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BANKCARD'S REVENGE: A CRITIQUE OF THE 1984 CONSUMER CREDIT AMENDMENTS TO THE BANKRUPTCY CODE

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I. Introduction

Virtually from the enactment of the Bankruptcy Code[1] in 1978, creditors attempted to roll back what they perceived to be the Code's undue bias toward bankrupts.[2] The Code was branded a debtor's paradise practically beckoning borrowers to shed their debts painlessly and needlessly.[3] It was certainly true that the number of bankruptcy filings rose substantially during the late 1970's and early 1980's,[4] and that some creditors attributed at least

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1. In this article, "Bankruptcy Code" or "Code" refers to the current version of Title 11 of the United States Code, originally enacted as part of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.A. §§ 1-151326 (West Supp. 1985)). "Bankruptcy Reform Act" refers to the Code and related provisions of federal bankruptcy law prior to their amendment in 1984. "Bankruptcy Act" or "Act" refers to the former Title 11, 11 U.S.C. §§ 1-1103 (1976), repealed by the Bankruptcy Reform Act.

2. In this article, "debtor" generally refers to an obligor and "bankrupt" to a person subject to proceedings under the Code. When the Code refers to the "debtor," it means "bankrupt." Bankruptcy Code, 11 U.S.C.A. § 101(12) (West Supp. 1985).

3. In the view of Congressman Jack Brooks:

> It has been estimated that as much as $1 billion of debt is unnecessarily discharged annually under the present bankruptcy system. As a result, consumer credit has become expensive and difficult to obtain. Consumers, especially those of middle and lower income groups, are paying dearly for the laxity we have introduced into our bankruptcy laws.

130 Cong. Rec. H1812 (daily ed. March 21, 1984).

4. *See generally* Ayers, *Reforming the Reform Act: Should the Bankruptcy Reform Act of 1978 be Amended to Limit the Availability of Discharges to Consumers?*, 17 New Eng. L. Rev. 719, 719-20 (1982). *Cf.* Woodward & Woodward, *Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study*, 88 Com. L.J. 309 (1983).

some of this to the Code's presumed generosity.[5] Whether the Code actually caused any of the increase in filings is, to put it mildly, controversial. Other factors, most significantly the general economic malaise of the past fifteen years, undoubtedly played a far larger role. Yet the perception that the Code was little more than a charter for deadbeats was not entirely baseless. It was, at least in theory, possible for some debtors to use the Code to shed debts which they were able to pay without hardship.

The horror story with which one of the authors was constantly regaled was that of the newly graduated medical doctor whose debts were high, assets meagre, and income potential immense. The doctor (or, for that matter, any high debt/low asset/high income debtor) could obtain a discharge of his/her debts for slight cost—the liquidation value of his/her assets. Worse, a significant portion of such assets as there were could be protected under state or, where applicable, federal exemptions. Worse still, the bankrupt could, by filing under Chapter 13 rather than Chapter 7, stretch the liquidation out over a three to five year period.[6] Not only

5. Remarks by Congressman G.V. Montgomery epitomize this attitude:

> Mr. Chairman, for the last couple of years in going home, I have been getting many complaints from the owners of small businesses about the large number of persons taking bankruptcy. It was pointed out to me that a number of these persons taking bankruptcy had good jobs. They could pay their obligations, but it was the easier route to go chapter 7 and take bankruptcy and not worry about their debts. I would like to read part of a letter from a friend of mine who is a minority person and has a small business in my State:
>
> > I would like to take this opportunity to again express my concerns about the number of bankruptcies that are taking place in our country and how these bankruptcies have affected small businesses. We have been in business for over 40 years and we have never seen as many people taking bankruptcy and starting right over in business, as we have seen in the last two years. We have been the victim of over $20,000 in losses through bankruptcies during this period.
> >
> > As one bankruptcy official told me when we went to Louisiana to try to collect for some products we had sold, he looked at me and told me that, that court was there to assist the people that were going bankrupt and not to assist the people who were still in business and when I explained to him how these bankruptcies were affecting our business, his remark was, the profitable thing to do today is to go bankrupt . . . .
>
> Well, something is wrong when the bankruptcy laws encourage people to take bankruptcy and then a small businessman goes before the courts and they tell him, "We can't help you at all."

130 CONG. REC. H1812 (daily ed. March 21, 1984). See also Congressman Jack Brooks' comment that since the enactment of "the present Bankruptcy codes [sic]," personal bankruptcies had "run 200 percent higher annually than they had in the 12 preceeding years." *Id.*

6. Bankruptcy Code, 11 U.S.C. § 1322(c) (1982) allowed a Chapter 13 plan to extend for a three-year period. With court approval "for cause," the plan period could be extended to five years. *Id.* This provision was not changed by the Bankruptcy Amendments and Federal

would such extension make bankruptcy still more attractive to the debtor, it would also increase the risk that the creditors would not get even the original liquidation value of the bankrupt's property. The reason was simple: if the bankrupt's assets were destroyed or otherwise diminished in value during the plan period, the bankrupt could freely modify his/her Chapter 13 payments downward.[7] Adding insult to injury, such payments as the debtor had made during the ninety days immediately preceding the filing were generally avoidable as preferences.[8] Finally, the creditors were to a large degree shut out of the proceedings; the pre-Code right to a formal voice in Chapter 13[9] was eliminated;[10] and the creditors'

Judgeship Act of 1984 [hereinafter cited as BAFJA].

7. Bankruptcy Code § 1329(a), (b)(1) stated:

> §1329. Modification of plan after confirmation
>
> (a) At any time after confirmation but before the completion of payments under a plan, the plan may be modified to—
>
> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
>
> (2) extend or reduce the time for such payments; or
>
> (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan, to the extent necessary to take account of any payment of such claim other than under the plan.
>
> (b)(1) Sections 1322(a) [required contents of plan], 1322(b) [permissive contents of plan], and 1323(c) [pre-confirmation modification requirement regarding certain secured claims] and the requirements of section 1325(a) [confirmation requirements, including liquidation value test] apply to any modification under subsection (a) of this section.

11 U.S.C. §§ 1329(a), (b)(1) (1982) (amended 1984). The legislative history made it clear that the liquidation value test for the modified plan was based on the value of the bankrupt's property at the time of the modification. H.R. REP. No. 595, 95th Cong., 1st Sess. 431 (1977). (The only change made by BAFJA to this section is a provision enabling the trustee or the holder of an allowed secured claim to seek modification of the plan after confirmation. *See infra* note 97.).

8. Bankruptcy Code, 11 U.S.C. § 547(b) (1982) (amended 1984). Although not directly relevant to the theme of this article, one aspect of the 1984 amendment of § 547 is worth noting. A new preference exception was created, applicable in consumer cases, for transfers by the bankrupt of less than $600. Bankrutpcy Code, 11 U.S.C.A. § 547(c)(7) (West Supp. 1985). The presence of this provision, which merely benefits one set of creditors (most likely small loan and revolving charge account creditors) at the expense of others, may indicate that the goals of those creditor organizations which pushed for consumer credit reform were a trifle parochial.

9. Known under the Act as Chapter XIII—Bankruptcy Act §§ 601-686, 11 U.S.C. §§ 1001-1086 (1976) (repealed 1979).

10. Although Chapter XIII proceedings did not utilize creditors' committees, they did include a meeting of creditors, and more importantly, a vote by creditors on the plan. Bankruptcy Act §§ 632, 633, 652, 653, 11 U.S.C. §§ 1032, 1033, 1052, 1053 (1976) (repealed 1979). *See generally* 10 COLLIER ON BANKRUPTCY ¶¶ 25.01-.11 (L. King 14th ed. 1978). The significance of this participation, however, was seriously questioned. Girth, *The Bankruptcy Reform Process: Maximizing Judicial Control in Wage Earner Plans*, 11 U. MICH. J.L. REF. 51 (1977).

ability to influence business reorganization proceedings was arguably reduced.[11] To at least some creditors, this seemed to create a bankruptcy system in which only the voice of the bankrupt was heard, and only the interests of the bankrupt served.

These issues primarily affected unsecured creditors. While secured creditors had their own gripes about the Code,[12] Constitutional and statutory protections remained reasonably effective in ensuring ultimate payment.[13] Moreover, the formal participation of secured creditors in some bankruptcy proceedings was actually increased.[14]

The potential abuses were real; however, what remained unclear was whether they actually occurred with any frequency. Much of the debate occurred in a factual vacuum; sweeping statements pronounced with *ex cathedra* authority were rarely supported by more than vague anecdotal evidence.[15] The one celebrated attempt to make an empirical study of bankruptcy and bankruptcy abuse, the so-called "Purdue Study,"[16] did not in detail address the question

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11. The primary concern in this regard was that Chapter 11 of the Code—which amalgamated Chapters X, XI, and XII of the Act—made it possible for a plan of reorganization to be confirmed by "cramdown." Cramdown, under Chapter 11, means that a plan can be confirmed if only one class of creditors votes to accept it, providing only that certain other conditions are met. Bankruptcy Code, 11 U.S.C.A. § 1129(a)(7), (8), (10) and (b) (West Supp. 1985). Under the Act, a Chapter XI plan could only be confirmed if all classes of creditors voted to accept it. Bankruptcy Act §§ 361, 362, 11 U.S.C. §§ 761, 762 (1976) (repealed 1979). However, cramdown was possible under the rarely used Chapters X and XII. Bankruptcy Act §§ 216(7), (8) and 461(11), 11 U.S.C. §§ 616(7), (8) and 861(11) (1976) (repealed 1979). *See generally* 6A COLLIER ON BANKRUPTCY ¶ 10.11-.17 (L. King 14th ed. 1978); 9 *id.* ¶ 9.03. Cramdown, of course, reduces the power of creditors by reducing the number of creditors who have to be satisfied with the plan for it to obtain confirmation.

12. Such as the invalidation of so-called ipso facto clauses under which insolvency or the filing of a petition triggers default under the Bankruptcy Code, 11 U.S.C.A. § 363(c) (West Supp. 1985) or the bankrupt's right under certain circumstances to grant superior liens on the secured party's collateral. Bankruptcy Code, 11 U.S.C.A. § 364(d) (West Supp. 1985).

13. For example, if secured parties so demand, their rights must be given what the Code calls "adequate protection" (defined in Bankruptcy Code, 11 U.S.C.A. § 361 (West Supp. 1985)) for the automatic stay to remain in effect (Bankruptcy Code, 11 U.S.C.A. § 362(d)(1) (West Supp. 1985)) or for the bankrupt to use, sell, or lease collateral (Bankruptcy Code, 11 U.S.C.A. § 363(e), (c)(2), (4), (f) (West Supp. 1985)).

