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The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and An Interpretive Theory

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THE "FRESH START" POLICY IN CONSUMER
BANKRUPTCY: A HISTORICAL INVENTORY AND AN
INTERPRETIVE THEORY

*Charles G. Hallinan**

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I. INTRODUCTION

Among the most striking and, at the same time, least well-explained characteristics of American bankruptcy law is the intensity of that law’s focus on providing relief to the bankrupt debtor. One firmly established tenet of time-worn bankruptcy lore holds, of course, that the bankruptcy system serves two functions: the protection and payment of creditors; and the provision of shelter and a “fresh start” to overburdened debtors.¹ That description is accurate, however, only when applied to the system as a whole. As a practical matter, the great majority of consumer bankruptcy proceedings produce little or nothing in the way of payments to creditors.² In those bankruptcies, relief of the debtor by means of the

1. See, e.g., *Kokoszka v. Belford*, 417 U.S. 642, 645-46, *reh'g denied*, 419 U.S. 886 (1974) (quoting *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913)); *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918); 3 J. STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1101 (1833).

2. Prior to the 1978 enactment of the Bankruptcy Code (the “Code”), *infra* note 6, “no-asset” and “nominal-asset” cases (that is, respectively, those in which the debtor had no nonexempt property and those in which any non-exempt property was consumed entirely in administrative expenses) consistently made up about 85% of all filings in “straight” bankruptcy (that is, asset liquidation under what would now be Chapter 7 of the Bankruptcy Code). See D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 20-21 (1971). While a larger percentage of cases under former Chapter 13 (wage earner plans) resulted in significant payments to creditors, see Boren & Ralston, *Chapter XIII Wage Earner Plans: An Analysis of Their Effectiveness*, 15 AM. BUS. L.J. 293, 304 (1978) (53.8% of Chapter 13 plans successfully completed, with successful plans paying an average 96.5% of all claims), those cases constituted a relatively small percentage of total filings, as discussed *infra* note 80. The available data on returns to creditors under the Code suggest that the situation has not materially improved. Thus, while Chapter 13 cases have increased as a proportion of total nonbusiness filings, the rate of successful completion appears to have dramatically declined. See *Bankruptcy Reform Act of 1978 (Future Earnings): Hearings Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong., 1st Sess. 52 (1981) [hereinafter *Future Earnings Hearings*] (29.6% of Chapter 13 plans successfully completed, paying on average 92.6% of total claims). Likewise, the proportion of no-asset cases in Chapter 7 appears to be higher than prior to enactment of the Code. See U.S. GEN. ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, COMM. ON THE JUDICIARY, HOUSE OF REPRESENT-

bankruptcy discharge and its ancillary protections is not merely *an* objective of the system; it is, rather, the principal (if not the sole) point of the exercise.

The central importance of debtor relief in consumer bankruptcies is a commonplace of legal discussion. Legislative decisions to adopt or modify specific debtor-protection devices are inevitably attacked or defended as impeding or aiding the debtor's "fresh start."³ Likewise, judicial efforts to define the scope and effect of those protections once enacted are recurrently framed with reference to the bankruptcy system's "fresh start" objectives.⁴ Yet, as is the case with many widely employed truisms, common acceptance of the phrase tends to obscure the elusiveness of its content. Indeed, as used most frequently in judicial and legislative analysis, the "debtor's fresh start" is simply a synonym for the existing set of debtor-protection devices, and the "fresh start policy" merely a shorthand label for a host of ill-defined, usually unstated, and perhaps unconscious assumptions about the purposes and effect of employing those devices to alter the relations between debtor and creditor.⁵

The "fresh start" policy's lack of a coherently articulated content has proven particularly troublesome in the years since the 1978 enactment of the Bankruptcy Code⁶ (the "Code") and of the

ACTIVES, BANKRUPTCY REFORM ACT OF 1978—A BEFORE AND AFTER LOOK 56-57 (1983) [hereinafter GAO STUDY] (estimate that 97% of nonbusiness Chapter 7 cases are no-asset cases).

3. See, e.g., 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 (1982); Countryman, *Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809 (1983); Note, *Toward a Reform of the Six-Year Bar to Discharge in Bankruptcy*, 97 HARV. L. REV. 759 (1984).

4. See, e.g., Perez v. Campbell, 402 U.S. 637 (1971) (motorists' financial responsibility act held incompatible with "fresh start" policy); Lines v. Frederick, 400 U.S. 18 (1970) (what constitutes property of the bankruptcy estate, determined in part by "fresh start" objectives); Local Loan Co. v. Hunt, 292 U.S. 234 (1934) (effect of discharge on prebankruptcy wage assignment, determined in part by "fresh start" objectives).

5. An excellent example of the phenomenon is the collection of decisions on the "good faith" requirement in Chapter 13 cases, discussed *infra* notes 185-95 and accompanying text. See also REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93d Cong., 1st Sess. 61 (1973) [hereinafter REPORT] (describing "inadequacy" of efforts to explain bankruptcy policy as attributable to a failure "to account for the overriding goals of the bankruptcy process in the context of its relationship with other economic and social processes"); Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1447 (1985) (noting that discussions of bankruptcy policy ordinarily proceed without a grounding in a "normative theory of discharge's functions, goals, and justifications").

6. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985)).

Code Amendments contained in the 1984 Bankruptcy Amendments Act.⁷ In the context of consumer bankruptcies, the Code is most notable for its significant expansion of the protection afforded to bankrupt debtors.⁸ The novelty of many of its provisions necessarily leads to interpretive uncertainties which require an analysis of the underlying policies for their resolution. Difficulties of that kind are, of course, characteristic of any new statute in its infancy, but relative to the Code they are aggravated by the open-textured drafting employed to define various new aspects of the debtor's "fresh start."⁹ This increase in the practical importance of bankruptcy policies has, regrettably, not been matched by improvements in the consistency or clarity of the articulation and application of those policies. As a result, interpretations of any given element of the Code's debtor-relief provisions are likely to be characterized by a wide diversity of results,¹⁰ which is too often attributable to the decisionmakers' lack of a clear conception of the social and economic function of the bankruptcy discharge in the system of consumer credit.

The present essay attempts to describe the content of the "fresh start" policy with greater precision than has previously been given

7. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amendments to scattered sections of 11 U.S.C. (Supp. II 1984)) [hereinafter Bankruptcy Amendments Act of 1984].

8. The strong "debtor orientation" of the Code's discharge provisions, especially in comparison with former law, has been noted by various commentators. See, e.g., Cohen & Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N. C. L. Rev. 681, 721 (1980); Eisenberg, *Bankruptcy Law in Perspective*, 28 U.C.L.A. L. Rev. 953, 980 (1981); Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N. C. L. Rev. 723, 725 (1980). Even with the modifications enacted as part of the 1984 Act, *supra* note 7, the chief characteristics of the Code's debtor relief features remain the breadth and accessibility of the postbankruptcy protection afforded debtors. Both the general tenor and particular aspects of the Code and the 1984 amendments are discussed more fully *infra* notes 152-68, 196-202 and accompanying text.

9. See, e.g., 11 U.S.C. §§ 524 (c), (d) (limiting enforceability of certain postbankruptcy agreements unless approved by the court as "not imposing an undue hardship" and "in the debtor's best interest"), 525 (prohibitions of "discrimination" against debtors), 707(b) (permitting dismissal where discharge would be a "substantial abuse" of Chapter 7 of the Code, discussed *infra* notes 367-415 and accompanying text), 1325(a)(3) (requirement for confirmation that Chapter 13 plan be filed in "good faith") (1982 & Supp. III 1985).

