup>

The Bill's legislative history<sup>41</sup> explains how Congress intended the courts to apply the various tests found in sections 1325(a)(3) and 1325(a)(4). Section 1325(a)(3) — the "good faith" test — applies only with respect to the debtor's motive or purpose for filing in Chapter 13.<sup>42</sup> The first part of section 1325(a)(4) — the "best interest of creditors" test — establishes an absolute minimum limit below which the level of proposed payments may not drop, regardless of the debtor's particular cir-

<sup>37</sup> See Klee, *supra* note 8, at 292.

<sup>38</sup> See H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 1 (1980).

<sup>39</sup> *Id.*

<sup>40</sup> 126 CONG. REC. H11,735 (daily ed. Dec. 3, 1980) (italicized portion added by proposed amendment).

<sup>41</sup> In its original version, the Technical Amendments Bill would have added a "best effort" requirement to § 1325(a)(5). S. REP. No. 96-305, 96th Cong., 2d Sess. 14 (1980). The House amended the Bill, changing "best effort" to "good faith effort." H.R. REP. No. 96-1195, *supra* note 38, at 24. The Senate amended the Bill once again, this time by dropping the "good faith effort" from § 1325(a)(3) and adding a "bona fide effort" requirement to § 1325(a)(4). 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980). The House accepted the "bona fide effort" requirement without change. 126 CONG. REC. H11,735 (daily ed. Dec. 3, 1980).

<sup>42</sup> The "good faith" test is intended to preclude confirmation of a plan which the debtor does not intend to implement as proposed, or where the proposed plan, if consummated, would contravene the spirit or purposes of Chapter 13. An example of such a plan would be one in which the debtor's purpose is to render himself incapable of meeting alimony or support obligations. See H.R. REP. No. 96-1195, *supra* note 38, at 24.

cumstances.<sup>43</sup> To satisfy the "bona fide effort" test a Chapter 13 plan would have had to represent a sincere and honest effort by the debtor to pay a significant percentage, if not all, of the debtor's unsecured debts.<sup>44</sup>

### B. Merits of the Bona Fide Effort Test

Congress intended Chapter 13 to "enable an individual, under court supervision and protection, to develop and perform under a plan for the repayment of his debts over an extended period."<sup>45</sup> As enacted, however, Chapter 13 permits confirmation of plans proposing few or no payments to unsecured creditors. As a result, it has become, in the words of Senator DeConcini, one of the principle proponents of the Reform Act, "the most misused and abused portion of the Bankruptcy Code."<sup>46</sup> The purpose of the "bona fide effort" test is to put an end to this abuse and preserve the historical spirit and intent of Chapter 13: to provide a legitimate alternative for the hardpressed debtor who honestly wants to pay his debts.

Yet, standards less ambiguous than this are clearly possible. One possibility would be to require Chapter 13 debtors to pay at least a specified percentage of their unsecured debts.<sup>47</sup> Another would be to require debtors to pay as much as they possibly could under the circumstances.<sup>48</sup> Either of these standards would be easier to apply to a particular set of facts than the more nebulous concept of a "bona fide effort." Nonetheless, both options are unacceptable. Establishing a minimum percentage requirement would severely restrict a bankruptcy court's discretion and possibly work to the detriment of both debtor and creditor.<sup>49</sup> A "best effort" requirement would deter eligible debt-

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<sup>43</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980)(remarks of Sen. DeConcini).

<sup>44</sup> *Id.*

<sup>45</sup> H.R. REP. NO. 95-595, *supra* note 13, at 118.

<sup>46</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980)(remarks of Sen. DeConcini).

<sup>47</sup> See note 32 *supra*, for a discussion of how two bankruptcy courts have attempted to establish such a requirement. See also *In re Curtis*, 2 Bankr. Rep. 43, 45 (W.D. Mo. 1980), where the court, in dictum, stated that, as a "rule of thumb," a debtor demonstrates his good faith by proposing to pay at least 10% of his take-home pay for three years, subject to exceptional circumstances.

<sup>48</sup> The original version of the Technical Amendments Bill would have had this result. See S. REP. NO. 96-305, note 41 *supra*.

<sup>49</sup> Consider the following hypothetical situation: Congress amends § 1325 so that no plan can be confirmed unless it proposes payments equal to or greater than 50% of the debtor's unsecured debts. A debtor files in Chapter 13; liquidation of the debtor's assets would leave nothing for creditors with unsecured claims. The debtor proposes payments that would equal 45% of the unsecured debts, and the plan represents the debtor's best

ors from filing<sup>50</sup> and thus conflict with Congress' stated policy of encouraging eligible debtors to take advantage of Chapter 13.<sup>51</sup>

The "bona fide effort" requirement would give a court the discretion it needs to insure that debtors who take advantage of Chapter 13 do not take advantage of their unsecured creditors as well. The extent to which it would resolve the "good faith" issue would depend, however, on how the courts exercise that discretion. To appreciate the practical difficulties courts would experience in attempting to apply the "bona fide effort" requirement, it is helpful to consider the fundamental questions involved in the present "good faith" issue.