14. Under Chapter XI, "creditors" were defined as the holders of the bankrupt's unsecured debts; "claim" and "debt" as unsecured debts. Bankruptcy Act, 11 U.S.C. § 707 (1976) (repealed 1979). Because of this, secured creditors had no formal role in Chapter XI proceedings. This limitation does not exist in Chapter 11, although only holders of unsecured claims are eligible for membership on the official creditors' committee. Bankruptcy Code, 11 U.S.C.A. § 1102(a) (West Supp. 1985).

15. *See, e.g., supra* note 5.

16. CREDIT RESEARCH CENTER, KRANNERT SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, MONOGRAPH NO. 23, CONSUMER BANKRUPTCY STUDY (1982) [hereinafter cited as PURDUE STUDY].

of whether the Code, as opposed to the Act, unduly favored debtors. Although used as ammunition against the Code,[17] the Purdue Study—and its legislative progeny[18]—focused on "income-based" bankruptcy (that is, bankruptcy proceedings which require payments from the bankrupt's future income) as an alternative to "asset-based" (liquidation) bankruptcy. Because both the Act and the Code create asset-based systems, which only require the debtor to shed existing assets to obtain discharge, the Purdue Study did not significantly speak to the creditors' allegations of new leniency.

In addition, many courts were sympathetic to the creditors' concerns, and were glossing the Code with additional protections against perceived abuse.[19] Moreover, while critics of the Code were easily able to demonstrate that the changes made to Chapter 13 made such filings more attractive than they had been under the Act,[20] they were hard-pressed to explain why Chapter 7 liquida-

17. E.g., the Purdue Study was presumably the basis for the statement of Rep. Brooks, *supra* note 51, that over one billion dollars of debt was needlessly discharged each year, since the study estimated the annual amount of unnecessarily discharged debt at $1,100,000,000. *See* 1 PURDUE STUDY, *supra* note 16, at 88-91.

18. *See, e.g.*, S. 2000, 97th Cong., 2d Sess. § 3 (1982) (one of the unsuccessful contenders in the bankruptcy reform stakes which was triggered by the invalidation of the bankruptcy courts' jurisdictional grant). Other studies dealing extensively with the question of asset- vs. income-based bankruptcy include Ayers, *supra* note 4, and Eisenberg, *Bankruptcy Law in Perspective*, 28 U.C.L.A. L. REV. 953, 976-91 (1981). The Purdue Study has recently been extensively examined and scathingly criticized for inadequate methodology, unfounded assumptions, and poorly analyzed recommendations. Sullivan, Warren, & Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WIS. L. REV. 1091 [hereinafter cited as *Analysis*]; *see also* Sullivan, *Reply: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1069; Sullivan, Warren & Westbrook, *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1087 [hereinafter cited as *Rejoinder*]; *cf.* Schuchman & Rhoper, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1 (1982); Schuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288 (1983). In theory, the failure of Congress to follow the recommendation of the Purdue Study, and impose mandatory income-based bankruptcy for many consumers, renders the Purdue Study, whatever its merits, a historical curiosity. However, as will be discussed further below, the Code makes possible a reading of the Chapter 7 eligibility requirements which could lead to the gradual imposition of the income model on consumer bankruptcy.

19. Most notably by reading Chapter 13's "good faith" requirement for plan confirmation as imposing upon the bankrupt the obligation to use his/her "best efforts" to fund the plan. *See infra* notes 87-90 and accompanying text.

20. The most significant of the "new" benefits provided Chapter 13 debtors was the expansive discharge they were granted. In most Chapter 13 proceedings, the only non-dischargeable debts were (and are) those arising from alimony, maintenance, and support obligations, and certain long-term debts. Bankruptcy Code, 11 U.S.C.A. §§ 1328, 1322(b)(5), 523(a) (West Supp. 1985). Compare the narrower "hardship discharge" available under Bankruptcy Code, 11 U.S.C.A. § 1328(c) (West Supp. 1985), under which the normal rules of § 523(a) apply.

tions had also become more popular. The naughty doctor has always been able to shed his/her debts in a "straight" bankruptcy; the Code did nothing to make that relief more available and little to make it more attractive. As indicated, the truth of the matter is that American bankruptcy laws have generally used an asset-based model rather than an income-based model; that is, bankruptcy has generally been used to liquidate and distribute existing assets rather than to manage future income for the benefit of creditors.[21] The exceptions to this approach have traditionally been both voluntary and limited in scope.[22] They were merely an opportunity for qualified bankrupts to pay more, and not a requirement that they do so.

The explanation for the increase in liquidations given by some creditors was only loosely related to the Code. They expressed concern that the moral and social sanctions which had previously deterred abusive filings and encouraged payouts in excess of liquidation value had largely disappeared. This process, they thought, had been accelerated by lawyer advertising and the general "pro-

21. *See generally Analysis, supra* note 18, at 1097-1103; Eisenberg, *supra* note 18, at 976-91; Ayers, *supra* note 4, at 721-23.

22. For example, proceedings under Chapters XI, XII, and XIII of the Act could only be commenced by a voluntary petition. Bankruptcy Act §§ 321, 421, 621, 11 U.S.C. §§ 721, 821, 1021 (1976) (repealed 1979). A Chapter X proceeding could be commenced by an involuntary petition but that Chapter applied only to corporations, and was used rather infrequently, to reorganize "public" corporations. (Bankruptcy Act § 126, 11 U.S.C. § 526 (1976) (repealed 1979)); *see, e.g.*, H.R. REP. No. 595, 95th Cong., 1st Sess. 664-65 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 722-23 (1978). Presumably, such corporations were, by virtue of their size, capable of being reorganized without the cooperation of any individual. Under current law, Chapter 13 proceedings can only be commenced by a voluntary petition on the theory that an involuntary Chapter 13 reorganization could not be made to work without imposing "involuntary servitude" on the bankrupt. (Bankruptcy Code, 11 U.S.C.A. § 303 (West Supp. 1985)); H.R. REP. No. 595, 95th Cong., 1st Sess. 321 (1977). On the other hand, most bankrupts can now be subjected to an involuntary Chapter 11 proceeding. Bankruptcy Code, 11 U.S.C.A. § 303(a) (West Supp. 1985). Curiously, it appears that there has never been an attempt to use an involuntary Chapter 11 as a substitute for an involuntary Chapter 13. In theory, at least, it would be possible to do so, since individuals can be bankrupts under Chapter 11, and there is no express requirement that a Chapter 11 bankrupt be in business. Bankruptcy Code, 11 U.S.C.A. § 109(d) (West Supp. 1985).

It should also be noted that an involuntary Chapter 11 bankrupt cannot unilaterally convert the case to a Chapter 7 liquidation. Bankruptcy Code, 11 U.S.C.A. § 1112(a), (b) (West Supp. 1985). However, an individual bankrupt subject to an involuntary Chapter 11 may still be able to avoid a true income-based bankruptcy, for at least two reasons. First, it is difficult to see how an individual who did not wish to reorganize could be forced by his/her creditors to do so effectively. Second, Chapter 11 permits the filing of a plan that merely liquidates the estate and distributes assets to creditors—the functional equivalent of Chapter 7. Bankruptcy Code, 11 U.S.C.A. § 1124(b)(4) (West Supp. 1984).

debtor" orientation of the Code[23]—an orientation exemplified by the new Chapter 13 and other protections provided to consumer bankrupts,[24] such as the substantial restrictions placed on reaffirmation agreements[25]—and epitomized by the Code's quixotic refusal to dub a bankrupt a bankrupt,[26] lest the bankrupt's tender feelings be hurt.[27]

Early attempts to translate these concerns into legislative action were unsuccessful. Indeed, it is quite possible that the credit industry would have had to resign itself to living outside the debtor's paradise but for the wholly unrelated *Marathon Pipeline* case[28] which struck down the Bankruptcy Court's jurisdictional grant and thereby forced Congress to readdress the bankruptcy laws. What emerged from this reassessment is the Bankruptcy Amendments and Federal Judgeship Act of 1984 (hereafter referred to as "BAFJA").[29] That statute went far beyond mere resolution of the jurisdictional problem; it rewrote many substantive provisions of the Code.

In part, this rewriting was to correct technical errors; to a much greater extent, it sought to appease those groups that were dismayed by the Code. Among those appeased—in part at least—were consumer creditors. The Consumer Credit Amendments[30] of BAFJA address all the problems outlined above, and most significantly, attempt to restrict access to discharge. Relief under the Code is supposed to remain available for those truly in financial distress; it is supposed to be made unavailable to those who are not.[31]

This article examines those provisions of the Consumer Credit Amendments which affect the perceived abuses of bankruptcy discharge, examining the devices by which BAFJA attempts to re-

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23. *See generally* Ayers, *supra* note 4, at 719-29, nn. 3-7.

24. *See, e.g.*, Cohen & Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N.C.L. REV. 681 (1980) (a study with far less pro-creditor bias than its title indicates).

25. *See infra* notes 130-35 and accompanying text.

26. Bankruptcy Code, 11 U.S.C.A. § 101(12) (West Supp. 1985).

27. "The general term debtor is used . . . for ease of reference . . . and as a means of reducing the stigma connected with the term bankrupt." H.R. REP. No. 595, 95th Cong., 1st Sess. 310 (1977).

28. Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982).

29. Pub. L. No. 98-353, 98 Stat. 33 (1984).

30. *Id.* at tit. III, subtit. A.

31. *See, e.g.*, Remarks of Rep. Brooks, 130 CONG. REC. H1812 (daily ed. March 21, 1984).

strict access to, increase the cost of, and limit the scope of, bankruptcy discharge. It takes the position that, in all probability, those devices will have only a minor impact on the availability of bankruptcy relief. On the other hand, the devices do represent what may be the beginning of a substantial change in the structure and philosophy of American bankruptcy law—the replacement of the traditional asset-based liquidation bankruptcy with a mandatory income-based reorganization bankruptcy.

II. Restrictions on Access to Discharge—Chapter 7

As suggested above, some critics of the Code sought not merely to return bankruptcy law to its pre-1978 balance between bankrupts and their creditors but to reshape that balance in a fundamental way. They asserted that many bankrupts would be able to pay a substantial portion of their debts if they were required to make future income, not merely present assets, available to creditors.[32] Critics proposed two devices to accomplish this goal. First, those debtors who were able to pay their debts would be ineligible for relief under Chapter 7.[33] Second, Congress should rewrite Chapter 13 to require the Chapter 13 bankrupt to pay his/her creditors as much as possible.[34] The combined effect of these provisions would have been that debtors with few assets but significant income would have had to choose between bankruptcy relief that required their "best efforts" in paying creditors, and no bankruptcy relief at all.