10. Compare, e.g., *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982) with *Ravenot v. Rim-gale*, 669 F.2d 426 (7th Cir. 1982) (effect of "good faith" requirement on Chapter 13 plans proposing minimal payments, discussed *infra* notes 185-95 and accompanying text); compare, e.g., *In re Pine*, 717 F.2d 281 (6th Cir. 1983), cert. denied, 466 U.S. 928 (1984) with *In re Maddox*, 713 F.2d 1526 (11th Cir. 1983) (effect of state law on scope of debtor's power to avoid liens on exempt property).

this subject. Part II is devoted to a review of the history of the "fresh start" policy in the context of bankruptcy law. While the discussion in part chronicles the legal or doctrinal evolution of the discharge, the central emphasis is on the development of the *idea* of debtor relief—identifying the empirical assumptions and value judgments that have animated debates over the "fresh start" policy and the administration of particular doctrines it embodies. Part III builds on that description to discuss the current manifestation of the "fresh start" policy in the Code. It employs the Code's existing discharge provisions to test the present validity or plausibility of various concerns that have historically been advanced as determinative of the appropriate scope and extent of discharge rights. In brief, the discussion in Part III suggests that the present state of discharge rights can be properly explained as a compulsory allocation of certain risks associated with credit use. This allocation rests on a few relatively clear assumptions about the economic competence of consumer borrowers and about the social costs of default. As described in the final section of Part III, a clear understanding of those underlying assumptions is an essential starting point in judicial interpretation and application of the Code's "fresh start."

II. THE EVOLUTION OF THE THEORY AND LEGAL STRUCTURE OF THE "FRESH START" POLICY

A. *Debtor Relief and the Bankruptcy System: Antecedents and Origins*

The idea of creating legal devices for the relief of insolvent debtors has ancient antecedents.¹¹ But debtor relief as a primary objective of bankruptcy laws in particular is a decidedly modern and peculiarly American phenomenon.¹² For most of its Anglo-Ameri-

11. See, e.g., THE HAMMURABI CODE AND THE SINAITIC LEGISLATION 36, 40 (C. Edwards trans. 1904) (provisions in Babylonian law compelling forgiveness of interest in any year in which crops failed, and affording debtors in any event a right to alternate forms of repayment if unable to make payment in corn or silver); W. BUCKLAND, A TEXTBOOK OF ROMAN LAW 645 (1966) (describing imperial Roman institution of *cessio bonorum*, by which an insolvent debtor could voluntarily surrender his assets to creditors as a means of limiting subsequent collections efforts); see also *Deuteronomy* 15:1-3 (Mosaic law provision for periodic release of debts).

12. Of the various legal systems in which bankruptcy is an available remedial device for adjusting debtor-creditor and creditor-creditor relationships, only that of the United States appears to afford a freely available discharge to debtors without regard to the level of payments to, or the consent of, creditors. See J. DALHUISEN, DALHUISEN ON INTERNATIONAL IN-

can history, bankruptcy was exclusively a creditors' remedy, a device for equitably dividing an insufficient pool of assets among multiple claimants. To the extent that the remedy afforded the debtor some degree of relief from other varieties of coercive collection, that effect was regarded as merely an incidental by-product of a system single-mindedly focused on advancing the interests of creditors.¹³ Even the centerpiece of the modern "fresh start," the bankrupt's discharge from further liability for prebankruptcy debts, was originally conceived not as a relief measure but as a reward for the debtor's efforts to maximize the return to his creditors.¹⁴ Indeed, until well into this century, despite the obvious intent of modern bankruptcy legislation and the empirical realities of consumer bankruptcy filings, respected authorities continued to argue that the protection and payment of creditors was the only legitimate point of permitting legal relief through bankruptcy.¹⁵

While pre-twentieth century bankruptcy was essentially a collections mechanism, this does not mean that there were no available legal means for insolvent debtors to avoid liability for credit obligations without satisfying their creditors. To the contrary, nineteenth century state legislatures and their colonial predecessors enacted a rich variety of laws with the avowed purpose of affording

SOLVENCY AND BANKRUPTCY § 1.07[1] (1986) (continental legal systems); Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 69 (1982) (comparison of English and American discharge provisions); Hon-berger, *Bankruptcy: A Comparison of the United States and Canada*, 45 AM. BANKR. L.J. 129, 144-46 (1971); Shuchman, *Field Observations and Archival Data on Execution Process and Bankruptcy in Jerusalem*, 52 AM. BANKR. L.J. 341, 356 (1978) (Israeli system).

13. See generally Cohen, *The History of Imprisonment for Debt and Its Relation to the Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153 (1982); Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1 (1919).

14. The bankruptcy discharge entered English law in 1705. 4 & 5 Anne, ch. 17, § 8 (1705). By amendment the following year, discharge was made conditional on the consent of four-fifths in number and amount of creditors. 6 Anne, ch. 22, § 2 (1706). On the intent to afford the debtor an incentive to cooperation, see Cohen, *supra* note 13, at 156-57. See also 2 W. BLACKSTONE, COMMENTARIES ON THE LAW OF ENGLAND *482-83. The early limited interest in discharge as a form of relief is perhaps most evident in the unavailability of bankruptcy on a debtor's voluntary petition until the mid-nineteenth century. See 24 & 25 Vict., ch. 134 (1861) (permitting voluntary petitions by nonmerchants); 7 & 8 Vict., ch. 96 (1844) (same for merchants).

15. See, e.g., Glenn, *Essentials of Bankruptcy: Prevention of Fraud, and Control of the Debtor*, 23 VA. L. REV. 373 (1937); Olmstead, *Bankruptcy A Commercial Regulation*, 15 HARV. L. REV. 829, 835, 842-43 (1902); Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 6, 8-9 (1940); Remington, *Bankruptcy and Peaceable Settlement of Business Failures*, 18 YALE L.J. 590, 594-95 (1909); see also 1A COLLIER ON BANKRUPTCY 14.01[6], 14.02[1] (J. Moore & L. King 14th ed. 1978) (collections function is "original and fundamental purpose" or "primary purpose," discharge "a secondary purpose").

insolvent debtors some greater or lesser degree of release from the enforcement of creditors' claims.¹⁶ For the most part, these state-created "insolvency laws" (so called to distinguish them from creditor-oriented bankruptcy statutes) had their origins in the widespread movement to abolish or severely limit the availability of civil imprisonment as a means of debt collection. The usual first step on the path to complete abolition was the legislative creation of a scheme in which an imprisoned debtor could obtain his release from confinement by executing an oath of impoverishment or a conveyance of all his nonexempt property to a trustee or assignee for the benefit of his creditors.¹⁷ The authors of many such relief measures were content to limit the debtor's relief to discharge from imprisonment, together with protection against future imprisonment for debt owed at the time of his release.¹⁸ Others, however, went further. Aided perhaps by the similarities both in label and in doctrinal structure between the insolvency discharge from confinement and the bankruptcy discharge from debt, these legislatures devised systems in which debtors had an opportunity to obtain permanent relief, not only from imprisonment, but from other means of collection as well.¹⁹

The widespread adoption of these state insolvency laws in the nineteenth century did not occur in isolation. Their enactment took place, rather, in the context of a number of other legislative developments that, taken together, established the framework of modern debtor-creditor and collections law. Those developments included continual efforts to increase the efficacy of creditors' remedies, such as by the expansion of the classes of property that could be seized to satisfy judgments, and by the streamlining of execution and levy procedures.²⁰ At the same time, these improvements in creditor advantage were accompanied by the rapid devel-

16. For more detailed accounts of some of these laws, see P. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA, passim* (1974); F. NOEL, *A HISTORY OF THE BANKRUPTCY CLAUSE OF THE CONSTITUTION* 55-65 (1918); *Bankrupt and Insolvent Laws*, 3 *AM. JURIST & L. MAG.* 201 (1830). See also L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 240-43 (1973); Williston, *The Effect of a National Bankruptcy Law Upon State Laws*, 22 *HARV. L. REV.* 547 (1909).

17. See P. COLEMAN, *supra* note 16, at 256.

18. See, e.g., Act of Feb. 23, 1824, 22 Ohio Laws 326 (establishing public commissioner of insolvents to administer property assigned to obtain release from imprisonment).

19. For example, see the New York scheme discussed at length in *Bankrupt and Insolvent Laws*, 4 *AM. JURIST & L. MAG.* 98, 100, 103 (1830).

20. See generally Riesenfeld, *Collection of Money Judgments in American Law—A Historical Inventory and a Prospectus*, 42 *IOWA L. REV.* 155 (1957); Riesenfeld, *Enforcement of Money Judgments in Early American History*, 71 *MICH. L. REV.* 691 (1973).

opment of debtor-protective devices—exemptions, valuation rights, moratory legislation—that tended to blunt the full force of the creditors' expanded remedies.²¹ Insolvency laws and, when available, their debtor-protective discharge were thus one aspect of a larger trend toward limiting the severity of the legal consequences attached to insolvency and economic failure.