The crux of the "good faith" issue is how a bankruptcy court should determine the minimum amount a Chapter 13 debtor must pay to creditors with unsecured claims. The answer depends on whether the section 1325(a)(4) "best interest of creditors" test is the sole criterion by which to judge such payments. If the court decides it is not, it needs to decide whether the standard should be the "good faith" test or some other standard. However, the minimum amount inquiry does not end here. As the cases illustrate, even when the courts agree which standard applies, nonuniform interpretation or application of the standard yields disparate results.<sup>52</sup> Thus, resolution of the issue

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effort. In this situation the debtor and his creditors would lose: the debtor because he is forced to liquidate; the creditors because they will receive nothing, where, had the plan been confirmed, they would at least have gotten 45% of their claims.

<sup>50</sup> A "best effort" requirement would tend to discourage the type of debtor who needs Chapter 13 the most. A debtor with few debts or a high income, or both, might be able to pay his debts entirely with little sacrifice. The debtor with a large amount of debts and low income, however, is in a different situation. For him, a "best effort" would presumably mean making payments that would put his plan just at the § 1325(a)(6) "feasibility" level or very close to it. The prospect of having to pay all his disposable income for three years is enough to discourage anyone from filing under Chapter 13.

The Bankruptcy Commission found that one of the reasons for the limited use of Chapter XIII was that debtors were often pressured into attempting to pay too much. The pressure came from several sources. Creditors were likely to object if a plan provided for less than a substantial percentage of their claims. In addition, since a plan calling for a small percentage of repayment would entail a disproportionate amount of paperwork for the court, the trustee, and the attorney, debtors were encouraged to opt for liquidation if they could not pay all their debts under the plan. As a result, many debtors assumed a commitment to pay the full amount of their indebtedness when it was really not realistic for them to do so. Due to unforeseen expenses, loss of income, or other circumstances, many failed to keep up their payments and the "mortality rate" of Chapter XIII plans was very high. Those debtors not willing to take the risk simply liquidated. COMMISSION REPORT, *supra* note 12, at 160-61.

<sup>51</sup> The House Report states: "In the consumer area, proposed Chapter 13 encourages more debtors to repay their debts over an extended period rather than to opt for straight bankruptcy liquidation and discharge." H.R. REP. No. 95-595, *supra* note 13, at 5.

<sup>52</sup> Compare *In re Raburn*, 4 Bankr. Rep. 624 (M.D. Ga. 1980) ("good faith" requires 70% payment of unsecured claims and debtor's best effort) with *In re Curtis*, 2 Bankr.

turns on the answer to a third question: once the standard is identified, how do the courts apply that standard to achieve uniform, equitable treatment of all Chapter 13 debtors and creditors? The "bona fide effort" test answers the first two questions;<sup>53</sup> its shortcoming is that it fails to answer the third. This shortcoming is most evident in cases where liquidation would leave nothing for creditors with unsecured claims.

In such cases there will normally be a significant difference between the minimum limit set by the "best interest of creditors" test and the maximum limit set by section 1325(a)(6).<sup>54</sup> It is not clear at what point between these limits a proposed plan amounts to a bona fide effort. The court would determine this amount by taking into account "all the circumstances of the debtor."<sup>55</sup> The broad scope of this discretion is likely to foster a controversy substantially similar to the one the amendment purports to resolve. Whereas the "good faith" controversy centers around the confirmability of no-payment plans, a similar controversy could be expected to develop over ten, fifteen, or twenty percent plans. Unless there is a consensus among the courts as to the proper interpretation and application of the "bona fide effort" test, the situation that exists now would continue, only in a slightly different form. A debtor filing in Arkansas, for example, would be confident that his thirty percent plan will be confirmed, whereas a debtor filing in the Northern District of California would be wasting time if he submitted anything less than a sixty percent plan.<sup>56</sup>

Adoption of a "bona fide effort" test is a necessary first step towards resolution of the "good faith" controversy. The test

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Rep. 43 (W.D. Mo. 1980)("good faith" requires payments of at least 10% of debtor's take-home pay) and *In re Goeb*, 6 B.C.D. 628 (S.D. Cal. 1980)("good faith" requires debtors to deal fairly and equitably with creditors). See also *In re Hurd*, 4 Bankr. Rep. 551 (W.D. Mich. 1980)("good faith" requires meaningful payments to creditors with unsecured claims).

<sup>53</sup> The test makes it clear that the "best interest of creditors" test is not the sole criterion with respect to the minimum amount of payments required for confirmation. It also identifies the standard that is to be used: the "bona fide effort" test.

<sup>54</sup> The closer the debtor's plan comes to the "feasibility" limit of § 1325(a)(6), the easier it is to make the "bona fide effort" determination. A "best effort" subsumes, *per se*, the concept of a "bona fide effort."

<sup>55</sup> See note 43 *supra*.

<sup>56</sup> These jurisdictions are used as examples merely to point out that a particular judge's attitude toward the purpose of Chapter 13, or the theory of wage earner relief in general, may influence his interpretation of a given standard. Compare *In re Terry*, 3 Bankr. Rep. 63 (W.D. Ark. 1980)(purpose of Chapter 13 is to give debtor a "fresh start"; no-payment plan confirmed) with *In re Burrell*, 2 Bankr. Rep. 650 (N.D. Cal. 1980)(purpose of Chapter 13 is to encourage full-payment plans and substantial-payment plans; 15% plan denied confirmation).

would identify the standard bankruptcy courts should use to determine the minimum amount a Chapter 13 debtor must pay to creditors with unsecured claims. The issue will not be laid to rest, however, until more specific guidelines are available to aid debtors in proposing acceptable plans and to assist courts in applying the new standard in a uniform, equitable manner.