BAFJA only partially embraced this approach. As will be discussed below, Congress indeed modified Chapter 13 to impose a "best efforts" (*sub nomine* "disposable income") test on the debtor's payments.[35] Liquidation under Chapter 7, however, seems to remain available as an alternative, even to bankrupts who could afford to pay more than the liquidation value of their non-exempt assets to their creditors. Rather than requiring that such bankrupts use Chapter 13, the Code continues and purportedly expands its attempt to encourage them to do so.

One of the means used to encourage the wider use of Chapter 13

32. 2 Purdue Study, *supra* note 16, at 135-44.

33. *See, e.g.*, Bankruptcy Improvements Act of 1981, H.R. 4786, 97th Cong., 1st Sess. § 2 (1981); *see also* S. Rep. No. 65, 98th Cong., 1st Sess. 3 (1983).

34. H.R. 4786, 97th Cong., 1st Sess. (1981).

35. Bankruptcy Code, 11 U.S.C.A. § 1325(b) (West Supp. 1985).

is informational. Consumer debtors are now to be informed of their alternatives to liquidation bankruptcy in two ways. First, the attorney for an individual whose debts are primarily consumer debts must now attach a declaration to the debtor's bankruptcy petition stating that the attorney has informed the debtor that the debtor may proceed under either Chapter 7 or Chapter 13 of the Code, and has further explained to the debtor the relief available under each alternative.[36] In conjunction with this, the voluntary petition form has been amended so that those debtors whose debts are primarily consumer debts must include a recital that the debtor is aware of his/her eligibility for Chapter 7 and Chapter 13, and the provisions of each Chapter.[37] Secondly, before an individual debtor with primarily consumer debts commences a case, the clerk is required to give written notice to the debtor that informs him/her of the various chapters of the Code under which the debtor may seek relief.[38]

Unfortunately, these provisions are almost grotesquely ill-drafted. The attorney is not formally required to tell the debtor about Chapter 13, although the certification requirements of Bankruptcy Rule 9011, which was transplanted from Rule 11 of the Federal Rules of Civil Procedure, would subject the lawyer to penalties for making a false declaration.[39] More significantly, the implication in the declaration that all debtors whose debts are primarily consumer debts are eligible for Chapter 13 relief is wrong. Only a debtor whose secured debts do not exceed $350,000[40] and whose unsecured debts do not exceed $100,000[41] can file under Chapter 13. While few consumers have debts in excess of those

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36. BAFJA § 322; Official Bankruptcy Form No. 1, Exhibit B.

37. BAFJA § 322; Official Bankruptcy Form No. 1, ¶ 6.

38. Bankruptcy Code, 11 U.S.C.A. § 342(b) (West Supp. 1985).

39. Bankruptcy Rule 9011 states, in pertinent part:

> (a) Every petition, pleading, motion and other paper served or filed in a case under the Code on behalf of a party represented by an attorney, . . . shall be signed by at least one attorney of record in his individual name . . . . The signature . . . constitutes a certificate by him that he has read the document; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law . . . . If a document is signed in violation of this rule, the court on motion or on its own initiative, shall impose on the person who signed it, the represented party, or both, an appropriate sanction . . . .

BANKR. R. 9011 (1984).

40. Bankruptcy Code, 11 U.S.C.A. § 109(e) (West Supp. 1985).

41. *Id.* It is possible to argue that BAFJA § 322 has implicitly changed the jurisdictional requirements of the Code, and that all consumer debtors are now eligible for Chapter 13.

limits, some obviously do, and a lawyer advising such a client will have to lie either to the client or to the court.[42] The same problem exists with the statement in the petition regarding eligibility for Chapter 13; some consumer debtors cannot honestly say that they know they are eligible for Chapter 13 relief, because they are not eligible for Chapter 13 relief.[43]

Moreover, neither of these provisions provides guidance to the lawyer in determining the meaning of "primarily consumer debts."[44] Nor do they provide for informing individuals whose debts are not primarily consumer debts of the potential availability of Chapter 13 relief.[45] Finally, and most absurdly, the Bankruptcy Court clerk is instructed to do something that is physically impossible. The clerk is to inform the debtor of alternatives *before* the commencement of the case.[46] However, a voluntary bankruptcy is commenced "by the filing with the bankruptcy court of a petition. . . ."[47] Obviously, barring the possession of a clairvoyance rare among government employees, the clerk cannot possibly inform a voluntary bankrupt of his/her alternatives prior to the time the bankrupt files the petition which commences the case.

These informational requirements are obviously designed to ensure that the debtor knows of the alternative which his/her creditors presumably want him/her to adopt—payment of disposable income rather than liquidation value of assets. Whether they will accomplish much in this direction is unlikely. Most of this information is probably already given to debtors, and the choice of

42. The idiocy of this result will probably lead courts to gloss the rule with an exception for debtors who do not qualify for Chapter 13.

43. It is an interesting question whether the Supreme Court, under its rule-making power, will be able to amend Official Form 1 to cure the absurdities created by BAFJA, 11 U.S.C. § 2075 (1982), which grants the Court this power, prohibits the Court from issuing rules that "abridge, enlarge, or modify any substantive right." *Id.* Does a change in a statutorily created rule constitute a change in a substantive right? It is at least arguable that a rule change which merely conforms the Official Form to the Code is not prohibited, even though the change would override the statute.

44. *See infra* notes 59-61 and accompanying text.

45. Chapter 13 relief, unlike Chapter XIII relief, is available to proprietorships. *See, e.g.*, Moller, *It Isn't Only for Wage Earners Anymore: The Individual in Business and Chapter 13 of the Bankruptcy Code*, 17 Hous. L. Rev. 331 (1980).

46. Bankruptcy Code, 11 U.S.C.A. § 342(b) (West Supp. 1985).

47. *Id.* § 301. It has been suggested that difficulties created by imposing the notification requirement on clerks can be resolved by rule changes. *See, e.g.*, Montali, *Important Bankruptcy Code Changes in the Bankruptcy Amendments and Federal Judgeship Act of 1984*, 1 Bankr. Prac. and Proc. 8 (1984). However, as discussed *supra* note 43, the extent to which the Supreme Court can correct BAFJA by rule is unclear.

which Chapter to use is unlikely to be a factor of the debtor's ignorance of alternatives.

It is by no means clear, for example, that the lawyer's implied duty to inform the client of Chapter 13 will change existing practice. What little information exists on the subject suggests that any failure to inform clients of their alternative to liquidation is likely to be the result of unfamiliarity with Chapter 13 or the lack of an efficient Chapter 13 administrative structure.[48] There is no indication that lawyers have been hiding Chapter 13 from their clients; indeed, given the apparent surge in popularity of Chapter 13 after the enactment of the Code, the reverse is likely to be true. In any event, it is already a commonplace that the lawyer ought to discuss options fully with the client.[49] BAFJA may encourage more attention to this aspect of professional responsibility; however, it did not create it.

Even if BAFJA has a significant impact on the amount of information that lawyers give their clients, it still may not thereby increase the popularity of Chapter 13. Just because the debtor knows of alternatives does not mean the debtor will choose them. It is probably true that the overwhelming majority of debtors will rely on advice of counsel in selecting which chapter to use. It is also probably true that most lawyers will advise most debtors to select the option which has the least economic cost to the debtor. In general, that option will be liquidation under Chapter 7.[50]

The statement added to the petition is even less likely to affect the debtor's action. At most, it may cause the rare debtor who reads the petition closely to ask his/her lawyer about Chapter 13, if the lawyer has not already explained that Chapter to the debtor. Finally, the notice from the clerk is not likely to have any effect on the debtor at all because the case will have already been filed.[51] However, it may create some additional headaches for the clerk.[52]

Two other changes may have a much greater impact on the availability of Chapter 7 discharge. The first is new section

48. Girth, *supra* note 10, at 55-61.

49. Indeed, this requirement is already embodied in two ethical considerations. *See* Model Code of Professional Responsibility EC 7-7, 7-8 (1979).

50. *See infra* notes 103-05 and accompanying text.

51. *See supra* note 46.

52. The clerk will face the difficult job of determining whether an individual's debts are primarily consumer debts, and whether the petitioner is eligible for Chapter 13.

707(b),[53] which gives the Bankruptcy Court power to dismiss "abusive" filings. The second, which is procedurally if not substantively related to the first, is amended section 521(1),[54] which requires all bankrupts to file schedules of their current income and expenditures.

Section 707(b) permits the court "on its own motion and not at the request . . . of any party" to dismiss a Chapter 7 case in which the primary debts are consumer debts if it finds that granting relief under Chapter 7 would be a "substantial abuse" of that Chapter.[55] This provision—one of the last remnants of the attempt to impose mandatory filings under Chapter 13 on high-income debtors—is rife with interpretational problems. How those problems are resolved will determine the extent to which the post-BAFJA Code abandons the traditional asset-based model of bankruptcy.

The first problem with the provision is, on the surface, merely procedural. The dismissal can be made only on the court's motion and, specifically, not at the suggestion or request of creditors or other parties in interest.[56] Yet it is likely to be either the creditors or the trustee who are most sensitive to the abuse of Chapter 7, and it is certainly the creditors who would most like the bankrupt to be forced into Chapter 13 or out of bankruptcy altogether. If creditors communicate their concern to the judge—or produce evidence indicative of abuse—does this divest the court of its power to dismiss under section 707(b)? What if the communication occurs inadvertently?

On the face of it, a rule that would bar a section 707(b) dismissal

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53. Bankruptcy Code states:

> After notice and a hearing, the court, on its own motion and not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of the chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C.A. § 707(b) (West Supp. 1985). It is at least worth mentioning that the development of procedures under this provision may prove rather difficult. If a judge suspects "substantial abuse," what power does he/she have to gather evidence? If the bankrupt disputes the judge's finding of substantial abuse, how will review be sought? If it is by regular appeal, who is the respondent? (More importantly, who will file the respondent's brief?) If review is by extraordinary writ, might not the trial court's discretion be given more weight than the "presumption" in favor of granting relief? Indeed, how exactly does that presumption apply? Does the judge carry the burden of persuasion that there is substantial abuse, and whom would he/she persuade?

54. Bankruptcy Code, 11 U.S.C.A. § 521(1) (West Supp. 1985).

55. *Id.* § 707(b).