The developing recognition of the legitimacy of debtor protection and debtor relief as legislative objectives in the nineteenth century is usually attributed to corresponding increases in the incidence and importance of credit in the nation's economic structure during that period.²² The enhanced role of credit in economic development was accompanied by an expansion in the social importance and political power of the most significant debtor class, the entrepreneurial merchants and traders. These developments created a fundamental change in public attitudes toward borrowing, and eventually toward economic failure and insolvency as well. Indebtedness, once regarded as a sign of extravagance and poor financial management, came to be seen as an appropriate and indeed essential aspect of successful commercial activity. At the same time, the era's recurring financial crises and the concomitant widespread business failures highlighted the idea that the economic risks involved in commercial activity were not inevitably a function of the actor's dishonesty or irresponsibility. There was, rather, an increasingly strong perception of the significant possibility that economic failures were produced by economic forces no more controllable or predictable than visitation by a tornado or the bite of a wild dog. This severing in public consciousness of the hitherto close relation between fault and default easily found its way into legal rhetoric and theory and provided a legitimizing framework for legislation shielding insolvent debtors from coercive collections activity.²³

21. See P. COLEMAN, *supra* note 16, *passim* (exemptions and moratory or stay laws); Feller, *Moratory Legislation*, 46 HARV. L. REV. 1061 (1933); Priest, *Law and Economic Distress: Sagamon County, Illinois, 1837-1844*, 2 J. LEGAL STUD. 469 (1973) (moratory and valuation laws).

22. See generally P. COLEMAN, *supra* note 16, at 283-85; M. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860*, at 228-29 (1977); W.E. NELSON, *AMERICANIZATION OF THE COMMON LAW* 153-54 (1975).

23. See e.g., W. BLACKSTONE, *supra* note 14, at *474 ("if by accidental calamities, as, by the loss of a ship in a tempest, the failure of brother traders, or by the non-payment of persons out of trade, a merchant or trader becomes incapable of discharging his own debts, it is his misfortune and not his fault"); 2 J. KENT, *COMMENTARIES ON AMERICAN LAW* 321 (1827) (availability of relief from consequences of "inevitable misfortune" particularly ap-

There were essentially two styles of explanation for such laws, each focused on considerations that have been and remain, at least rhetorically, recurring themes in the debate over the "fresh start" policy. By far the more common was framed in terms of socioeconomic policy and social utility. In large part, this approach was founded on a perception of insolvent debtors as potentially valuable contributors to the nation's economic development, whose participation in the economy was impeded by the hopelessness of their financial conditions. Relief measures, the argument ran, were an appropriate means of restoring to the public at large the benefits of these debtors' entrepreneurial skills and energies, and of doing so with minimal impact on their creditors' realistic expectations of repayment.²⁴ The second line of explanation, one framed in moral terms, was usually offered more tentatively, and frequently accompanied arguments of the social utility sort. Building on a characterization of the insolvent's default as a matter of misfortune rather than blameworthiness, this approach focused on mercy or forbearance as the morally correct response to financial failure and depicted collection efforts as a morally repugnant effort to inflict suffering for greedy motives. From this perspective, relief legislation was, if not precisely an enforcement of a creditor's obligation to forbear and forgive, at least a refusal to involve the state in his morally questionable pursuit of repayment.²⁵

appropriate for merchants, given the "enterprising nature of trade" and its "extraordinary hazards"); *On A National Bankrupt Law*, 1 AM. JURIST & L. MAG. 35, 39, 51 (1829) (describing the causes of insolvency in terms of external events and not as fault-based).

24. See, e.g., CONG. GLOBE, 27th Cong., 1st Sess. 134 (1841) (message of President Tyler transmitting petitions for a bankruptcy act: "The distress incident to the derangements of some years past has visited large numbers of our fellow citizens with hopeless insolvency, whose energies, both mental and physical, by reason of the load of debt pressing upon them, are lost to the country."); 2 W. BLACKSTONE, *supra* note 14, at *484 ("the bankrupt becomes a clear man again: and . . . may become a useful member of the commonwealth"); 3 J. STORV, *supra* note 1, § 1101 ("an absolute right to appropriate and monopolize all their future earnings . . . obviously destroys all encouragement to industry and enterprise [sic] on the part of the unfortunate debtor"); Mack, *Bankruptcy Legislation*, 28 AM. U. L. REV. 1, 5 (1894) ("society needs the activity of every one of its members; . . . while a man, whose earnings are entirely at his creditor's mercy, would be little disposed to work, he might, if freed from this burden, retrieve his reputation and become a valuable member of the community"); *On a National Bankrupt Law*, *supra* note 23, at 44 ("It is important, too, to the nation to be able to avail itself of the services of all classes of citizens . . . and to convert [insolvent debtors] into active and useful members of society.").

25. See, e.g., CONG. GLOBE, 26th Cong., 1st Sess. 814 app. (1840) (remarks of Daniel Webster attributing failure to "selfish, unjust, or indifferent creditors"); *id.*, 27th Cong., 1st Sess. 318 (1841) (remarks of Representative Roosevelt describing effects of insolvency as a "moral calamity": "Talk of slavery and abolition! What slavery was to compare with the bondage of the mind and heart? Men talked of physical chains and shackles, but these were nothing to

The absorption of these concerns into the framework of bankruptcy law and the consequent transformation of that law from collections device to debtors' remedy was in large part a product of the allocation of powers between state and federal governments in the constitutional scheme. Among the federal powers enumerated in the Constitution was the authority "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."²⁶ In any effort to identify the scope of "the subject of Bankruptcies," the traditional notion of bankruptcy as a creditors' remedy was clouded by the tendency of preconstitutional state legislatures to be less than precise in labelling their creations. A few debtor relief statutes had been enacted as "bankruptcy" laws,²⁷ and even the most debtor-protective insolvency laws nonetheless had included some provision for distributing the insolvent's estate among creditors.²⁸ There was thus more than sufficient room for those with an expansive conception of federal powers to contend that the constitutional phrasing extended to the entire range of laws "for the benefit and relief of creditors and their debtors, in cases, in which the latter are unable, or unwilling to pay their debts."²⁹

Although this expansive view had its opponents, they were a distinct minority among constitutional commentators and federal judges.³⁰ Moreover, as time passed, the practical necessity of broad

the chains of the soul."); 3 J. STORY, *supra* note 1, § 1101 ("[W]hen the debtors have no property, or have yielded up the whole to their creditors, to allow the latter at their mere pleasure to imprison them, is a refinement in cruelty, and an indulgence of private passions, which could hardly find apology in an enlightened despotism It is incompatible with the first precepts of Christianity; and is a living reproach to the nations of christendom."); J. TIFFANY, *A TREATISE ON GOVERNMENT AND CONSTITUTIONAL LAW* 215 (1867) ("One of the first duties of legislation, while providing for the obligation of contracts, is, to relieve the unfortunate and meritorious debtor from a slavery of mind and body, which deprives him in great measure of the enjoyment of the comforts of life and the common benefits of society."); *Bankrupt and Insolvent Laws*, *supra* note 19, at 110 (exercise of collections rights against insolvent debtors "is rarely of any value to the creditor, while, on the other hand, it is in a great majority of cases ruinous to the debtor"); *id.* at 116 (imprisonment of insolvent described as "barbarous cruelty").

26. U.S. CONST. art. I, § 8, cl. 4.

27. For example, the short-lived Pennsylvania statute of 1812, described in P. COLEMAN, *supra* note 16, at 153, and the Rhode Island legislation of 1756 and 1771, described *id.* at 91-93.

28. See generally P. COLEMAN, *supra* note 16, *passim*; *Bankrupt and Insolvent Laws*, *supra* note 16.

29. 3 J. STORY, *supra* note 1, § 1108, at 13-14 n.3.