### III. PROPOSED GUIDELINES FOR USE OF THE "BONA FIDE EFFORT" TEST

The "bona fide effort" test would give a bankruptcy court the discretion it needs to strike an equitable balance between the conflicting interests of Chapter 13 debtors and creditors.<sup>57</sup> But in exercising its discretion the bankruptcy judiciary should strive for uniform interpretation and application of the standards set by Congress. Short of restricting the court's discretion altogether,<sup>58</sup> the most effective way to achieve uniform interpretation and application of the "bona fide effort" test is through the use of standard guidelines. If Congress adds a "bona fide effort" test to Chapter 13 by amendment to the Code, a set of uniform guidelines should be featured prominently in the amendment's legislative history to make it clear that Congress intends the courts to address and discuss each guideline in every Chapter 13 case.<sup>59</sup> In the absence of express Congressional action, bankruptcy courts should adopt and adhere to such recommended guidelines *sua sponte*.<sup>60</sup>

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<sup>57</sup> In *Bank of Marin v. England*, 385 U.S. 99, 103 (1966), Justice Douglas said, "There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."

<sup>58</sup> See notes 46-50 and accompanying text *supra*.

<sup>59</sup> See note 100 *infra*, for a discussion of *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974) (*held* district court must consider twelve specific guidelines in deciding whether to award attorney's fees in a Title VII action). Two years after the *Johnson* court set forth the appropriate guidelines, Congress enacted the Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, 90 Stat. 2641 (1976) (amending 42 U.S.C. § 1988 (1976)), which allows a court to award attorney's fees to a prevailing party in suits brought to enforce certain civil rights acts. Congress expressly recognized the appropriateness of the *Johnson* guidelines for determining the reasonableness of attorneys' fees claimed by the prevailing party. S. REP. No. 94-1011, 94th Cong., 2d Sess. 6, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 5908, 5913.

<sup>60</sup> See note 100 and accompanying text *infra*.

### A. A Proposed Set of Standard Guidelines

Bankruptcy courts should use the following guidelines in applying the "bona fide effort" test in Chapter 13 cases:<sup>61</sup>

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<sup>61</sup> The Technical Amendments Bill will probably be enacted during the current session of Congress. The House and Senate agreed last session on the form of the section that addresses the "good faith" controversy. See note 41 *supra*. Thus, it is safe to assume that if the Bill does pass it will be in its present form with respect to the "bona fide effort" test. If the Bill fails to pass, however, the courts will be left in a difficult situation. On the one hand, it is now clear that Congress never intended the "best interest of creditors test" to be the sole criterion with respect to the minimum amount Chapter 13 debtors must pay to unsecured creditors. 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980) (remarks of Sen. DeConcini). On the other hand, however, the courts cannot use this information as authority to read a "bona fide effort" test into § 1325(a)(3). The question remains whether bankruptcy courts should continue to use the "good faith" test to require Chapter 13 debtors to make "meaningful" or "substantial" payments.

Dean Epstein argues that they should not. Epstein, *supra* note 5, at 13. His conclusion is supported by two observations. First, he points out that there is no statutory basis for such a requirement. Second, he argues that there would be serious problems with the practical application of a standard as subjective as "meaningful" or "substantial" payments. *Id.*

The argument that there is no statutory basis for such a requirement is simplistic. It suggests that a court has no power to disregard form for substance, to hold that a transaction that complies with the literal terms of a statute is not within its spirit. The courts should follow the long-standing rule cited by Chief Justice Burger that "when interpreting a statute, the court will not look merely to a particular clause . . . but will take in connection with it the whole statute . . . and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry out the will of the Legislature . . ." *Kokoszka v. Belford*, 417 U.S. 642, 650 (1973), (citing *Brown v. Duchesne*, 19 How. 183, 194 (1857)). Several courts have examined the legislative history of Chapter 13 and federal bankruptcy law in general, and have reached the conclusion that a literal reading of the Chapter 13 confirmation criteria would yield results that contravene the spirit and purpose of Chapter 13 and the entire Bankruptcy Code. The scholarly opinions of Judge Mabey and Judge Nims provide persuasive support for this position. See *In re Iacavoni*, 2 Bankr. Rep. 256 (D. Utah 1980); *In re Hurd*, 4 Bankr. Rep. 551 (W.D. Mich. 1980). Thus far, over thirty courts have reached the same conclusion. Apparently, however, Dean Epstein's article was prepared very early in 1980, before these opinions were available. See Epstein, *supra* note 5, at 1.

Dean Epstein's second argument is that a "meaningful" or "substantial" payment standard is too subjective to achieve uniform results. Epstein, *supra* note 5, at 13. That, of course, is the thesis of this article: such a requirement, whether phrased in terms of "meaningful" payments or "bona fide effort," is by itself likely to yield disparate results. An easy solution to the problem, as Dean Epstein suggests, is to avoid it altogether and stick with the "best interest of creditors" test. But a bankruptcy court is a court of equity, 28 U.S.C. § 1481, and courts of equity are expected to deal with difficult problems. The proper approach is to strive for uniform application of the standard without sacrificing the court's discretion. This can be accomplished through the use of standard guidelines.