56. *Id.*

whenever a creditor or the trustee made any indication of abuse to the court would be an absurd technicality. On the other hand, given the refusal of Congress to enact a mandatory Chapter 13, it seems quite clear that the section represents a carefully drawn compromise between those who wished to preserve asset liquidation bankruptcies and those who did not. Congress decided not to let creditors force debtors directly into Chapter 13. That intention would be frustrated if they were allowed to do so indirectly by initiating the section 707(b) inquiry. This does not necessarily mean that any reference to abusiveness by creditors bars dismissal; if the court acts independently of the creditors, it should still be allowed to dismiss the case.[57] To ensure that the congressional intent is not frustrated, however, the courts should impose a rebuttable presumption that whenever any creditor takes action to raise the issue of abuse, a subsequent dismissal under section 707(b) by the Bankruptcy Court is "at the request or suggestion" of the creditor and thus improper. On the other hand, where it is demonstrated that the creditor's action has in no way affected the court's decision, the court should uphold the dismissal.[58]

A second question concerns the meaning of "primarily consumer debts." There are at least three ways in which this requirement could be read: number of debts, quantity of debts, or purpose of filing. The first would focus solely on the number of consumer and non-consumer obligations the bankrupt has, without regard to the relative size of those obligations. The second would look solely to the overall amount of consumer and non-consumer debts. For example, if a bankrupt had twenty-five consumer obligations totalling $6,000 and three non-consumer obligations totalling $75,000, the first test would treat the debtor as one who has "primarily consumer debts"; the second would not.

Neither of these numerical tests focuses appropriately on the

57. Unfortunately, legislative history is not especially helpful. The Senate Report on S.445, from which proposal the final version of § 707(b) was derived, states that:

> Under this provision, the court may not dismiss a case in response to a request or suggestion from any party in interest, nor may a party in interest make such a request or suggestion. Instead, the case may be dismissed only where the court, acting independently on its own motion, finds substantial abuse . . . .

S. REP. No. 65, 98th Cong., 1st Sess. 53 (1983). This does not even address the issue of whether an independent dismissal by a court after a request or suggestion by a creditor is permissible. *See In re* Christian, 13 BANKR. CT. DEC. (CRR) 313 (D.N.J. 1985); 130 CONG. REC. H1811 (daily ed. June 19, 1984) (statement of Sen. Metzenbaum).

58. These problems may be resolved by the rules the Supreme Court is supposed to issue defining procedures for § 707(b) dismissals. BAFJA § 320.

purpose of section 707(b), which was to avoid the abusive filing of consumer bankruptcy. Abusive, in this context, seems to relate to the utilization of Chapter 7 to avoid paying consumer debts. Indeed, it is quite arguable that there is no need for section 707(b) to avoid abusive discharge of business debts because a business debtor can be forced into an involuntary reorganization;[59] a consumer debtor cannot.[60] Since the purpose of the provision is to compensate for the creditors' inability to force into Chapter 13 a consumer debtor who is abusively using Chapter 7 to discharge his/her debts, the proper focus of the inquiry should be on the purpose of the debtor in filing bankruptcy. If the primary purpose of the bankruptcy is to discharge consumer debts, then section 707(b) is applicable. The number and amount of the bankrupt's consumer obligations are of course relevant to this inquiry, but should not be dispositive. The slight case law on this point is somewhat supportive of this interpretation.[61]

By far the most significant question of interpretation is the meaning of the phrase, "substantial abuse." It can also be interpreted in at least three ways: narrowly, to apply to a few, clearly illegitimate filings; broadly, to apply to any Chapter 7 filing by one who could manage more than mere liquidation, or somewhere in between. A narrow interpretation of substantial abuse would limit section 707(b) dismissals to those cases in which the bankrupt acted fraudulently, failed to comply with the requirements of the Code, or failed to comply with orders of the court. A broad interpretation, on the other hand, would treat as abusive any Chapter 7 filing by a bankrupt who could make substantial payments on his/her existing debts. The latter reading would of course slip a mandatory Chapter 13 into the Code, because it would force bankrupts who could fund a Chapter 13 plan either to do so or to forego bankruptcy.

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59. *See supra* note 22.

60. *Id.*

61. *In re* Bryant, 47 Bankr. 21 (Bankr. W.D.N.C. 1984), rejected the argument that "primarily consumer debts" means that the amount of consumer debts must exceed the amount of non-consumer debts. It held that whether or not a case involves "primarily consumer debts" depends on all the facts and circumstances, and that the court can consider the relative number of consumer debts as well as the total amount. The court further determined that the debtor's home mortgage was a consumer obligation, and thus should have been classified as a consumer debt. *Id.* at 26. While the court did not speak in terms of intent, it seems clear that the bankrupt's purpose in filing bankruptcy was to obtain relief from consumer obligations.

The narrow reading is far more consonant with Congress' rejection of mandatory Chapter 13 proceedings. On the other hand, it could render section 707(b) practically meaningless. Even without section 707(b), the court probably has the power to dismiss cases for fraud, for failure to comply with the Code, or for failure to comply with court orders, either under section 707(a) or other provisions.[62] Moreover, there is at least some suggestion in the revised requirements for the petition that the broad reading is correct. As noted above, the consumer debtor is now obligated to file schedules of income and expenses.[63] There is no earthly reason for imposing such a requirement in a Chapter 7 consumer case unless the court is supposed to use those schedules to determine whether or not the bankrupt has enough income to pay a substantial portion of his/her debts. The only time the court has any reason to make such a determination is in conjunction with its determination under section 707(b) of the propriety of the debtor's decision to file under Chapter 7.

The very limited case law under section 707(b) is inconclusive at best. *In re Bryant*[64] contains language which supports the broad interpretation; it states that when a Chapter 7 is filed not because of the bankrupt's unemployment or inability to repay creditors, but merely because of a desire to "shuck a couple of his debts," the congressional purpose underlying the Code is frustrated.[65] On the other hand, the facts of the case are more in line with the narrow reading of section 707(b). The petitioner lied about his financial position and his current expenses.[66] His petition was fraudulent under any standard, and could undoubtedly have been dismissed with or without section 707(b). Practically the only other reported case on this issue, *In re Wright*,[67] is primarily concerned with penalizing an attorney for failure to provide his bankrupt clients with

62. 11 U.S.C.A. § 707(a) (West Supp. 1985); *see, e.g., In re* Richards, 43 Bankr. 554 (Bankr. D. Minn. 1984); *In re* Import Toy Sales, Inc., 41 Bankr. 784 (Bankr. S.D. Fla. 1984); *cf. In re* Jennings, 31 Bankr. 378 (Bankr. S.D. Ohio 1983).

63. *See supra* note 54 and accompanying text.

64. 47 Bankr. 21 (Bankr. W.D.N.C. 1984).

65. *Id.* at 24.

66. In *Bryant*, the debtor intentionally failed to list seven or eight credit cards upon which he was making payments. Further, while the debtor said he did not list them because the amounts owed were insignificant, he allocated $400 per month for payments on those cards in his expenses schedule. The court also found that the debtor's estimates for food, medical and automobile expenses were grossly excessive. The debtor's actions were characterized as a fraud on the court. *Id.* at 25.

67. 48 Bankr. 172 (Bankr. E.D.N.C. 1985).

adequate representation. The court, however, notes that the debtor's income and expenses statement "reflected a disposable income of $553 per month." Apparently on the basis of this statement, the court issued a "Notice of Possible Dismissal of Case for 'Substantial Abuse' Pursuant to 11 U.S.C. § 707(b)."[68] It may well be that, in the opinion of at least one bankruptcy judge, anyone who has income of $553 per month over and above bare living expenses is presumptively ineligible for Chapter 7.

Perhaps the best solution to the substantial abuse conundrum is to take the middle position between the broad and narrow readings of this requirement. Under this middle ground approach, substantial abuse would exist in either of two circumstances. The first would be where the bankrupt filed a fraudulent petition or schedules. The second would be where the the bankrupt clearly had the ability to pay creditors an amount greatly in excess of the liquidation value of his/her assets without significant hardship. This would breathe life into section 707(b) without destroying the distinction Congress sought to preserve between asset liquidation bankruptcies under Chapter 7 and income bankruptcies under Chapter 13. Bankrupts who could pay somewhat more than liquidation value, or who could pay substantially more, but only with significant hardship, could choose either Chapter 7 or Chapter 13. Those who could not pay more would be unable to use Chapter 13.[69] Those who could easily pay much more would be forced to choose between Chapter 13 or no bankruptcy relief at all.[70] The

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68. *Id.* at 173.

69. Since a Chapter 13 plan cannot be confirmed unless the court finds that "the debtor will be able to make all payments under the plan . . . ." (Bankruptcy Code, 11 U.S.C.A. § 1325(a)(6) (West Supp. 1985)), those who do not have enough disposable income to pay their creditors more than liquidation value cannot use Chapter 13.

70. Some limited support for this can be found in the legislative history to § 202(c) of the unenacted Omnibus Bankruptcy Improvements Act of 1983, which was a provision identical to § 707(b). The Senate Report on the 1983 Act states:

> This provision represents a balancing of two interests. It preserves the fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment *where such repayment would not be a burden.*
>
> Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable debt burdens bankruptcy relief under Chapter 7. However, if a debtor can meet his debts *without difficulty* as they come due,

net result, of course, would be that section 707(b)'s restriction on access to discharge would affect very few cases.

III. Increased Cost of Discharge—Chapter 13

While the significance of BAFJA's limitations on Chapter 7 discharge may be open to question, the same is not true of BAFJA's increase in the cost of a Chapter 13 discharge. Chapter 13, which began life as the "wage earner plan" under the Bankruptcy Act,[71] was greatly expanded in scope by the Code.[72] More significantly, Chapter 13 was redesigned in an effort to attract debtors to use a voluntary, income-based bankruptcy by giving bankrupts who chose Chapter 13 significant advantages over those who used Chapter 7. Chief among these advantages were the ability of the bankrupt to retain his/her existing assets in exchange for making payments to creditors under the plan of arrangement, and the grant of a much wider discharge than that afforded other bankrupts. In most Chapter 13 proceedings, all the debts made nondischargeable in Chapter 7 and 11 proceedings by section 523, other than those for alimony, maintenance and support, are discharged.[73]

The perceived problem with Chapter 13 was that it did not exact a sufficient quid pro quo for these additional benefits.[74] Read literally, the original version of Chapter 13 required only that the bankrupt pay his/her creditors the liquidation value of his/her assets.[75] In other words, the payments made over the life of the plan, when reduced to present value, only had to equal what would have

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> use of Chapter 7 would represent a substantial abuse.

S. Rep. No. 65, 98th Cong., 1st Sess. 53-54 (1983) (emphasis added). It is also worth noting that mere ability to pay debts is not viewed as sufficient cause to permit voluntary dismissal of a bankruptcy petition. *See In re* Green, 49 Bankr. 7 (Bankr. W.D. Ky. 1984).

71. Bankruptcy Act, §§ 601-86, 11 U.S.C. §§ 1001-86 (1976) (repealed 1979).

72. Primarily, the Chapter was made available to all individuals, not just wage earners, who have (1) regular income, (2) unsecured debts of less than $100,000, and (3) secured debts of less than $350,000. Bankruptcy Code, 11 U.S.C.A. § 109(e) (West Supp. 1985).

73. *See supra* note 20.

74. *See, e.g.*, S. Rep. No. 65, 98th Cong., 1st Sess. 21 (1983).