30. The difference between the narrow (collections-oriented) and broad (encompassing both collections and relief) definitions surfaced most frequently in debate over whether the federal government could constitutionally establish a voluntary "bankruptcy" system. That

federal power was made apparent by the constitutional limitations faced by the states. In particular, a series of early decisions by the Supreme Court held that state-created discharge schemes were ineffective as to debts incurred before their enactment³¹ and as to any debts, pre- or postenactment, owed to foreign creditors or contracted in other states.³² As a result, any comprehensive and broadly effective discharge legislation could be enacted, if at all, only by Congress. The expansive idea of "bankruptcy" was further aided by the fact that the debate over the scope of the federal bankruptcy power took place in an era most notable for congressional restraint in its exercise. There were only three, relatively short-lived, national bankruptcy acts passed prior to 1898, and

question was often treated as part of the era's larger debate over states' rights and the constitutional scope of federal power. The leading proponents of the broad view were, of course, Chief Justice Marshall and Justice Joseph Story. See *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 193-96 (1819) (Marshall, C.J.); 3 J. STORY, *supra* note 1, § 1108, at 13-14 n.3. The narrow view enjoyed its greatest strength in Congress. See, e.g., CONG. GLOBE, 26th Cong., 2d Sess. 124 (1840) (Senator Calhoun, arguing that voluntary bankruptcy would be unconstitutional). See generally C. WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 3-92 (1935) (recounting the nineteenth century legislative debates). Only a few judges expressed doubts as to the correctness of the expansive approach. See, e.g., *In re Klein*, 14 F. Cas. 719, 720-21 (C.C.D. Mo. 1842) (No. 7866), *rev'd*, 42 U.S. 277 (1843); *Adams v. Storey*, 1 F. Cas. 141, 143 (C.C.D.N.Y. 1817) (No. 66); see also 1 N. DANE, *A GENERAL ABRIDGMENT AND DIGEST OF AMERICAN LAW* 317-18 (1824) (emphasizing the distinction between involuntary, creditor-oriented "bankruptcy" and voluntary, relief-oriented "insolvency" laws).

31. *Farmers & Mechanics' Bank of Pa. v. Smith*, 19 U.S. (6 Wheat.) 131 (1821); *Sturges*, 17 U.S. (4 Wheat.) at 122.

32. See *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827). In what appears to have been the only instance of his being outvoted in the course of his entire tenure, Chief Justice Marshall (together with Justices Story and Duvall) dissented, on the ground that even the prospective discharge of obligations owed only to local creditors was nonetheless beyond state power. *Id.* at 332-58; see also *M'Millan v. M'Neill*, 17 U.S. (4 Wheat.) 209 (1819) (Marshall, C.J.). As noted by Professor Countryman, the precise constitutional basis of the rule announced by the majority in *Ogden* is "obscure." V. COUNTRYMAN, *CASES AND MATERIALS ON DEBTOR AND CREDITOR* 249 (1974). In the main, it appears to have been based on the early nineteenth century conceptions of territorial sovereignty of which (ironically enough, in view of his dissent) Justice Story was a leading proponent. See Hazard, *A General Theory of State Court Jurisdiction*, 1965 SUP. CT. REV. 241, 258-62. Thus, in much the same manner as state adjudicative jurisdiction was later held to be territorially bounded under the due process clause, see *Pennoyer v. Neff*, 95 U.S. 714 (1878), legislative competence was viewed as equally circumscribed. See *Baldwin v. Hale*, 68 U.S. (1 Wall.) 223 (1864). To the extent that that was the basis of *Ogden* and similar cases, one might reasonably doubt their authority today, given the changes in jurisdictional theory in the intervening 160 years. See, e.g., *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957). The point is moot, though, given the effect of existing federal bankruptcy legislation in pre-empting state discharge laws. See *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929). In any event, the decisions remain notable as early examples of limitations on state power that appear to have been derived solely from political theory and the structure of the government, rather than from the constitutional text, since there was at the time no due process clause applicable to the states.

only one of those (the most short-lived) clearly departed from the traditional bankruptcy objective of protecting and paying creditors.³³ This congressional inactivity effectively deferred any authoritative judicial pronouncement on the constitutional scope of "bankruptcy" until the beginning of the twentieth century. By that time, the expansion of the term to include debtor relief measures had been so often stated, and concepts of federalism had so radically changed, that the correctness of the expansive view could be affirmed by the Supreme Court as "really not open to discussion."³⁴

B. *The 1898 Act and the Entrepreneurial Model*

The enactment of the first permanent American bankruptcy legislation, the Bankruptcy Act of 1898 (the "Act"),³⁵ thus took place in an environment in which the modern concept of bankruptcy had already become relatively well established. Central to that concept was the use of a single remedy to carry out the dual functions of debtor relief and creditor payment that were previously served by distinct legal devices. At the doctrinal level, the merger was most clearly reflected in the availability of a discharge under the Act to petitioning debtors without regard to the level of payments to creditors and without any requirement of creditor consent.³⁶ By thus severing the previously existing link between payment and discharge, the authors of the Act had necessarily adopted a view of debtor relief as a legitimate independent objective of legislation in general and of the bankruptcy system in particular.

General acceptance of the propriety of debtor relief as a federal legislative concern did not go far, however, toward defining the nature and quality of the relief to be afforded. As originally formu-

33. Act of Mar. 2, 1867, ch. 176, 14 Stat. 517, *repealed by* Act of June 7, 1878, ch. 160, 20 Stat. 99; Act of Aug. 19, 1841, ch. 9, 5 Stat. 440, *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614; Act of Apr. 4, 1800, ch. 19, 2 Stat. 19, *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248.

The exception was the 1841 Act, *supra*, which was the first American bankruptcy legislation to permit voluntary petitions and which was alone among the pre-1898 statutes in affording discharge without regard to payment levels or creditor consent. Act of Aug. 19, 1841, ch. 9, 5 Stat. 440.

34. *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 187 (1902); *see also* Boshkoff, *supra* note 12, at 108 n.159 (noting that the congressional debates over the 1898 Act are "curiously silent" on the federal power issues that had fueled legislative passions regarding prior acts).

35. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544.

36. *Id.* § 14, 30 Stat. at 550.

lated, the discharge under the Act was available to any debtor who made a timely application unless he had concealed property after filing the petition, given false testimony in the proceeding, or failed to keep adequate records prior to bankruptcy "with fraudulent intent . . . and in contemplation of bankruptcy."³⁷ Once granted, the discharge extended to all "provable" debts except liabilities for unpaid taxes, for fraud, for "willful and malicious injuries," or for misconduct as a fiduciary.³⁸ This facially broad scope was somewhat limited, however, by the definition of "provable" debts to exclude unliquidated noncontractual obligations, which thereby precluded the discharge of most "pure" tort liabilities that had not been reduced to judgment.³⁹ Moreover, beginning almost immediately after its adoption, the Act was repeatedly amended to further narrow both the availability and the scope of the discharge. These amendments added as grounds for complete denial of relief the debtor's failure to cooperate in the proceeding⁴⁰ or to satisfactorily explain his financial condition,⁴¹ the commission of a fraudulent conveyance within the twelve months preceding bankruptcy,⁴² his receipt of a discharge within the preceding six years,⁴³ and his having obtained prebankruptcy credit on the basis of a false financial statement.⁴⁴ Similarly, the list of nondischargeable debts was expanded to include alimony and child support obligations,⁴⁵ liabilities for certain torts having to do with sex relations,⁴⁶ and employ-

37. *Id.* §§ 14(b), 29, 30 Stat. at 550, 554.

38. *Id.* § 17, 30 Stat. at 550-51.

39. *Id.* § 63(a), 30 Stat. at 562-63. When, however, the creditor's claim could be framed either in tort or in contract or quasi-contract, it remained dischargeable, whether or not liquidated and whether or not framed in tort. *Schall v. Camors*, 251 U.S. 239, 248 (1920); *Crawford v. Burke*, 195 U.S. 176 (1904). Likewise, liabilities for fines and penalties were held nondischargeable because not provable "debts" within § 63(a). *See, e.g., Parker v. United States*, 153 F.2d 66 (1st Cir. 1946). In 1934, § 63(a) was amended to include within "provability" any unliquidated negligence claims as to which an action was pending at the time the bankruptcy petition was filed. Act of June 7, 1934, ch. 424, § 4(a), 48 Stat. 911, 923-24.