Thus, if Congress fails to require a "bona fide effort" test as in the Technical Amendments Bill, or otherwise, bankruptcy courts should use the "good faith" test to require Chapter 13 debtors to propose "meaningful" or "substantial" payment to holders of unsecured claims. This standard can be expressed as a "good faith effort" requirement. The recommended guidelines are as applicable to a "good faith effort" test as they are to a "bona fide effort" test. Courts could then use the recommended guidelines, substituting



1. *The ratio of proposed payments to the debtor's total indebtedness*— In discussing the impact of a “bona fide effort” standard, Senator DeConcini stated that the test “envisions . . . payments . . . that represent a significant percentage, if not all, of the debts owed.”<sup>62</sup> He made no attempt, however, to define the parameters of a “significant” percentage.<sup>63</sup> The statement, though ambiguous, effectively conveys two thoughts. First, it expresses Congress’ expectation that the average Chapter 13 plan will provide for a high percentage of repayment. But at the same time, it leaves to the court’s discretion the ultimate determination, *i.e.*, whether or not, in view of “all the circumstances of [the] debtor,”<sup>64</sup> the payments represent a “significant” percentage of the debts owed. Thus, the courts should make this determination on a case-by-case basis, rather than by establishing arbitrary repayment levels for confirmation.<sup>65</sup>

The proscription against setting arbitrary percentage levels as a requirement for confirmation does not mean that the percentage of repayment is not relevant. Courts should compare the amount the debtor proposes to pay with the minimum amount allowed by the “best interest of creditors” test. The “bona fide effort” test calls for a “sincere good faith effort” by the debtor.<sup>66</sup> By proposing to make payments that barely exceed the “best interest of creditors” test the debtor casts doubt on his sincerity. If the debtor’s payments would only slightly exceed the minimum limit, closer scrutiny of the plan is in order.

The court might also find it useful to set certain percentage levels to indicate which party is to bear the burden of proving or disproving the existence of a “bona fide effort.” For example, a court might say that a ninety-percent repayment plan is a *prima facie* “bona fide effort” and the creditors would have to prove that it is not. Conversely, a plan calling for less than ten percent repayment would be presumed not to represent a “bona fide effort” and the debtor would have to prove that the circumstances justify the small amount. In other words, the percentage levels would not be used to automatically determine the confirmability of a Chapter 13 plan; they would be used only to determine which party must come forward with evidence to prove or disprove the existence of a “bona fide effort.”

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“good faith effort” for “bona fide effort.”

<sup>62</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980) (remarks of Sen. DeConcini).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*; H.R. REP. No. 96-1195 *supra* note 38, at 25.

<sup>66</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980) (remarks of Sen. DeConcini).

2. *Unusual circumstances relating to the debtor's indebtedness*— A court should take into account any unusual or suspicious circumstances surrounding the debtor's indebtedness. For example, the debtor might have incurred an inordinate number or amount of unsecured debts within a short period of time before filing.<sup>66.1</sup> A court might reasonably conclude that the debtor, contemplating bankruptcy, went on a "spending spree" in hopes of obtaining a subsequent discharge for a large percentage of his debts. Under these circumstances the court should give the debtor a choice to either pay the debts in full or file under Chapter 7.<sup>67</sup>

3. *The debtor's ability to pay*— When evaluating a Chapter 13 plan a court must keep in mind Congress' goal of encouraging eligible debtors to take advantage of wage earner relief instead of liquidation.<sup>68</sup> For this reason, a court should not impose undue financial hardship on the debtor<sup>69</sup> or require of him an absolute "best effort."<sup>70</sup> On the other hand, the court must also bear in mind that the removal of creditor control in Chapter 13 cases has made the court the sole protector of creditors' interests.<sup>71</sup> Consideration of the debtor's ability to pay allows the court to further both goals: debtors are not discouraged by overburdensome payments, and creditors are protected from being taken advantage of by debtors who have the ability but not the willingness to make an honest attempt to repay their debts. Thus, this factor is the touchstone of the "bona fide effort" test.

Case law provides little guidance with respect to how courts should evaluate a debtor's ability to pay. This is because most cases in which the matter was at issue involved no-payment plans or plans that barely satisfied the "best interest of creditors" test.<sup>72</sup> In such cases it is usually clear that the debtor has the ability to pay more; therefore, the court is able to deny confirmation of the plan without going into a detailed analysis of the debtor's ability to pay. However, the adoption of a "bona fide effort" test would deter debtors from submitting such

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<sup>66.1</sup> See, e.g., *In re Frederickson*, 5 Bankr. Rep. 199 (M.D. Fla. 1980), where the debtor, a shipping clerk with over fifty credit cards, had incurred over \$100,000 in unsecured debts within a short period before filing.

<sup>67</sup> "In some cases courts should require the debtor to repay his unsecured creditors in full, but that should not necessarily become the norm . . ." 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980) (remarks of Sen. DeConcini).