75. Prior to BAFJA, the only minimum payment for Chapter 13s contained in the Code was that found in § 1325(a)(4), which stated that a plan could be confirmed only if:

> 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 . . . .

11 U.S.C. § 1325(a)(4) (1982). *But see infra* notes 87-90 and accompanying text.

been yielded by a Chapter 7 liquidation. This, of course, is the so-called "best interest of creditors" standard long familiar to parties to Chapter 11[76] (nee Chapter XI[77]) proceedings. That standard has never been particularly controversial in business reorganizations, although it became so in Chapter 13 reorganizations, for at least three reasons.

First, of course, was the wider Chapter 13 discharge. It seemed unfair at best, unwise at worst, to grant discharge of those debts labeled heinous by section 523 in exchange for payments no larger than those made on ordinary debts. Second, though of far less significance, was the perceived unfairness of giving the bankrupt the right to retain his/her assets for a liquidation payout.[78] Third, the bankrupt's ability to freely modify the plan[79] should his/her ability to pay be reduced meant that creditors were not even assured of receiving the liquidation value of the bankrupt's original assets. The modified plan was also subject to the best interest of creditors test, but the bankrupt's assets were revalued as of the time of the modification.[80] The bankrupt would thus have to pay only the revised liquidation value, and if the value of his/her assets had declined since the original plan, would be able to cut payments to creditors accordingly.

To these objections should be added a fourth which was not clearly articulated, but to some extent lay at the root of the other three. Unlike every other reorganization proceeding under both the Act and the Code, Chapter 13 gives creditors no formal role in the formulation of the plan.[81] There is no creditor's committee and no requirement that creditors approve the plan. Although creditors retain some significant tools to encourage the debtor to be accomodating,[82] those tools existing prior to BAFJA were cumbersome and uncertain, especially for unsecured creditors.

76. To be precise, the Bankruptcy Code generally requires that creditors "receive or retain . . . property of a value, as of the effective date of the plan, that is not less than the amount that [would be received or retained] if the debtor were liquidated under Chapter 7 . . . ." 11 U.S.C.A. § 1129(a)(7)(A)(ii) (West Supp. 1985).

77. Bankruptcy Act § 366(2), 11 U.S.C. § 366(2) (1976) (repealed 1979).

78. *See, e.g.*, S. REP. No. 65, 98th Cong., 1st Sess. 21 (1983).

79. *See supra* note 7.

80. *Id.*

81. *See supra* note 10.

82. For example, all creditors retained (and still retain) the right to object to confirmation under the Bankruptcy Code (11 U.S.C. § 1324 (1982)) and the right of the holder of a secured claim to seek modification of the automatic stay was unaffected. Bankruptcy Code, 11 U.S.C. § 362 (1982) (amended 1984).

Congress deleted formal creditor participation on the plausible ground that the small size of Chapter 13 proceedings discouraged effective creditor participation anyway; creditors under Chapter XIII rarely bothered to exercise their rights because the costs of participation in the proceeding were disproportionate to the benefits obtained.[83] Although it seems to be true that creditor participation was rare, the degree to which it was irrelevant is debatable.[84] While it is reasonably clear that Congress assumed that debtors would, even without the prod of creditor oversight, generally produce plans that provided for substantial payouts, it is equally clear that this did not happen—or at least did not happen universally. That, in turn, was the primary cause for dissatisfaction with Chapter 13.

What Congress overlooked in deleting formal creditor participation from Chapter 13 was that the threat of a creditor veto, even if rarely exercised, inevitably induced most debtors to propose reasonably satisfactory plans. Although Chapter 11 and Chapter 13 have exactly the same minimum payout requirement—best interest of creditors—in Chapter 11 the standard is not controversial. The reason is simple. "Best interest of creditors" in Chapter 11 is only the minimum amount the bankrupt can pay *if its creditors will let it*. The Chapter 11 bankrupt must bargain with its creditors for permission not to liquidate. The only thing the Chapter 11 bankrupt has to bargain with is payment in excess of liquidation value,[85] since, obviously, the creditors will get that even if the reorganization fails. This bargaining almost always produces the promise (if not necessarily the reality) of additional payments. By limiting (and indeed virtually eliminating) this bargaining process, Chapter 13 took away one of the bankrupt's greatest incentives to offer creditors more than an installment liquidation.[86]

Prior to BAFJA, many courts addressed this problem by imposing a "best efforts" standard.[87] Chapter 13 required (and still re-

83. *See supra* note 10.

84. The mere possibility of creditor intervention may have been responsible for the fact that, in general, Chapter XIII plans proposed substantial payouts. With regard to the size of proposed Chapter XIII payouts, see Girth, *supra* note 10, at 57-58.

85. Indeed, this is all the parties are bargaining over even when they discuss payment *terms*, since the terms (e.g., length of plan, funding of plan, collateral) are important only insofar as they increase or decrease the amount of money the creditors will ultimately get.

86. Some other incentives remain, such as a sense of moral obligation or a desire to stay on good terms with individual creditors.

87. *See generally* 5 COLLIER ON BANKRUPTCY ¶ 1325.01[2][C], at 1325-28 (L. King 15th ed. 1984).

quires), as a condition of plan confirmation, that the plan be proposed in "good faith."[88] This was widely—although not universally—interpreted to require that the debtor pay as much to his/her creditors as he/she reasonably could. While this reading of "good faith" was clearly incorrect from a historical standpoint,[89] and conveniently ignored Congress' refusal to enact an express best efforts standard,[90] it did serve the purpose of more clearly distinguishing Chapter 13 from Chapter 7. It required that something more than liquidation value be paid if something more than liquidation value were available.

The Code's new approach is slightly different. Under BAFJA, a Chapter 13 debtor need only meet the liquidation value standard if neither the trustee nor any unsecured creditor objects to the plan.[91] In other words, if those parties acquiesce, the debtor can still use Chapter 13 for installment liquidations. Conversely, if objection to the plan is made, the debtor must either pay the claim of the objecting party in full or fund the plan with all of his/her projected disposable income for the three years which succeed confirmation of the plan.[92]

Utilization of the disposable income standard has several effects on Chapter 13 proceedings. First, it obviously increases the mini-

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88. Bankruptcy Code, 11 U.S.C. § 1325(a)(3) (1982).

89. *See generally* 5 COLLIER ON BANKRUPTCY ¶ 1325.01[2][C] (L. King 15th ed. 1984).

90. Congress had at least one chance to do so. *See* Bankruptcy Amendments Act of 1981, S. 863, 97th Cong., 1st Sess. § 128[b] (1981).

91. Bankruptcy Code § 1325(b)(1) states in full:

> If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

11 U.S.C.A. § 1325(b)(1) (West Supp. 1985).

92. *Id.* Two minor problems are worth mentioning. First, the Code manages to be marvelously ambiguous about what the bankrupt must do if only the trustee objects to confirmation. Since the trustee does not have an allowed unsecured claim, and thus cannot be paid in full, the bankrupt must presumably meet the disposable income standard. Second, it is not certain that the disposable income standard wholly displaces case law under the good faith/best efforts standard. This could be significant to a court willing to consider, as some pre-BAFJA courts did, the possibility of requiring full or very substantial payment of § 523 obligations as a condition of discharge, without regard to the bankrupt's means. *See, e.g., In re* Rimgale, No. 80 C 4862 (N.D. Ill. 1981), *vacated*, 669 F.2d 426 (7th Cir. 1982).

mum payout required for confirmation of many Chapter 13 plans. Second, it requires the court to conduct an inquiry into the bankrupt's personal financial affairs—an inquiry some judges may be unwilling, and others unable, to make. Third, it may paradoxically discourage many debtors from filing under Chapter 13 rather than Chapter 11. Finally, it may revive, through backdoor means, direct creditor participation in the formulation of the Chapter 13 plan.

It should be obvious that, if creditors' perceptions of the frequency of abusive Chapter 13 filings are accurate, the "disposable income" standard will increase the costs of a Chapter 13 discharge to a significant number of bankrupts. It can probably be assumed that unsecured creditors will almost routinely object to any plan that does not provide for a very substantial payout, thereby triggering the disposable income standard. (The traditional apathy of creditors in Chapter 13 proceedings, however, may sharply limit the number of objections in smaller cases.) The disposable income standard, in turn, will require payments that will be far in excess of liquidation value, at least if the bankrupt meets the high debt/low asset/high income profile discussed above.

Under the amended Code, "disposable income" is defined as income in excess of that which is reasonably necessary for the support or maintenance of the bankrupt and his/her dependents.[93] In addition, the disposable income standard is based, not on current disposable income, but on a projection of the bankrupt's future disposable income during the three years following the commencement of the plan.[94] Thus, the court is required to estimate both the bankrupt's future income and the bankrupt's future "reasonably necessary" expenses to determine the adequacy of payments under the proposed plan.[95] Each of these calculations is fraught with uncertainty. If the bankrupt is not employed under a long-term contract, his/her income may fluctuate widely over the three year pe-

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93. Bankruptcy Code § 1325(b)(2) reads in full:

> For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—
>
> (A) for the maintenance or support of the debtor or a dependent of the debtor; or
>
> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C.A. § 1325(b)(2) (West Supp. 1985).

94. *Id.* § 1325(b)(1)(B).

95. It is also worth noting that, when dealing with a proprietorship, the court must calculate as well the "necessary" expenditures of the business. *Id.* § 1325(b)(2)(B). Congress was remarkably discrete about the difference between "reasonably necessary" and "necessary."

riod.[96] Indeed, some bankrupts have the ability to manipulate their income. Can a bankrupt deliberately choose to earn less than he/she is capable of earning during the plan period? Can a bankrupt lawyer elect to spend three years earning karma at Legal Aid rather than luchre on Wall Street? The disposable income standard encourages such manipulation and gives the bankrupt no economic incentive to maximize income because everything the bankrupt earns above his/her "reasonably necessary" expenses goes to creditors anyway.[97]

The debtor's expenses may be equally difficult to measure. Obviously, unexpected illness could radically change the expense side of the ledger—but how should the court deal with planned discretionary increases in expenses? For example, suppose a debtor plans to marry or have a child during the plan period—can the court take this expectation into account, in calculating disposable income? Indeed, can the court prohibit the debtor from undertaking such expenses? Just as the debtor has no incentive to maximize income during the plan period, he/she has no incentive to minimize expenses.

While the uncertainties of future income and expenses will make the disposable income standard difficult to apply in some cases, a more serious problem is the degree to which it invites the court to undertake a paternalistic restructuring of the debtor's lifestyle. As noted, the court may have to decide whether having a child is a "reasonably necessary" expense. How about sending the child to college?[98] These hypotheticals are not as extreme as they may appear at first blush; indeed, one "best efforts" case decided that, to obtain confirmation of his plan, the debtor would have to forego

96. This may be an especially difficult task if the bankrupt is a proprietor, since the business may well have almost no history of prior profits from which the court could calculate future income.