40. Act of Feb. 5, 1903, ch. 487, § 4, 32 Stat. 797-98.

41. Act of May 27, 1926, ch. 406, § 6, 44 Stat. 663-64.

42. Act of Feb. 5, 1903, ch. 487, § 4, 32 Stat. 797, amended by Act of May 27, 1926, ch. 406, § 6, 44 Stat. 663-64.

43. Act of Feb. 5, 1903, ch. 487, § 4, 32 Stat. 797-98.

44. *Id.*

45. *Id.* § 5, 32 Stat. 798. Prior to the amendment, the Supreme Court had already held that family obligations were nondischargeable even in the absence of an express exception. *Dunbar v. Dunbar*, 190 U.S. 340 (1903); *Audubon v. Shufeldt*, 181 U.S. 575 (1901).

46. Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 798 (liabilities for seduction and criminal conversation); Act of Mar. 2, 1917, ch. 153, 39 Stat. 999 (seduction nondischargeable only if breach of a promise to marry accompanied by seduction); Act of Jan. 7, 1922, ch. 22, 42 Stat.

ees' claims for wages earned shortly before bankruptcy.⁴⁷

As to the operation and effect of a discharge, the Act provided only that it "shall release" a bankrupt from all his dischargeable debts.⁴⁸ Under prior common-law doctrines, however, the discharge was not regarded as extinguishing liabilities but merely as interposing a bar to their judicial enforcement, much like a statute of limitations.⁴⁹ That approach was quickly embraced in the Act's interpretation. As a result, because the debtor's "moral obligation" to pay survived the discharge, he was held to be capable of reviving the legal obligation by an express reaffirmation following bankruptcy.⁵⁰ Similarly, because the discharge was an affirmative defense, it was deemed to have been waived if not timely pleaded in any postbankruptcy suit by the creditor.⁵¹ Moreover, because the discharge was a bar only to legal enforcement of the debtor's personal liability, the creditor remained wholly free to enforce prebankruptcy lien rights,⁵² even in exempt property,⁵³ and could seek repayment by informal means.⁵⁴

The shape of this "fresh start" policy as defined by the Act and the early judicial decisions reflected in large part a federal adoption and refinement of the policy concerns that had underlain the Act's state law predecessors. Most apparent was a continuing reliance on the notion that relief measures served the public welfare by restoring the overburdened debtor to economic productivity. As

354 (seduction or breach of a promise to marry accompanied by seduction). As it had relative to support obligations, *supra* note 45, the Supreme Court had already concluded prior to the amendment that criminal conversation liabilities were nondischargeable. *Tinker v. Colwell*, 193 U.S. 473 (1904) (criminal conversation constitutes "willful and malicious" injury).

47. Act of Jan. 7, 1922, ch. 22, 42 Stat. 354.

48. Bankruptcy Act of 1898, *supra* note 35, § 17, at 550-51.

49. See *Jersey City Ins. Co. v. Archer*, 122 N.Y. 376, 25 N.E. 338 (1890); *Hill v. Trainer*, 49 Wis. 537, 5 N.W. 926 (1880); *Another Question under the Bankrupt Act of 1867*, 4 ALB. L.J. 294 (1871).

50. *Zavelo v. Reeves*, 227 U.S. 625 (1913). See generally Boshkoff, *The Bankrupt's Moral Obligation to Pay His Discharged Debts: A Conflict Between Contract Theory and Bankruptcy Policy*, 47 IND. L.J. 36 (1971).

51. See, e.g., *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942). See generally 8 H. REMINGTON, A TREATISE ON THE BANKRUPTCY LAW OF THE UNITED STATES § 3240 (6th ed. 1955).

52. See, e.g., *Sample v. Beasley*, 158 F. 607 (5th Cir. 1908). See generally 8 H. REMINGTON, *supra* note 51, at §§ 3230-3231.

53. See 8 H. REMINGTON, *supra* note 51, at 3233; see also *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903) (bankruptcy court may stay entry of discharge to permit creditor to create lien on exempt property pursuant to prebankruptcy exemption waiver).

54. See, e.g., *Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977); *McClendon v. Kenin*, 235 Or. 588, 385 P.2d 615 (1963).

summarized by the Supreme Court in phrasings that have since provided the standard labels for the debtor-relief objectives of bankruptcy, the discharge was available to the "honest but unfortunate" debtor due to the "public interest" in affording him "a fresh start in life," a "new opportunity," and "a clear field for future effort."⁵⁵ That vision of the appropriate role of the discharge was strongly influenced by a view of debt and insolvency as largely the products of business activities. The productivity rationale itself was rooted in the established conception of financial failure as an unavoidable consequence of entrepreneurial risk taking. Moreover, although noncommercial borrowing had been a factor in the economy since well before adoption of the Act, it had ordinarily taken forms that underplayed its significance, especially in the bankruptcy context.⁵⁶ As a result, in the drafting and early interpretation of the Act, there was a strong tendency to focus on the "typical" insolvent as a commercial actor,⁵⁷ an orientation that was most apparent in the statutory and doctrinal limits on the scope and effect of the discharge. "Pure" tort claims and family obligations, for example, were said to be nondischargeable because they were unlikely to be the product of commercial activity.⁵⁸ Similarly,

55. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918); *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904).

56. Prior to the early decades of the twentieth century, the primary lawful form of consumer credit was the installment purchase of consumer durables, a marketing device first attempted on a mass consumption basis and rapidly mastered by the Singer Sewing Machine Co. in the mid-nineteenth century. See I. E. SELIGMAN, *THE ECONOMICS OF INSTALLMENT LENDING* 14-19 (1927). In addition, by the end of the nineteenth century, building and loan societies were engaged in extensive residential mortgage lending. See H. KROOSS & M. BLYN, *A HISTORY OF FINANCIAL INTERMEDIARIES* 114-15 (1971). Because both these forms of credit involved the lenders' retention of a security interest (by conditional sale or mortgage), the bankruptcy discharge would have been of little use to the consumer borrower due to its limited effect on property interests. Unsecured consumer lending did not become institutionalized until after the widespread enactment of higher usury ceilings under small loan laws beginning about 1916. Prior to that time, unsecured "salary lending" was generally confined to the grey market of loansharking, in which the possibilities for informal collections tended to vitiate the utility of any release from merely legal liabilities. See Haller & Alviti, *Loansharking in American Cities: Historical Analysis of a Marginal Enterprise*, 21 AM. J. LEGAL HIST. 125 (1977); Hubacheck, *The Development of Regulatory Small Loan Laws*, 8 LAW & CONTEMP. PROBS. 108 (1941).

57. See, e.g., *Maynard v. Elliott*, 283 U.S. 273, 277 (1931) (discharge affords relief from "business misfortunes"); *Wetmore*, 196 U.S. at 77 (purpose of discharge to provide "a fresh start in business or commercial life," freed of liabilities "which may have resulted from business misfortunes").

58. See *Wetmore*, 196 U.S. at 77; *Audubon*, 181 U.S. at 577 ("[a]limony does not arise from any business transaction"); Glenn, *Basic Considerations in Tort Claims in Bankruptcy and Reorganization*, 18 N.Y.U. L.Q. REV. 367, 367-69 (1941) (critically describing nonprovability of tort claims as founded in focus on commercial credit).

even if they arose in a commercial setting, fraud and "willful and malicious" conduct, which would preclude or be excepted from discharge, were seen as far removed from the central concern for socially useful risk taking.⁵⁹ Even limiting the effect of the discharge was explained less as a limitation than as a means of enabling the debtor to return to commercial activity by facilitating his acquisition of postbankruptcy credit.⁶⁰

While the encouragement of commercial risk taking was thus established as the chief organizing principle of the bankruptcy "fresh start" policy, it was by no means the sole consideration shaping either the policy or its doctrinal embodiment. One additional concern, peculiar to the provision of debtor relief in the specific context of bankruptcy, was the bankruptcy system's historical function as a collections device. It was indeed conventional to declare that the Act served two purposes, both debtor relief and the facilitation of payments to creditors.⁶¹ The tension, if not opposition, between those purposes may not have been fully apparent until some years later, but their juxtaposition in relation to a single remedial scheme raised, at the least, the possibility that the two might at times be difficult to fulfill simultaneously. Related to that concern were generally held assumptions about the redistributive impact of the discharge. To the extent that bankruptcy released indebtedness short of full repayment, it was viewed as conferring an unearned benefit on the debtor and imposing a corresponding uncompensated loss on creditors.⁶² Although the process causing this apparent wealth transfer could be justified as advancing the public welfare, the transfer itself was not universally regarded with undiluted enthusiasm. In particular, it appears to have been generally taken as a given, first, that the benefits of any such transfer should be limited to deserving or "worthy" beneficiaries, and second, that its cost should not be borne by those with little ability to bear it.⁶³

These additional concerns, relating both to the payments func-

59. See *McIntyre v. Kavanaugh*, 242 U.S. 138, 141-42 (1916); *Tinker*, 193 U.S. at 489.

60. See, e.g., *Schuman Bros. v. First Nat'l Bank*, 115 Okla. 23, —, 240 P. 647, 648 (1925) (reason for rule permitting reaffirmation said to be "stronger" relative to reaffirmation made to obtain new credit), *appeal dismissed*, 274 U.S. 716 (1927).