<sup>68</sup> See note 51 *supra*.

<sup>69</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980)(remarks of Sen. DeConcini).

<sup>70</sup> See notes 47-50 and accompanying text *supra*.

<sup>71</sup> See Merrick, *supra* note 10, at 605.

<sup>72</sup> See, e.g., *In re Iacavoni*, 2 Bankr. Rep. 256 (D. Utah 1980).

clearly inadequate plans and thus make the court's determination of the debtor's ability to pay more significant. It is necessary, therefore, to discuss how a court should address certain aspects of the debtor's ability to pay.

An obvious starting point would be an analysis of the debtor's present and future employment prospects. Circumstances affecting the debtor's employment prospects may raise or lower the court's determination of what amount constitutes a "bona fide effort" for that particular debtor.

For example, the debtor may have little or no present income but anticipate substantial earnings in the near future. Consider hypothetical debtors H and W, a married couple. H has recently graduated from medical school and W from law school. They have no nonexempt assets and no income. However, they both have job offers and plan to begin working in a month or two. Their starting salaries are expected to total more than \$75,000. It would make no sense to take into account only their present ability to pay in such circumstances if H and W were to file a Chapter 13 plan.

On the other hand, the debtor might be earning a significant amount when he files, but anticipate a decrease in earnings. One example would be an auto worker who expects to be laid off in the near future. The debtor's ability to pay might be decreased due to the fact that he is setting aside a significant amount each month from his salary to get him through the layoff.

The court should also consider the nature of the debtor's employment. If the debtor is employed in an industry or trade that is seasonal or highly dependent on a particular cyclical market, the debtor's present earnings may not represent a true reflection of the debtor's ability to make payments over the life of the plan. The court could approach this problem two ways. The first way would be to take into account only the debtor's present earnings. Then if the debtor suffers an unexpected loss of income he could return to the court to have his plan modified<sup>73</sup> or seek a "hardship discharge."<sup>74</sup> The alternative is to attempt to determine a reasonable average amount that the debtor might be expected to maintain over the life of the plan. The latter method would obviously be difficult to administer. However, it might be worth the effort if it would avoid situations wherein the debtor seeks a "hardship discharge" because of a temporary

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<sup>73</sup> 11 U.S.C. § 1329 (Supp. III 1979) provides for modification of a plan after confirmation.

<sup>74</sup> See note 16 *supra*.

loss of income that may last but a few weeks.

The court might also want to take into account whether the debtor is receiving substantial support from third parties. Consider, for example, a debtor who is supported solely by his parents or the income from a trust. Of course, the court has no power to compel contributions from anyone other than the debtor.<sup>76</sup> It is debatable, though, whether such a debtor should be allowed to claim *no* ability to pay and thus receive a discharge of his indebtedness with a no-payment plan.

Finally, the court might also wish to consider whether the debtor has the ability to work but has chosen not to. Consider, for example, the case of a recent medical school graduate who decides to take a year or two off before he begins working. Although he has no income, it cannot be said that his ability to pay his debts is zero, since he could easily earn a substantial amount if he chose to do so.

4. *The debtor's claimed living expenses and present lifestyle*— If the debtor claims to have living expenses that seem exorbitant, such as \$400 per month for food for two adults,<sup>76</sup> or \$300 per month for church tithes,<sup>77</sup> the court may require the debtor to “pursue a more modest lifestyle.”<sup>78</sup>

In addition, the court should determine whether any debts relate to luxury items which the debtor intends to keep and enjoy. A court should deny Chapter 13 relief to the debtor who wishes to continue paying for luxury items at the expense of unsecured creditors.<sup>79</sup> However, the court's inquiry should go beyond the nature of the item in question. The court should take into account other factors, such as the debtor's reasons for purchasing the item, the number of similar items owned by the debtor, and how the debtor plans to use it. For example, Senator DeConcini states that a Chapter 13 debtor should not be allowed to purchase a new car or continue to make payments on a nearly new one at the expense of unsecured creditors.<sup>80</sup> The purchase of a new car might be considered a luxury to someone who already has a good car or who has no need for a new one; on the other hand, it might be considered a necessary business expense for a traveling salesman or a car dealer. By the same token, that traveling salesman does not need a Maserati; the *type* of car

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<sup>76</sup> See 11 U.S.C. § 1322(a)(1) (Supp. III 1979).

<sup>76</sup> See *In re Schongalla*, 6 B.C.D. 408 (D. Md. 1980).

<sup>77</sup> See *In re Cadogan*, 4 Bankr. Rep. 598 (W.D. La. 1980).

<sup>78</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980) (remarks of Sen. DeConcini).

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

purchased also seems relevant. The purchase of a hot tub is another example. Under most circumstances a hot tub would be considered a definite luxury item. A person suffering from severe arthritis might look at it differently. In that case, the court should consider whether the tub is truly necessary, and also whether a less expensive alternative is available, *e.g.*, a portable whirlpool, membership at a local health spa, or available hospital facilities.