97. *See generally Analysis, supra* note 18, at 1133-35. The creditors' newly acquired ability under the Bankruptcy Code (11 U.S.C.A. § 1329 (West Supp. 1985)) to force modification of the plan after confirmation will only make this problem worse. If the bankrupt does manage to increase his/her income beyond that which the court initially estimated, the creditors have the power to force the bankrupt to increase payments under the plan. Thus, the sensible Chapter 13 bankrupt will either decline opportunities to increase income or attempt to hide his/her success in doing so.

It should also be noted that any too flagrant abuse of the ability to increase or decrease income at will might run afoul of the "good faith" requirement of 11 U.S.C.A. § 1325(a)(3) (West Supp. 1985).

98. At least one pre-BAFJA "best efforts" case indicates that the answer is no. *See In re* Jolly, 13 Bankr. 123, 125 (Bankr. E.D. Wis. 1981) (money saved for children's education properly available to creditors).

tithing his church and pay that money to his creditors instead.[99] While the choice between God and Mammon is one many Americans might make with ease, forcing the debtor to choose the latter raises troubling questions.[100] If religious faith must yield to the compelling necessity to pay, then a fortiori any expenditure beyond that needed to sustain a very modest way of life is at risk. If a bankrupt cannot tithe, by what right can he/she take a vacation, rent an $800 per month apartment if a $200 per month apartment is available, or take night courses to complete a college degree?[101] To some degree at least, Chapter 13 has been transformed into a guardianship proceeding in which the court plays a dour trustee to the bankrupt's rakish spendthrift.[102] Some courts will not be pleased with the role. Others may be ill-equipped to handle it in non-routine cases. Courts are not generally noted for their financial acumen, and they may find it quite difficult to apply the disposable income standard to such situations as the financial affairs of a small business.

It is also worth noting that, in making the disposable income determination, the courts will face an especially delicate task in deal-

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99. *In re* Breckenridge, 12 Bankr. 159 (Bankr. S.D. Ohio 1980).

100. It raises first amendment questions, if nothing else.

101. Such a limitation, although indicated by *In re* Jolly, 13 Bankr. at 123, is irrational because such further education might increase both the bankrupt's income and his/her ability to pay.

102. Several commentators, reviewing the pre-BAFJA proposals for a mandatory Chapter 13, focused on the difficulty of administration as one of the central problems created. *See* Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*, 30 U.C.L.A. L. REV. 327, 356-57 (1982); LoPucki, *Encouraging Repayment under Chapter 13 of the Bankruptcy Code*, 18 HARV. J. ON LEGIS. 347, 369-72 (1981); *Rejoinder*, *supra* note 18, at 1098-99; *see also Analysis*, *supra* note 18, at 1136 n.283:

> [O]n February 14, 1983, "The CBS Evening News with Dan Rather," featured a story suggesting that bankruptcy abuse is increasing. The attention grabbing examples were Rick Upchurch and Harvey Martin, professional football players each earning over $100,000 per year . . . . Aside from the obvious fact that these bankruptcies are hardly typical, the reporter's assumption that they "could pay" missed the point which their circumstances actually revealed. The two aging athletes almost certainly could not have paid as much as half their enormous debts during the remainder of their professional careers, after which they might well have relatively modest incomes. Even in the immediate future, the players' large incomes depend on constant acceptance of brutal conditioning and pain, and on achieving a high level of performance. Would the bankruptcy judge, sweatshirted and bewhistled, decide if Martin was "dogging it" in order to avoid enduring great suffering for the benefit of his creditors?

Id.

Somewhat naively, Sullivan, Warren & Westbrook elsewhere assume that judges would be "horrified" to make the types of decisions required by a disposable income standard. *Id.* at 1141. At least some of the "best efforts" cases indicate otherwise. *See supra* notes 98-99.

ing with the very type of debtor at whom the standard is aimed. The high-income/low-asset bankrupt may well be used to a comfortable, or even extravagant, lifestyle. To the extent the court forces him/her to trim back, it discourages him/her from using Chapter 13. To the extent it does not do so, the court is placing the lower-income Chapter 13 debtor at a relative disadvantage.

This suggests the most serious problem with the disposable income standard. Its effect may be precisely opposite to that intended. Except for those debtors who need the very broad Chapter 13 discharge, there is little or no economic incentive to choose Chapter 13 rather than Chapter 7.[103] Even some debtors who have obligations which are not dischargeable under Chapter 7 will choose liquidation because the cost of meeting the disposable income requirement will exceed the cost of paying the section 523 obligations. Moreover, the broader discharge available under Chapter 13 is granted only upon completion of the plan, or of the plan as modified.[104] Obviously, even the debtor who might benefit from Chapter 13 is subject to a significant risk that discharge will not be granted, a risk that arises in part from the difficulty of complying with the disposable income standard.[105] Thus, anyone who undertakes to pay substantial amounts to his/her creditors under Chapter 13, but who is unsuccessful in his/her attempt, might lose the benefits of both Chapter 7 and Chapter 13.

The courts have significant power to ameliorate this risk. The bankrupt is given broad power to amend the plan if it proves infeasible,[106] and the courts have to date been fairly generous in interpreting this power, at least where there has been some bona fide change in the bankrupt's economic circumstances.[107] In addition,

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103. There are of course non-economic incentives for those who wish to meet moral obligations, and economic incentives for those who wish to retain good relations with certain creditors. However, either of those two goals can be easily accomplished without reorganizing under Chapter 13, either by making voluntary repayment or by reaffirmation. If a bankrupt only wishes to pay a few of his/her creditors more than liquidation value, it makes more sense to make separate arrangements with them than to bear the burden of paying extra to all creditors.

104. Bankruptcy Code, 11 U.S.C.A. § 1328(a) (West Supp. 1985). While § 1328(b) permits the unsuccessful reorganizer to obtain a "hardship discharge," that discharge does not relieve it of § 523(a) obligations. *Id.* § 1328(c).

105. Even before BAFJA, the failure rate of Chapter 13 (or, more precisely, Chapter XIII) plans was said to be 50%. Countryman, *Legal Relief: Straight Bankruptcy and Wage Earner Plans*, 26 BUS. LAW. 933, 939 (1971). There do not appear to be any reliable figures for the Chapter 13 failure rate under the Code.

106. Bankruptcy Code, 11 U.S.C.A. § 1329(a) (West Supp. 1985).

107. *See, e.g., In re* Costen, 39 Bankr. 29, 31 (Bankr. W.D. Va. 1984) (§ 1329 "contem-

the court has the power to permit the bankrupt to extend the plan period to five years for "cause."[108] Such an extension would not increase the minimum payout required, which is set at three years' disposable income without regard to the length of the plan.[109] The limited case law has taken a very narrow view of cause.[110] It may now, however, be appropriate to rethink this; if bankrupts are able to spread their disposable income obligation over a five, rather than a three, year period, Chapter 13 will become much more attractive.

What the courts cannot significantly affect, however, is the substantial increase in the cost of Chapter 13 discharge. This increase will surely discourage many debtors from filing Chapter 13—unless the courts force them out of Chapter 7 by a broad reading of section 707. It may also have another unintended effect. Since any unsecured creditor can impose the disposable income standard on the bankrupt merely by objecting to the plan, it is possible, in relatively large Chapter 13 proceedings, that the bankrupt will attempt to reach some accomodation with his/her creditors prior to filing the plan. The creditors' primary bargaining chip would be their power to trigger the disposable income standard. The bankrupt's chip would be an option to convert to Chapter 7.[111] Since the payout could not possibly be more than the bankrupt's disposable income or less than the liquidation value of his/her assets, such accomodations would tend to produce what bargaining under Chapter 11 produces—a payout less than the former but more than the latter.[112] The small size of the typical Chapter 13 proceed-

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plates financial difficulties which may arise following confirmation, as well as unforeseen circumstances relating to the uncertainty of many debtors' incomes, emergency expenses, and other individual problems."); *In re* Davis, 34 Bankr. 319 (Bankr. E.D. Va. 1983) (bankrupt need not show "grievous" change in circumstances to modify Chapter 13 plan).

108. Bankruptcy Code, 11 U.S.C.A. § 1322(c) (West Supp. 1985).

109. *Id.* § 1325(b)(1)(B).

110. What little case law there is seems to be addressed more to the courts' dislike of the liquidation value standard than the desirability of an extended plan. *In re* Price, 20 Bankr. 253 (Bankr. W.D. Ky. 1981) (cause to extend to five years not shown when sole purpose of extension was to improve debtor's chance of reorganizing and dividend to creditors would only be five percent); *In re* Stein, 18 Bankr. 768 (Bankr. S.D. Ohio 1982) (desire to make 100% payout sufficient cause to extend time beyond three years); *In re* Purdy, 10 Bankr. 902, 906 (Bankr. N.D. Ga. 1981) (inability to pay secured creditors in three years cause to extend plan to four years).

111. Of course, the value of this chip will depend upon the courts' reading of section 707(b). Curiously, it is arguable that § 707(b) does not apply to conversions, since it speaks in terms of cases "*filed* . . . under this Chapter." Bankruptcy Code, 11 U.S.C.A. § 707(b) (West Supp. 1985).

112. *See supra* notes 85-86 and accompanying text.

ing has discouraged such bargaining in the past,[113] and will presumably continue to do so in most cases. However, some Chapter 13 actions (especially those involving sole proprietorships in service industries) can involve substantial sums of money.[114] At least in those proceedings, haggling over the plan—and perhaps even some form of creditors' committee—may return.

IV. Limitation on the Scope of Discharge—"Luxury Goods"

One limitation on the consumer debtor's access to discharge which will primarily affect Chapter 7 proceedings[115] is found in new section 523(a)(2)(C). This provision creates a presumption that consumer debts aggregating more than $500 owed by the debtor to a single creditor for the acquisition of "luxury goods or services" within forty days before the order for relief are non-dischargeable.[116] Also presumed non-dischargeable are debts arising from consumer credit advances under an open-end credit plan if such advances exceed $1,000 and were obtained within twenty days of the order for relief.[117]

These provisions are part of section 523(a)(2)(A), which makes debts incurred by false pretenses or actual fraud non-dischargea-

113. *See supra* note 10.

114. The preparation of a plan by, and the activities of, a business that is just within the maximum limit of $100,000 in unsecured debt and has sufficient income to make a substantial distribution on that debt may well be worth monitoring by creditors during both the formulation of the plan and the plan period. *See supra* note 40 and accompanying text. This is especially true if the business is a service business with few assets because the creditors would not have significant assets to fall back on should the plan abort or be sabotaged by the bankrupt.