61. See, e.g., *Stellwagen*, 245 U.S. at 617; *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915); *Hanover Nat'l Bank*, 186 U.S. at 188.

62. See, e.g., *Canada S. R.R. Co. v. Gebhard*, 109 U.S. 527 (1883); *Baylor v. Rawlings*, 200 F. 131, 134 (8th Cir. 1912); *In re Evans*, 235 F. 956, 961 (S.D. Idaho 1916).

63. See, e.g., *Williams*, 236 U.S. at 554-55; *Wetmore*, 196 U.S. at 77.

tion of bankruptcy and to the perceived redistributive effect of the discharge, were reflected in a variety of ways. The common rhetorical emphasis on the "honest" debtor's "hopeless" state,⁶⁴ for example, suggested not only the debtor's moral worth but also the limited impact of the discharge on his creditors' chances of repayment. Similarly, the requirement that the debtor surrender all but the basic assets protected by exemptions, as well as doctrines that facilitated postbankruptcy payments and reaffirmations, tended to reduce the perceived loss to creditors. Likewise, the nondischargeability of tort liabilities, family obligations, and wage claims could be said to reflect judgments both as to the relative moral worth of the claimants and as to their capacity to bear the losses imposed by the discharge.⁶⁵

C. *The Advent of the Consumer Bankrupt*

In a process that began almost immediately, the decades following adoption of the Act witnessed a substantial erosion in the accuracy and persuasive force of some of the assumptions upon which the Act was based. Of primary significance was the evolution in volume and importance of consumer credit during that period, which was accompanied by a steady increase in the resort to bankruptcy by consumer debtors. In 1912, wage-earner bankruptcies had constituted about one-fifth of voluntary filings;⁶⁶ by 1930, the proportion was over half,⁶⁷ and by 1940 closer to three-quarters.⁶⁸ As the "typical" bankrupt thus shifted from merchant to wage earner, the rationale of the discharge as an entrepreneurial incentive tended to lose its force and the incentive structure established under that rationale became increasingly problematic. Yet, while there was certainly no shortage of commentary directed to the apparent mismatch between law and policy, the basic legal structure and most of the details of the "fresh start" remained unchanged until the years shortly before the enactment of the Bankruptcy Code in 1978.

The chief cause of this legislative inertia appears to have been

64. See, e.g., *Dunbar*, 190 U.S. at 352; J. POMEROY, AN INTRODUCTION TO THE CONSTITUTIONAL LAW OF THE UNITED STATES 349 (1883).

65. See, e.g., *Friend v. Talcott*, 228 U.S. 27, 40 (1913); *Wetmore*, 196 U.S. at 77; *Dunbar*, 190 U.S. at 352.

66. See 1912 ATT'Y GEN. ANN. REP. app. 3, table following p. 200.

67. See 1920 ATT'Y GEN. ANN. REP. 377.

68. See D. STANLEY & M. GIRTH, *supra* note 2, at 18, 25.

the lack of a strong consensus as to the appropriate role of bankruptcy and of the bankruptcy discharge in the system of consumer credit. To be sure, there appears to have been little dispute about the propriety of bankruptcy for consumers whose inability to pay their debts could be attributed to external economic events or personal misfortune. In those cases, the causes of insolvency (the Great Depression or catastrophic illness, for example) fit comfortably into the entrepreneurial model's conception of financial difficulties as an unavoidable risk inherent in the economic system. There was, likewise, a parallel to that model in the perceived social cost of failing to afford relief to consumer debtors, since the debtor's loss of employment, and hence a net social loss in productivity, appeared to be among the primary accompaniments of economic distress.⁶⁹ To the extent that relief measures sprang from moral considerations, the wage-earning victims of economic catastrophe were even more appealing candidates for mercy than had been their entrepreneurial predecessors. Thus, the source of controversy and the impediment to consensus was not the "unfortunate" consumer debtor; it was, rather, the "improvident" or "extravagant" consumer whose financial difficulties stemmed, not from external events, but from high levels of consumption and credit use accompanied by misjudgments about his capacity to repay.

The central difficulty with permitting "improvident" consumers to resort to bankruptcy was the apparent avoidability and low social utility of the conduct leading to their financial problems. In the commercial or entrepreneurial model, debtors were expected and encouraged to take steps that involved a risk of economic failure corresponding to their prospects for economic success. Thus, when insolvency did occur it was regarded, absent dishonesty, as an acceptable price for the gains capable of being achieved by risk taking.⁷⁰ In the entrepreneurial "fresh start," there was thus little reason to distinguish between *ex ante* (predefault) incentives to engage in risk taking and *ex post* (postdefault) incentives to return to productive activity. Both were useful and were usefully en-

69. See, e.g., V. SADD, CAUSES OF BANKRUPTCIES AMONG CONSUMERS 10 (1933); Cover, *Consumer Credit and Individual Bankruptcy*, 196 ANNALS 86, 87 (1938); Fortas, *Wage Assignment in Chicago—State Street Furniture Co. v. Armour & Co.*, 42 YALE L.J. 526, 532 (1933); Note, *Wage-Earner Receiverships*, 6 U. CHI. L. REV. 459, 461 (1939).

70. See, e.g., *Bankruptcy Law and Its Administration*, 5 ALB. L.J. 3 (1872) (describing discharge as appropriate not only for merchants who have met with "unforeseen losses" but also in cases where insolvency is "not so entirely in the nature of an accident").

couraged by the discharge. In the case of the consumer debtor, however, that harmony between *ex ante* and *ex post* incentives was lacking. In particular, while consumer borrowing was recognized as a boon to the economy, the social gain was not seen as a consequence of the borrower's willingness to take risks. The consumer borrower was, rather, assumed to have a relatively stable and predictable probability of future income. This probability, unlike the entrepreneur's prospects, would not be improved by increases in the level of his debt-financed consumption.⁷¹ Thus, whatever the value of incentives for productivity after default, there appeared to be little social utility in encouraging consumers to push borrowing to its limits before the fact.⁷² Yet, to the extent that default was associated with the debtor's own low aversion to the risk of failure (his "improvidence"), rather than with the unavoidable risk of external events ("misfortune"), the ready availability of a bankruptcy discharge appeared to create precisely that incentive.⁷³

Standing alone, that concern might have led to revisions in discharge policy narrowing the scope of the "fresh start" available to "improvident" or "extravagant" consumers.⁷⁴ But the concern did not stand alone. Doubts about the social utility of incentives to consumer risk taking were accompanied, rather, by doubts about the economic competence of many consumer participants in credit markets. In the usual characterization a substantial portion of consumers were depicted as "amateur" debtors who failed to rationally evaluate the costs and risks of borrowing and whose use of credit was frequently an aid to the pursuit of foolish, illusory, or overvalued goals.⁷⁵ That vision of the consumer debtor as not necessarily very sensible was complemented by a vision of many con-

71. See, e.g., Sturges & Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L.J. 487, 514-16 (1933).

72. See, e.g., Hamilton, *In re the Small Debtor*, 42 YALE L.J. 473, 478 (1933); Radin, *Discharge in Bankruptcy*, 9 N.Y.U.L.Q. REV. 39, 47 (1931) ("discharge loses much of its reason when it is applied to any but business men").