5. *Prior filings in Chapter 13*— The “bona fide effort” test requires the debtor to make a sincere good faith effort to repay creditors with unsecured claims.<sup>81</sup> A history of unsuccessful attempts to complete Chapter 13 plans, though not a technical bar to further Chapter 13 relief,<sup>82</sup> may indicate a lack of sincerity. For example, it may appear that the debtor is filing merely to take advantage of the automatic stay that protects the debtor from formal and informal collection efforts during the life of the plan.<sup>83</sup> A plan submitted for such a purpose would violate both section 1325(a)(3) and section 1325(a)(4).<sup>84</sup>

A history of successful attempts at Chapter 13 relief might also raise some questions. A debtor can receive successive Chapter 13 discharges, provided that he successfully completes each plan.<sup>85</sup> Suppose for example, D, a hypothetical debtor, incurs \$10,000 in unsecured debts. He then submits a Chapter 13 plan which provides for seventy-five percent repayment of his debts. The plan is confirmed; D makes the seventy-five percent payments in six months and receives a discharge of the remaining twenty-five percent. During those six months, however, D has incurred an additional \$10,000 in unsecured debts. So the day that he receives his first discharge he files another seventy-five percent Chapter 13 plan. Assume that D follows the same procedure every six months for two or three years. The court should question whether D is simply using Chapter 13 as part of an elaborate discount scheme. In most cases, a seventy-five percent repayment plan would probably be considered a *prima facie*

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<sup>81</sup> *Id.*

<sup>82</sup> See 11 U.S.C. § 109(e) (Supp. III 1979).

<sup>83</sup> See *Id.* § 362.

<sup>84</sup> The plan violates section 1325(a)(3) if it appears that the debtor does not intend to effectuate it. H.R. REP. NO. 96-1195, *supra* note 38, at 24. The same plan would also violate § 1325(a)(4) in that it does not represent a sincere good faith effort to repay creditors. See 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980).

<sup>85</sup> Compare 11 U.S.C. § 727(a)(8) (Supp. III 1979)(previous discharge in Chapter 7 within the preceding six years bars the debtor from receiving another Chapter 7 discharge) with 11 U.S.C. § 1328 (Supp. III 1979)(previous discharge in Chapter 13 does not act as a bar to further relief in Chapter 13). See also note 16 *supra*.

"bona fide effort." In D's case the court might require a higher percentage of repayment, if not complete repayment.

6. *The payment period*— Chapter 13 anticipates a three-year plan,<sup>86</sup> but a court should not automatically deny confirmation to one of shorter duration.<sup>87</sup> Previously, some debtors proposed plans that were to last only until the debtor had reached the "best interest of creditors" limit.<sup>88</sup> The "bona fide effort" test would preclude confirmation of such plans. Yet, there still may be circumstances that justify a plan of short duration, such as the debtor's impending retirement or the anticipated birth of a child.

7. *Attorney's fees*— The debtor's attorney has priority over holders of general unsecured claims.<sup>89</sup> The court should compare the amount the debtor proposes to pay the attorney under the plan with the amount the debtor proposes to pay to holders of general claims. If the attorney's fees significantly reduce the debtor's ability to pay other creditors the court should inquire into the fee arrangement and reasonableness of the fee.<sup>90</sup> On the other hand, if the debtor attempts to make informal arrangements with his creditors before filing and is forced into court because they refuse to cooperate, they can hardly complain that the debtor's legal expenses have caused them to receive less than they would have otherwise.

8. *Exceptional circumstances and other considerations*— Bankruptcy courts should address each of the preceding guidelines in every Chapter 13 case. However, the factors represented

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<sup>86</sup> See 11 U.S.C. § 1322(c) (Supp. III 1979), which limits the duration of the plan to three years unless the court, for cause, permits an extension, which cannot exceed two years. See H.R. REP. NO. 96-1195, *supra* note 38, at 25.

<sup>87</sup> A plan of short duration should not *per se* be held to be less than a "bona fide effort." A plan that provides for payments totalling 95% of the debtor's indebtedness is probably a "bona fide effort" whether stretched out over three months or three years. See also *In re Markman*, 6 B.C.D. 632 (E.D.N.Y. 1980), where the court held that the setting of a mandatory time period would amount to involuntary servitude and thus violate the 13th Amendment. The court's reasoning is questionable, however, in light of the voluntary nature of Chapter 13. See 11 U.S.C. § 303(a) (Supp. III 1979). Even after a plan is confirmed the debtor is always free to stop paying or to convert his case to a Chapter 7 (liquidation) case. 11 U.S.C. § 1307(a) (Supp. III 1979).

<sup>88</sup> See, e.g., *In re White*, 4 Bankr. Rep. 349 (E.D. Va. 1980) (27-month plan tailored to barely meet the "best interest of creditors" test denied confirmation).

<sup>89</sup> 11 U.S.C. § 1322(a)(2) (Supp. III 1979) requires that the plan provide for full payment of all claims entitled to priority under § 507. Section 507(a)(1) grants a priority to administrative expenses allowed under 11 U.S.C. § 503(b) (Supp. III 1979). Section 503(b)(4) includes reasonable compensation for professional services rendered by an attorney.