115. Indeed, almost exclusively, because the debts made presumptively non-dischargeable would be discharged upon successful completion of a Chapter 13 plan. *See* Bankruptcy Code, 11 U.S.C.A. § 1328(a) (West Supp. 1985).

116. Bankruptcy Code § 523(a)(2)(C) reads in full:

> [F]or purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $500 for "luxury goods or services" [sic] incurred by an individual debtor on or within forty days before the order for relief under this title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within twenty days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act (15 U.S.C. 1601 et seq.).

Id. § 523(a)(2)(C).

117. *Id.*

ble.[118] Thus, the substance of the provisions is that the debtor is presumed to have defrauded his/her creditors in the acquisition of the goods, services, or cash advances. The provisions appear to have been intended to prevent a debtor from enjoying one last spree just prior to bankruptcy.[119]

These provisions are also loaded with serious ambiguities.[120] What in the world are "luxury goods or services"? The Code grudgingly defines what they are not: they are not goods or services reasonably acquired for the support or maintenance of the bankrupt or the bankrupt's dependents.[121] This definition, however, leaves the original ambiguity virtually unscathed. On the surface, a debtor who buys a Jaguar or a Mercedes just before bankruptcy is buying a "luxury good"—but what if the debtor has always bought Jaguars or Mercedes? Is the standard based on what type of goods or services the debtor usually buys? This approach seems to fit the policy against pre-bankruptcy sprees, but it significantly favors well-to-do bankrupts, and ignores the fact that free-spending habits may have brought him/her to bankruptcy court in the first place. Is the standard based on what is "luxurious" to the average consumer? This seriously disadvantages the affluent bankrupt whose spending habits were not changed just prior to bankruptcy.

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118. Bankruptcy Code § 523(a)(2)(A),(B) read in full:

> (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—
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> . . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive.

Id. § 523(a)(2)(A),(B).

119. *See* S. Rep. No. 65, 98th Cong., 1st Sess. 58 (1983) (discussing § 202(a) of the Omnibus Bankruptcy Improvements Act of 1983, which was a predecessor of § 523(a)(2)(C)).

120. Not to mention some of the most cumbersome and prolix English ever to appear in print. This provision is a mere fraction of an execrable thousand-word sentence which appears, like so much of the Code, to be poorly translated from the Japanese. Indeed, the drafters of the Code may now be able to claim the record for bad writing long held by James Fenimore Cooper. *See generally* Twain, *Fenimore Cooper's Literary Offenses*, in 1 L. Teacher, The Unabridged Mark Twain 1241 (1976).

121. Bankruptcy Code, 11 U.S.C.A. § 523(a)(2)(C) (West Supp. 1985).

By far the most difficult and subtle interpretation problem relates to the content of the spending spree presumption. What exactly must the bankrupt do or demonstrate to avoid the penalty of non-dischargeability? Since the statute creates the presumption that the goods, services, or loans were obtained under false pretenses, what are the "false pretenses" which the bankrupt is presumed to have used to get them? Is it implied misrepresentation of solvency, of willingness to pay, of ability to pay, or of having no intention to go bankrupt? The content of the presumption will have a substantial effect on what the bankrupt must show to rebut it. For example, if the presumed lie concerns solvency, the bankrupt would have to produce evidence of assets and liabilities on the date of the credit extension. If the lie relates to ability to pay, the issue to be resolved will be the adequacy of the now-bankrupt debtor's cash flow on the date of the purchase. In either event, would it be sufficient for the bankrupt to show that he/she did not intentionally make the misrepresentation? Moreover, what evidentiary burden(s) does the presumption shift? Is it sufficient for the bankrupt to produce some evidence that there was no fraud or false pretenses? Or must the bankrupt persuade the court of this? The former standard is the more widely used definition of a presumption,[122] but it may make section 523(a)(2)(A) virtually meaningless, since a disingenuous bankrupt could easily deny that he/she intended to defraud his/her creditors.[123]

One further problem which may occasionally arise is the treatment of involuntary debtors under Chapter 7. If a consumer debtor has been involuntarily pushed into bankruptcy, should the presumption apply? Read literally, section 523 (a)(2)(C) would say it does, since no distinction is drawn between voluntary or involuntary bankruptcy. In part, the answer to this question will depend upon the content of the presumption. If the presumption is that the debtor was fraudulently misrepresenting his/her willingness or ability to pay, then involuntary petitions should not be treated differently than voluntary petitions. If the presumption is that the

122. *See, e.g.*, FED. R. EVID. 301.

123. There is not much help in the case law. *See, e.g.*, *In re* Barnacle, 44 Bankr. 50 (Bankr. D. Minn. 1984) (Under § 523(a)(2)(A), the creditor must prove by clear and convincing evidence that the debtor obtained property by representations that the debtor knew to be false or that were made with a reckless disregard for their truth or falsity.). It can at least be argued that the normally heavy burden imposed on the creditor to demonstrate non-dischargeability should lead to a correspondingly slight burden on the debtor to rebut the presumption.

debtor was fraudulently misrepresenting his/her intentions regarding bankruptcy, then the presumption should not ordinarily apply. The import of this latter interpretation is that the debtor defrauded creditors because he/she knew at the time the bills were incurred that he/she would soon be filing bankruptcy. It is rather difficult to see how a debtor can be presumed to know that creditors will file an involuntary petition against him/her in the near future. While it would not necessarily require an impossible feat of precognition to obtain such knowledge, the logic of the presumption fits this situation awkardly at best.[124]

As is true with the other limitations on discharge, section 523(a)(2)(A) presupposes widespread abuse of bankruptcy law by consumer debtors. Unlike the provisions contained in sections 707(b) and 1325(b)(1), however, section 523(a)(2)(A) benefits a class of creditors who lack even a colorable claim to special protection by the Code. The sellers of "luxury goods" are in a position to demand collateral for their extensions of credit. These creditors could easily obtain a security interest in the goods sold,[125] and, under the Uniform Commercial Code, such security interests would ordinarily be automatically perfected.[126] Thus, by simply in-

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124. On the other hand, it is very sensible to impose this presumption upon an involuntary bankrupt for purchases made during the "gap period" which may exist between the filing of the petition and the order for relief. Bankruptcy Code, 11 U.S.C.A. § 303(g), (h) (West Supp. 1985).

125. All that is required for a security interest to attach is that (a) either the collateral be in possession of the secured party pursuant to agreement or the debtor sign a security agreement which contains a description of the collateral, (b) value be given, and (c) the debtor have rights in the collateral. U.C.C. § 9-203(1) (1977). Obviously, anyone who is selling "luxury goods" should be able to afford the few lines of ink necessary to meet these requirements.

126. It seems clear that the "luxury goods" which the Code refers to will nearly always be consumer goods under the U.C.C.—goods "used or bought for use primarily for personal, family or household purposes." *Id.* § 9-109(1). Rarely will a debtor whose obligations are primarily consumer debts be buying "luxury goods" for use in his/her business or for resale. And, since the creditor is financing the purchase of the goods, the security interest retained is a purchase money security interest. *Id.* § 9-107. Such security interests are automatically perfected, unless the goods are subject to a certificate of title law. *Id.* § 9-302(d). The cost of noting the security interest on a certificate of title is not likely to excessively burden the seller of a Jaguar or a Mercedes.

In fairness to the creditors, however, it should be noted that, to a rather limited degree, the protection given to an automatically perfected security interest is less than that given to one perfected by filing. A consumer who buys consumer goods for consumer use takes free of a security interest which is not perfected by filing if he/she does not know of the security interest. *Id.* § 9-307(2). Although the security interest would continue in the proceeds of sale, it would become unperfected shortly after the proceeds were received. *Id.* § 9-306. Unperfected security interests are, of course, inferior to the rights of the trustee/debtor in poscluding a sentence or two in the sale contract, and generally without having to file a financing statement, such creditors could become secured parties, holding secured claims in the bankruptcy proceeding. The economic rationale for rewarding creditor indolence in this regard with a new non-dischargeability provision is thus by no means entirely clear.[127]

V. Limitations on Discharge—Reaffirmation Agreements

The original Bankruptcy Code had, as one of its major goals, the preservation of a debtor's "fresh start" through bankruptcy. One aspect of this preservation was its substantial restriction of post-discharge reaffirmation agreements. Virtually every state enforces as a binding obligation a bankrupt's promise to pay a discharged debt.[128] The Bankruptcy Act permitted such enforcement almost without limitation.

While there is nothing intrinsically objectionable about a debtor voluntarily making such repayment, the drafters of the Code apparently believed that many creditors were unfairly inducing, and many debtors foolishly agreeing to, reaffirmation.[129] Consequently, the Code imposed a fairly elaborate procedure for reaffirmation and rendered unenforceable any reaffirmation agreements which did not comply with these requirements.[130] The agreement had to

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session. *Id.* § 9-301; Bankruptcy Code, 11 U.S.C.A. § 544 (West Supp. 1985). Thus, the seller of "luxury goods" who relied on automatic perfection would not be protected against the improbable debtor who bought on a spree, resold the goods to another consumer, and drank the proceeds. The seller would be protected against even this eventuality if it undertook the less than monumental task of filing an appropriate financing statement.

127. In a very limited way, this provision is merely a reflection of the whole purpose of income-based bankruptcy, which is to replace what has traditionally been the creditors' protection against non-payment (access to the debtor's assets) with a new protection (access to the debtor's future income). The negative aspect of this is that it deprives the debtor of his/her own protection against peonage—the inability of creditors to seize more than the debtor's non-exempt assets at the time the debtor chooses bankruptcy. Giving this new non-dischargeability protection to creditors is simply one way of giving creditors access to future income as well as present assets, since the debt survives the discharge and may thus be satisfied from the debtor's subsequently acquired property. Indeed, § 523(a)(2)(A) even gives access to future income to creditors who specifically bargained for additional asset protection (i.e., secured creditors), since the non-dischargeability presumption does not depend upon the creditor for being wholly unsecured.

128. 1A Collier on Bankruptcy ¶¶ 17.33-17.37 (L. King 14th ed. 1978).

129. The primary legislative history is, however, rather vague. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 366 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978).