73. See, e.g., MITCHELL, *STRENGTHENING OF PROCEDURE IN THE JUDICIAL SYSTEM*, S. Doc. No. 65, 72d Cong., 1st. Sess. 9 (1932) (accessibility of discharge "encourages reckless extravagance").

74. For examples of proposals to vary the availability or effect of the discharge according to the causes of the debtor's difficulties or his repayment of some minimum amount of claims, see MITCHELL, *supra* note 73, at 96-98; Douglas, *Some Functional Aspects of Bankruptcy*, 41 YALE L.J. 329, 349-63 (1932).

75. See, e.g., Cover, *supra* note 69, at 91; Douglas, *supra* note 74, at 358; Hamilton, *supra* note 72, at 478.

sumer lenders as driven by competitive necessity to "exploit" their customers' weaknesses and incapacities through the hard selling of "easy" credit.⁷⁶ Thus, the financial difficulties of even "improvident" consumers were perceived as partly the product of a kind of market failure—the result of "excessive" competition by lenders intent on the profits derived from credit extensions to unsophisticated high-risk consumers without regard to the adverse social and economic consequences of default. To the extent that one held to that view, the appropriate focus relative to *ex ante* incentives was not the debtor but his creditors. In that regard, the discharge and other limitations on creditors' remedies seemed capable of serving a useful corrective function, penalizing lenders with "lax" credit standards and hence encouraging care in credit extensions.⁷⁷

These competing policy considerations, with their opposing implications regarding the appropriate scope of relief for "extravagant" debtors, were a chief source of the disagreements and ambivalence which impeded legislative change. The situation was compounded by the difficulties inherent in drawing meaningful lines between classes of debtors. The commercial model had fostered a rhetorical and operational division of the universe of insolvents into the "dishonest," who were denied relief, and the "honest but unfortunate," for whom the "fresh start" was readily available. Proposals to afford a narrowed or different discharge for a new class, "improvident" or "extravagant" consumers (who were neither dishonest in the usual sense nor entirely the victims of misfortune),⁷⁸ depended on the existence of some workable means for identifying cases in the new class. But the proposals usually classified by paradigmatic example rather than by definition, and were in any event almost inevitably premised on controversial value judgments about the acceptability of various consumer behaviors leading to insolvency. Moreover, even when there might be agreement that a particular cause of financial difficulty was properly characterized as "improvidence" (and, indeed, even if there were agreement as to what to do about it), actual cases tended to in-

76. See, e.g., Douglas, *supra* note 74, at 349-50; Sturges & Cooper, *supra* note 71, at 514-17.

77. See, e.g., Douglas, *supra* note 74, at 352; Sturges, *A Proposed State Collection Act*, 43 YALE L.J. 1055, 1056-57 (1934).

78. See, e.g., Douglas, *Wage Earner Bankruptcies—State vs. Federal Control*, 42 YALE L.J. 591, 598-601 (1933); see also Sturges & Cooper, *supra* note 71, at 514 (noting that any effort to distinguish between "honest" and "reprehensible" debtors requires moral judgments, "because the classes do not otherwise exist").

volve a complex medley of causes, including both "improvidence" and "misfortune,"⁷⁹ and the proposals provided few tools for isolating and weighing the various factors to determine which sort of discharge would be appropriate.

Given these countervailing pressures, it may not be surprising that, from 1926 to 1960, there was virtually no significant legislative response to the steady "consumerization" of the bankruptcy population.⁸⁰ The congressional failure to significantly alter the terms of the discharge meant, of course, that the bankruptcy statute drafted as a regulation of commercial credit continued to operate, but in a significantly different world. On the judicial front, the consequent dissonance required a degree of change in the stated policy bases for discharge. That was accomplished in part by a reduction of the existing rationales to a series of vague and essentially meaningless phrases ("fresh start," "honest but unfortunate") that were recited more as preambles than as premises in determination of the proper scope and effect of the discharge.⁸¹ To the extent that the modified rationales went beyond that, they were framed in terms of work incentives: the point of the discharge

79. See V. SADD, *supra* note 69, at 4,10; Douglas, *supra* note 78, at 596-614.

80. The sole significant congressional nod in that direction was contained in the Chandler Act, 52 Stat. 840, 930 (1938). That enactment dealt principally with aspects of bankruptcy that were relevant mainly in business failures, and it left untouched the existing substantive rules governing the availability, scope, and effect of the discharge. Among its provisions, however, was an alternative form of bankruptcy relief, the Chapter 13 wage earner's plan, which was designed specifically for use by consumer debtors. *Id.* Under Chapter 13, a debtor could propose a plan of partial or complete repayment (that is, a debtor could propose a composition or extension) of the claims against him. If accepted by the court, by affected secured creditors, and by the holders of a majority in number and amount of unsecured claims, the plan was binding on all affected creditors. Successful completion of payments under the plan (or an ability to persuade the court that a failure to complete payments was due to "circumstances for which [the debtor] could not justly be held accountable") resulted in a discharge essentially identical in scope and effect to the ordinary bankruptcy discharge.

At base, Chapter 13 appears to have been an effort aimed less at sorting the existing population of consumer debtors than at expanding the availability of relief to the least controversial class of financially troubled consumers, namely those with the desire and capacity to make substantial payments to their creditors. Resort to a wage earner's plan, however, offered little advantage over "straight" bankruptcy, even for that group. Most often mentioned was an intended reduction in the supposed "stigma" associated with bankruptcy, but the existence and importance of social disapproval were open to question and it was equally doubtful that a debtor's choice of Chapter 13 made a difference. Moreover, even a debtor's desire to repay could be effectively satisfied in an ordinary bankruptcy proceeding (with a great deal more flexibility and without any delay in obtaining a discharge) by the simple expedient of postbankruptcy payment or reaffirmation. There was, in short, not much incentive for consumer debtors to elect Chapter 13 relief, and the Chapter's forty-year history was characterized by corresponding low levels of use.

81. See, e.g., *Reitz v. Mealey*, 314 U.S. 33 (1941).

was said to be an incentive for employment to the deeply indebted wage earner, an incentive that would not exist if the debtor's earnings were devoted largely to paying his creditors.⁸² To a degree, that rationale borrowed from and was suggestive of the productivity explanations for the entrepreneurial "fresh start." As did the entrepreneurial model, the consumer-productivity rationale afforded little basis for drawing distinctions among debtors as to the circumstances and causes of their financial difficulties. Indeed, by focusing primarily on the costs and incentives affecting the debtor *after* default, the rationales appeared to assume (in accord with the views of the "exploitation" theorists) that the only significant *ex ante* incentive effects of the discharge were those affecting the behavior of creditors. Thus, the rationale implied, as far as the bankruptcy system was concerned, distinctions between the "extravagant" and the "unfortunate" were immaterial. Financially distressed consumers who were not dishonest were by definition unfortunate.⁸³

As one might expect, that judicial focus appears to have fostered a generally undifferentiated reception to the use of bankruptcy by consumers.⁸⁴ To be sure, there were some decisions reflecting much the same ambivalence that could be found in the works of critics and commentators. Heavy gamblers and uninsured motorists, in particular, were treated to doctrinal manipulations that limited the scope or effect of the discharge and that seem explainable only in terms of an underlying hostility to the "irresponsible" behavior that had led to the debtor's problems.⁸⁵ Likewise, the distributive and creditor-payment concerns that had provided grounds for limiting the entrepreneurial "fresh start" remained important rhetori-

82. See *Local Loan Co. v. Hunt*, 234, 292 U.S. 245 (1934); J. MACLACHLAN, *HANDBOOK OF THE LAW OF BANKRUPTCY* 88 (1956); 1A *COLLIER ON BANKRUPTCY*, *supra* note 15, at 14.01[6].