<sup>90</sup> See 11 U.S.C. § 502(b)(5) (Supp. III 1979), which allows a court to examine the claim of a debtor's attorney and to disallow it to the extent that it exceeds the reasonable value of the attorney's services.

in these guidelines are not presumed to be exhaustive. The range of potentially relevant factors, if not limitless, is bounded only by the imagination and resourcefulness of the attorneys who represent Chapter 13 debtors and creditors.<sup>91</sup> This guideline leaves the court free to address relevant factors that do not relate to any of the preceding guidelines.<sup>92</sup> The court should not assume that the relevancy of the factor is obvious to other courts. Subsequent courts will appreciate the relevancy of the factor more readily if provided with a thorough discussion of the factor by the court that suggests it.

### B. *The Merits of Uniform Guidelines in Chapter 13 Cases*

Bankruptcy court opinions are usually very brief, making it difficult, if not impossible, to distill from them the various factors influencing the court's decision.<sup>93</sup> When a court does articulate the factors it has considered, it too often merely lists them and fails to explain how the different factors weighed in the ultimate decision.<sup>94</sup> Standard guidelines, such as the set proposed in this article, would provide the court with a framework for setting forth the factors it has considered and highlighting their relative importance to the particular facts of the case. The guidelines would not substantively affect a court's decision; that is, they would not tell the court how it must decide.

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<sup>91</sup> For an interesting but ironic example, see *In re Keckler*, 6 B.C.D. 14 (N.D. Ohio 1980). The debtor had been an employee of a bank and had forged checks at the bank totalling \$9,363. The bank obtained a judgment against her for the entire amount. After she was released from prison she submitted a Chapter 13 plan which proposed repayment of five percent of the debt. The court noted the small percentage of repayment but confirmed the plan anyway, finding that due to her past prison record (for forging the checks) her employment prospects were limited and thus a five percent plan represented her best effort.

<sup>92</sup> For example, several courts have stated that the *nature* of the debts covered by the plan is relevant to the amount the debtor should be required to pay. This means that a court should take into account whether the debts would be nondischargeable under Chapter 7. The attitude seems to be that the debtor should pay in proportion to the special benefits he wishes to receive from Chapter 13: the more debts the debtor has that would be nondischargeable in Chapter 7, the more he should pay to receive a Chapter 13 discharge. See, e.g., *In re Cook*, 6 B.C.D. 219 (S.D. W.Va. 1980). This factor was not included in the recommended guidelines because there is no indication that Congress intended such a factor to be taken into account. The thrust of the "bona fide effort" test is to make sure that the debtor makes a sincere effort to pay his creditors; the emphasis is put on the relation between the proposed payments and the debtor's ability to pay, not on the nature of the debts sought to be discharged. See H.R. REP. NO. 96-1195, *supra* note 38, at 24; *In re Thorson*, 6 Bankr. Rep. 678, 682 (D.S.D. 1980).

<sup>93</sup> See, e.g., *In re Webb*, 3 Bankr. Rep. 61 (N.D. Cal. 1980).

<sup>94</sup> See, e.g., *In re Iacovoni*, 2 Bankr. Rep. 256, 267 (D. Utah 1980).

1. *Uniformity*— Use of such guidelines would promote uniform application of the “bona fide effort” test because subsequent courts would benefit from knowing how previous courts applied the test to different factual settings. In time, a consensus should develop with respect to the relative importance of the separate factors.<sup>95</sup>

The use of standard guidelines would also promote the appearance of uniformity and fairness.<sup>96</sup> When conflicting decisions result from the application of a single standard there is a danger that the legal system will be perceived as arbitrary and capricious. By using the guidelines the judiciary would demonstrate that its goal is to decide every Chapter 13 case by the same standards. A court’s discussion of how each guideline relates to the facts of a case would illustrate that conflicting decisions are the result of different factual settings and not the application of different judicial standards.

2. *Judicial economy*— The use of standard guidelines would also promote judicial economy. Since most Chapter 13 debtors probably want to get a discharge by paying as little as possible,<sup>97</sup> their estimates of what constitutes a “bona fide effort” are likely to be meager. It would be a waste of the debtor’s money and the

<sup>95</sup> See *In re Bellgraph*, 6 B.C.D. 480 (W.D.N.Y. 1980), where the court recognized the relevance of the factors set forth in *Iacovoni*, *supra* note 94. *Bellgraph* is noteworthy also in that the court gives an unusually detailed recitation of the fact of the case. The court’s discussion of the facts gives an indication of how it analyzed the *Iacovoni* factors, which are listed later in the opinion.

<sup>96</sup> “[The bankruptcy] court must be, and appear to be, a fair and credible forum.” H.R. REP. No. 95-595, *supra* note 13, at 13 (emphasis added).