130. Prior to BAFJA, Bankruptcy Code § 524(c) read, in full:

> An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under

be made before the discharge was granted.[131] An individual debtor who sought to reaffirm a consumer debt not secured by his/her real property had to have court approval to do so. The court could approve the reaffirmation only if it determined that the agreement imposed no undue hardship on the debtor and was in the debtor's best interests,[132] or if the reaffirmation were entered into in good faith and in settlement of dischargeability or redemption litigation.[133] The debtor also had an absolute right to rescind the reaffirmation within thirty days after the agreement became enforceable.[134] Finally, at the discharge hearing for any reaffirming individual bankrupt, the court would inform the bankrupt of the voluntary nature of reaffirmation and its legal consequences.[135]

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this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if—

(1) such agreement was made before the granting of the discharge under section 727, 1141, or 1328 of this title;

(2) the debtor has not rescinded such agreement within 30 days after such agreement becomes enforceable;

(3) the provisions of subsection (d) of this section have been complied with; and

(4) in a case concerning an individual, to the extent that such debt is a consumer debt that is not secured by real property of the debtor, the court approves such agreement as—

(A)(i) not imposing an undue hardship on the debtor or a dependent of the debtor; and

(ii) in the best interest of the debtor; or

(B)(i) entered into in good faith; and

(ii) in settlement of litigation under section 523 of this title [non-dischargeability litigation], or providing for redemption under section 722 of this title.

11 U.S.C. § 524(c) (1982) (amended 1984).

131. *Id.* § 524(c)(1).

132. *Id.* § 524(c)(4)(A).

133. *Id.* § 524(c)(4)(B).

134. *Id.* § 524(c)(2).

135. *Id.* § 524(d). It states in full:

In a case concerning an individual, when the court has determined whether to grant or not to grant a discharge under section 727, 1141, or 1328 of this title, the court shall hold a hearing at which the debtor shall appear in person. At such hearing, the court shall inform the debtor that a discharge has been granted or the reason why a discharge has not been granted. If a discharge has been granted and if the debtor desires to make an agreement of the kind specified in subsection (c) of this section [a reaffirmation agreement], then at such hearing the court shall—

(1) inform the debtor—

(A) that such an agreement is not required under this title, under nonbankruptcy law, or under any agreement not made in accordance with the provisions of subsection (c) of this section; and

(B) of the legal effect and consequences of—

(i) an agreement of the kind specified in subsection (c) of this section; and

(ii) a default under such an agreement;

These requirements seem to have had their intended effect; consequently, they were among the chief targets of BAFJA. Although the timing and informational provisions have been retained without change,[136] and the time for rescission extended to sixty days,[137] court supervision of reaffirmation agreements has been virtually eliminated. Only those (presumably rare) bankrupts who are not represented by counsel in the negotiation of their reaffirmation agreement need to obtain court approval of it.[138] Even the unrepresented bankrupt can reaffirm without court approval if the debt reaffirmed is secured by real property.[139] In all other cases, the at-

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> (2) determine whether the agreement that the debtor desires to make complies with the requirements of subsection (c)(6) of this subsection [sic], if the consideration for such agreement is based in whole or in part on a consumer debt that is not secured by real property of the debtor.

136. Bankruptcy Code, 11 U.S.C.A. § 524(c)(1), (c)(5), (d) (West Supp. 1985).

137. *Id.* § 524(c)(2), (4). It reads:

> (c) An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if—
>
> . . . .
>
> (2) such agreement contains a clear and conspicuous statement which advises the debtor that the agreement may be rescinded at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim;
>
> . . . .
>
> (4) the debtor has not rescinded such agreement at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim . . . .

138. *Id.* § 524(c)(6)(A). This section makes a reaffirmation agreement unenforceable unless:

> [I]n a case concerning an individual who was not represented by an attorney during the course of negotiating an agreement under this subsection, the court approves such agreement as—
>
> (i) not imposing an undue hardship on the debtor or a dependent of the debtor; and
>
> (ii) in the best interest of the debtor.

139. *Id.* § 524(c)(6)(B). It states that "Subparagraph (A) [the provision on court approval] shall not apply to the extent that such debt is a consumer debt secured by real property." This obviously means that any bankrupt who seeks to reaffirm any debt secured by real estate, does not enjoy the benefit of judicial review, even if he/she was not represented by a lawyer during the negotiations. Note, however, that the provision says "to the extent" the debt is secured by realty the court approval provisions do not apply. On the face of it, this means that if a debt is secured only partially by realty, then only that part of the debt may be reaffirmed without court approval. If so, attorneys representing creditors seeking reaffirmation by an unrepresented debtor of a debt secured in part by realty and in part by personalty (or which are in part unsecured) should be careful to allocate clearly in the reaffirmation agreement the portion of the debt secured by the realty, and to have only that portion reaffirmed.

In any event, the significance of this may be rather slight, since the reaffirmation must torney who negotiated the reaffirmation agreement on behalf of the bankrupt must file an affidavit or declaration with the court which states that the agreement is a voluntary and informed decision by the bankrupt, and that it will put the bankrupt and his/her dependents under no undue hardship.[140] To this structure is appended the pious wish that even those bankrupts who do not reaffirm will voluntarily repay their debts.[141]

One problem not adequately addressed by BAFJA, which may reduce the effectiveness of this streamlined procedure, is the responsibility of the lawyer to determine the accuracy of the "no hardship" declaration. The obligation to certify "no hardship" creates a number of serious professional responsibility dilemmas for the attorney. First, it puts the lawyer in the awkward, if not untenable, position of evaluating the client's ability to pay. How will attorneys—who are generally not expert financial advisors—make this evaluation? What happens if the attorney guesses wrong?[142] Second, the declaration encompasses hardship to both the bankrupt and the bankrupt's dependents. What if the bankrupt assures the attorney that reaffirmation will cause no hardship, but the basis of this assurance is that the bankrupt will stop paying for his/her children's education? By including hardship to the dependents in the declaration, section 524(c)(3) in effect forces the attorney to consider and represent their interests. This may create an insoluble conflict which would disqualify the attorney from further representation of the bankrupt. Third, the attorney will sometimes be forced to refuse to accede to the client's wish to reaffirm because the lawyer (though not the client) believes that the proposed reaf-

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occur prior to discharge, and thus during the pendency of the proceeding. During the proceeding, the bankrupt is likely to have had legal representation and will presumably avail him/herself of the lawyer's advice regarding the reaffirmation.

140. *Id.* § 524(c)(3). A reaffirmation agreement is unenforceable unless:

> [S]uch agreement has been filed with the court and, if applicable, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that such agreement—
>
> (A) represents a fully informed and voluntary agreement by the debtor; and
>
> (B) does not impose an undue hardship on the debtor or a dependent of the debtor.

Curiously, the section seems to permit the declaration to be made by any attorney who negotiated "an" agreement to reaffirm for the debtor, not only the attorney who negotiated the specific reaffirmation agreement in question. Surely Congress meant "the," instead of "an," agreement.

141. *Id.* § 524(f).

142. He or she will get sued for malpractice, of course; but let us pass over *that* in silence.

firmation will subject the client to undue hardship.

Sensible lawyers are likely to respond to these problems in either of two ways. Some will routinely file the declaration on the representation of the client that there will be no undue hardship. Others will refuse to file the declaration in any but the most obvious cases, such as reaffirmation of a fifty dollar debt. The first response will frustrate the purpose of the requirement. The second will make it quite difficult for creditors to obtain reaffirmation. Each response constitutes a failure of the attorney to represent the client fully and adequately. By routinely filing the declaration, the lawyer abdicates the Code-imposed responsibility to review the bankrupt's financial situation. By routinely refusing to file the declaration, the lawyer ignores the fact that some reaffirmations are beneficial to, and in any event desired by, the client. The declaration requirement thus imposes an undesirable burden on the attorney-client relationship. It is an unnecessary burden as well, since the court can just as easily make the determination that there will be no undue hardship.

VI. Restriction on Access to Discharge—Effect of Dismissal

A final limitation on access to bankruptcy discharge is contained in new subsection 109(f),[143] which prohibits certain individuals from qualifying for relief under the Code. If an individual has been a bankrupt within 180 days prior to the order for relief,[144] but the prior proceeding was dismissed for failure to abide by the court's orders, for failure to press the case forward, or upon request of the bankrupt following a creditor's request for relief from the automatic stay, the bankrupt does not qualify as a "debtor" under the Bankruptcy Code.[145] This provision is obviously designed to avoid

143. Bankruptcy Code, 11 U.S.C.A. § 109(f) (West Supp. 1985) reads:

> Notwithstanding any other provision of this section, no individual may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—
>
> (1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or
>
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

144. *Id.* Actually, the provision is somewhat unclear about the date to which the 180-day period runs; this could be significant in an involuntary bankruptcy, in which the order for relief may not occur on the same date as the filing of the petition. *See supra* note 124.

145. *Id.*

situations in which a debtor repeatedly makes bad-faith bankruptcy filings for the sole purpose of delaying creditors through the automatic stay, and further to encourage diligence on the part of good-faith bankrupts. On the whole it is unobjectionable, but may not quite succeed in plugging the dike.

A truly bad-faith debtor may simply go ahead and file anyway; the current official form for voluntary petitions lacks any requirement that the debtor disclose his/her ineligibility to file.[146] Since the mere filing of a voluntary petition triggers the automatic stay,[147] creditors could at least be delayed by the time it takes to obtain a dismissal. More Machiavellian debtors may note that section 109(f) prohibits a person falling within its provisions from being a "debtor"—not just from filing a voluntary petition.[148] A debtor who fears an involuntary petition might file a voluntary petition, get a friendly creditor to move for relief from the automatic stay, then seek voluntary dismissal. If the court were to grant the dismissal, the debtor would be immune from an involuntary action for 180 days. Presumably, however, the courts would react negatively to any obvious manipulation of this sort.

VII. Conclusion

BAFJA's restrictions on access to discharge in bankruptcy will probably not radically change the shape of American bankruptcy law. If, as suggested, a somewhat narrow reading of section 707(b) prevails, the overwhelming majority of debtors will continue to have a choice of liquidation or reorganization. Indeed, the presence of the disposable income standard in Chapter 13 may even increase the attractiveness of liquidation bankruptcies.

It is equally clear, however, that substantial sentiment exists for a total restructuring of bankruptcy. There is no doubt that a major segment of the credit industry wants to change bankruptcy from the asset-based liquidation paradigm to the income-based reorganization paradigm. The traditional reorganization chapters, while certainly representing the opening wedge of this approach, usually created only voluntary proceedings. While, to a certain extent, the Bankruptcy Reform Act changed this for certain business reorgani-

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146. *See* Official Bankruptcy Form 1.
147. Bankruptcy Code, 11 U.S.C.A. § 362(a) (West Supp. 1985).
148. *Id.* § 109(f).

zations,[149] Congress then was quite clear that no consumer could be forced to reorganize involuntarily; indeed the possibility that such a proceeding could work was peremptorily dismissed.[150] To at least a small degree, BAFJA changes this; for at least some consumer debtors, reorganization under Chapter 13 will be the only available bankruptcy vehicle. If section 707(b) is read as broadly as some creditors would no doubt like, the number of such debtors will be quite large. Thus, it is at least possible that BAFJA will prove as significant to the structure and future of bankruptcy law as the 1898 Act, the 1938 Amendments, and the 1978 Code.

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149. *See supra* note 22.
150. *Id.*