<sup>97</sup> At least one court’s findings tend to prove the validity of this assumption. In *In re Hurd*, 4 Bankr. Rep. 551 (W.D. Mich. 1980), the court compared two groups of wage earner plans. The first group was submitted to the court between June 1, 1979, and September 30, 1979. The second group was submitted in March of 1980, under the Reform Act. The plans were compared according to the percentage of repayment proposed by the debtor. They broke down as follows:

Amount of Proposed Repayment	Percentage of Plans Submitted	
	Group 1	Group 2
100% .....	83%	5%
50-99% .....	0	0
11-49% .....	7%	2%
6-10% .....	5%	36%
5% or less .....	2%	53%

*Id.* at 559. While any of the new incentives created by the Reform Act would contribute to the change in the number of debtors using Chapter 13, *see* notes 16 & 17 *supra*, only the removal of creditor control could arguably be responsible for this dramatic change in the character of the plans submitted. In Judge Nims’ words: “Thus, once the necessity of obtaining acceptance was removed, many debtors found that they could not pay substantial amounts to unsecured creditors.” *Id.* at 560.



court's time to discover at the confirmation hearing that the court has an opposite point of view. Of course, it is impossible to provide a simple mathematical formula for determining how much debtors must propose in order to have their plans confirmed.<sup>98</sup> On the other hand, it is possible to inform the debtor of the factors the court will consider in making its determination. If this information were available, fewer debtors would propose unrealistic plans and the courts would save the time that would otherwise be wasted in futile confirmation hearings.

3. *Facilitation of appellate review*— Finally, the use of standard guidelines would facilitate appellate review of Chapter 13 cases. Most Chapter 13 appeals will probably involve the court's application of the "bona fide effort" test.<sup>99</sup> The appellate court will have to determine whether the bankruptcy court abused its discretion. It cannot make this determination, however, unless the bankruptcy court articulates the factors upon which it based its decision. A bankruptcy court can provide this information most effectively by adhering to a set of standard guidelines when it applies the "bona fide effort" test.<sup>100</sup>

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<sup>98</sup> See notes 47-51 and accompanying text *supra*.

<sup>99</sup> This assumption is based on an analysis of the various confirmation criteria contained in § 1325(a). Subsections 1325(a)(1), (2), and (5) are straightforward determinations, as is the "best interest of creditors" portion of subsection (4). The objective character of these criteria makes it unlikely that there would be any grounds for appealing from the court's determination. Subsection 1325(a)(3) is open to argument, because the court is called upon to exercise its discretion in evaluating the debtor's motives for filing in Chapter 13. However, the difficulty of proving an improper motive makes it unlikely that this subsection would be the source of much litigation. *But see In re Goeb*, 4 Bankr. Rep. 735 (S.D. Cal. 1980), where the court denied confirmation of a Chapter 13 plan on the ground that the debtor's sole purpose for filing was to defer certain taxes. Subsection 1325(a)(6) also gives the court discretion to evaluate the "feasibility" of the plan. While this determination is open to argument, the issue is not likely to arise with great frequency. See note 20 *supra*. This leaves the "bona fide effort" test of § 1325(a)(4). This section is likely to foster litigation for two reasons. First, it is highly subjective and thus susceptible to conflicting interpretations in different factual settings. Second, it lies at the root of most unsecured creditors' objections: they think they are not getting paid enough.

<sup>100</sup> For example, see *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974). In *Johnson*, the district court had awarded attorneys' fees to a successful plaintiff in a case brought under Title VII of the Civil Rights Act of 1964. The Fifth Circuit remanded the case for reconsideration of the amount of attorneys' fees awarded. The court explained that it was impossible to determine whether the district court had abused its discretion without knowing the factors which contributed to the decision, and upon which specific factors the decision was based. *Id.* at 717. It ordered the district court to reconsider its decision in light of 12 specific guidelines set forth in Ethical Consideration 2-13, Disciplinary Rule 2-106, of the ABA CODE OF PROFESSIONAL CONDUCT. The *Johnson* guidelines are now recognized and held to be mandatory in eight other circuits. See *Hampton v. Hanrahan*, 600 F.2d 600, 643 (7th Cir. 1977); *King v. Greenblatt*, 560 F.2d 1024, 1026 (1st Cir. 1977), *cert. denied*, 438 U.S. 916 (1978); *Prate v. Freedman*, 583 F.2d 42, 48 (2d Cir. 1978); *Hughes v. Repko*, 578 F.2d 483, 488 (3d Cir.

## CONCLUSION

Congress did not intend Chapter 13 to be a haven for debtors who wish to receive a discharge of unsecured debts without making an honest effort to pay those debts. Unfortunately, the present Chapter 13 confirmation criteria do not adequately express Congress' intent. As a result, conflicting interpretations of the confirmation criteria have caused disparate treatment of Chapter 13 debtors. To prevent future abuse of Chapter 13, Congress must first amend the confirmation criteria, adding a "bona fide effort" requirement. Further, to insure fair and uniform treatment of Chapter 13 debtors, bankruptcy courts should use a set of standard guidelines when applying this "bona fide effort" test. Only then will Chapter 13 cease to be "the most misused and abused portion of the Bankruptcy Code."<sup>101</sup>

—Stephan M. Vidmar

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1978); *Barber v. Kimbrell's, Inc.*, 577 F.2d 216, 226 (4th Cir. 1978); *Allen v. Amalgamated Transit Union Local 788*, 554 F.2d 876, 884 (8th Cir. 1977); *Kerr v. Screen Extras Guild, Inc.*, 526 F.2d 67, 70 (9th Cir. 1975), *cert. denied*, 425 U.S. 951 (1976); *Evans v. Sheraton Park Hotel*, 503 F.2d 177, 188 (D.C. Cir. 1974).

<sup>101</sup> 126 CONG. REC. S15,175 (daily ed. Dec. 1, 1980)(remarks of Sen. DeConcini).