83. Thus, denial of discharge was not permitted on the basis of "general equitable considerations" or on any ground other than the particular species of misconduct set out in the Act. *Shelby v. Texas Improvement Loan Co.*, 280 F.2d 349, 355 (5th Cir. 1960); see also *Jones v. Gertz*, 121 F.2d 782 (10th Cir. 1941); *In re Boner*, 169 F. 727 (N.D. W. Va. 1909); cf. *Talcott v. Friend*, 179 F. 676, 682 (7th Cir. 1909) (earlier references to discharge as a "privilege" tended to give way to an emphasis on the debtor's "right" to relief, *aff'd*, 228 U.S. 27 (1913). *But see* *Dixwell v. Scott*, 115 F.2d 873, 874 (1st Cir. 1940).

84. See 7 H. REMINGTON, *supra* note 51, at 104 (noting in 1955 the tendency "of recent years" toward liberality in granting discharge).

85. See, e.g., *Reitz*, 314 U.S. 33 (upholding motor vehicle financial responsibility act); *Klein v. Morris Plan Indus. Bank*, 132 F.2d 809 (2d Cir. 1942) (denial of discharge to window dresser for failure to keep records of gambling losses); *In re Bank*, 34 F. Supp. 706 (W.D.N.Y. 1940) (denial of discharge where debtor failed to keep records of gambling losses).

cal themes, even in consumer bankruptcies.⁸⁶ In the main, however, judicial administration of the discharge was characterized by a readiness to adjust doctrine in ways that enlarged the effectiveness of the discharge in consumer cases. For example, in the seminal consumer "fresh start" case, *Local Loan Co. v. Hunt*,⁸⁷ the Supreme Court carved a wage earner exception to its long-standing reliance on state law to define the existence *vel non* of liens that would survive the discharge. Relative to the postbankruptcy effects of wage assignments, the Court held, the federal "fresh start" policy provided the governing standard and required that the debtor hold his future earnings entirely free of discharged claims, without regard to state-created lien rights.⁸⁸ Similar doctrinal accommodations of value, mainly to consumer debtors, took place in a variety of other settings.⁸⁹ More importantly, the accommodations, taken together with existing doctrines, established a consumer discharge system in which neither the availability nor the scope of relief was ordinarily limited or defined by reference to the causes of the debtor's failure.

D. *The Consumer Law "Revolution" and the 1978 Code*

Given the generally accepted limits of the judicial function, a posture of openness to the phenomenon of consumer bankruptcy was not and could not be, in the absence of legislative change, a sufficient basis for a wholesale restructuring of bankruptcy doctrines. Thus, the basic legal theory of the discharge as a waivable

86. For example, in *Klein*, 132 F.2d 809, a failure to keep records of gambling losses was held to bar discharge. The court rested its view in part on the utility of the records to the trustee in pursuing restitution from the winners, on behalf of the estate.

87. 292 U.S. 234 (1934).

88. *Id.* at 242-45. The focus of the decision on consumer debtors was particularly evident in the emphasis given to the character of the property as earnings. As to other forms of future property (expectancies, for example, or future crops), state law appears to have been regarded as still dispositive of the existence of liens. See 1A COLLIER ON BANKRUPTCY, *supra* note 15, at 1742.12. *But see* *Segal v. Rochelle*, 382 U.S. 375, 379-80 (1966) (dictum suggesting a contrary view).

89. In *Local Loan Co.*, for example, the Court authorized federal injunctive relief against state court collections procedures in cases in which the bankrupt's ability to claim his discharge in state court was limited by settled state practice and the financial burdens of an appeal. *Local Loan Co.*, 292 U.S. at 239-43. The latter condition tended to limit the utility of the *Local Loan Co.*, injunction to any debtors but consumers. Similarly, consumer debtors were generally immunized from the Act's provision for denial of discharge to those who had failed to keep adequate financial records. See, e.g., *Morris Plan Indus. Bank v. Henderson*, 131 F.2d 975, 977 (2d Cir. 1942); *In re Pinko*, 94 F.2d 259 (7th Cir. 1938). *But see supra* note 85 and accompanying text.

bar only to legal enforcement of the debtor's personal liability remained essentially unchanged until enactment of the Bankruptcy Code in 1978. Preserved with that theory were longstanding doctrines establishing the postbankruptcy enforceability of reaffirmations and security interests as well as those permitting extrajudicial collections methods. The judicial capacity for doctrinal change was further limited by the peculiarities of bankruptcy jurisdiction, which generally relegated to state courts the resolution of disputes over the dischargeability of specific debts.⁹⁰ Those courts were not (or at least did not appear to be) as taken as their federal counterparts with the notion of a broadly drawn consumer "fresh start" policy.⁹¹

Notwithstanding these limitations, however, the "official" judicial theory of the discharge and its hospitable implications for consumers did much to set the framework and direction for the policy debates and legislative changes of the 1960's and 1970's which culminated in adoption of the Code. Nonbusiness bankruptcies during that period had reflected a dramatic increase, both in absolute numbers and as a proportion of total filings.⁹² At the same

90. The jurisdictional division was not explicitly stated in the Act. It was, however, routinely adhered to by lower federal courts, apparently on the basis of practice under earlier enactments. *See, e.g., In re Bernard*, 280 F. 715 (2d Cir. 1922). The approach was implicitly ratified by the Supreme Court's decision in *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), which authorized injunctive intervention in state dischargeability litigation "under unusual circumstances." *Local Loan Co.*, 292 U.S. at 241; *see supra* note 89.

91. The difference in receptivity to a broad "fresh start" was a widely accepted hunch throughout the period. *See, e.g., Smedley, Determination of the Effect of a Discharge in Bankruptcy*, 15 VAND. L. REV. 49, 59 (1961). Anecdotal evidence of the difference could be derived from a comparison of reported federal and state holdings as to the scope of particular exceptions to discharge. *See, e.g., Jaco v. Baker*, 174 Or. 191, 148 P.2d 938 (1944) (characterized in *J. MACLACHLAN, supra* note 82, at 103, as "[i]mputing an animal's malice to its owner"). *Compare, e.g., Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934) (malicious injuries exception requires actual malice) with *Greenfield v. Tucillo*, 265 A.D. 343, 38 N.Y.S.2d 758 (1942) (liability for injuries caused by running a red light, with no apparent aggravating circumstances, held nondischargeable). A statistical test of the hunch was made possible by the 1970 amendments which conferred jurisdiction on federal courts to hear the most commonly raised claims of nondischargeability. *See infra* note 142. Notably, while there was a decline in the rates of dischargeability challenges and of default judgments, there appeared to be no significant alteration in success rates as to litigated challenges. *See Schuchman, Impact Analysis of the 1970 Bankruptcy Discharge Amendments*, 51 N.C. L. REV. 233 (1972). *But cf. Priest & Klein, The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984) (discussing the limited utility of litigation success rates as evidencing a tribunal's bias for or against particular kinds of claims).

92. *See* ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, BANKRUPTCY STATISTICAL TABLES iii (1982) (table summarizing annual filings 1970 through 1981) [hereinafter BANKRUPTCY STATISTICAL TABLES]; ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, TABLES OF BANKRUPTCY STATISTICS 6 (1969) (figure summarizing filings from 1954 through 1969).

time, the "consumer law revolution" had begun, and with it came intensified interest in questions regarding the adequacy of the legal structure protecting consumers of credit. Discussion of these concerns was fueled in part by the work of social scientists, who had produced a remarkable mass of statistical data on financially distressed consumers in general, and consumer bankrupts in particular.⁹³

One relatively immediate and pervasive consequence of these developments was an enlarged conception of the social costs that were the foundation of the "fresh start" policy. Armed with empirical studies of wage garnishment, critics of the coercive collections system argued that debt burdens were not merely a disincentive to productive employment, but an affirmative impediment even for the willing worker, since one common result of garnishment appeared to be the debtor's involuntary loss of employment.⁹⁴ Beyond questions of productivity, cost conceptions were further broadened by data suggesting the existence of significant adverse psychological and health consequences resulting from financial difficulties.⁹⁵ Moreover, consciousness of the social nature of these personal and economic costs was sharpened by the existence of social insurance and public assistance programs, which added actual public expense to what might otherwise be somewhat remote notions of productivity and net social welfare.⁹⁶

93. See, e.g., J. BROSKY, *A STUDY OF PERSONAL BANKRUPTCY IN THE SEATTLE METROPOLITAN AREA* (1965); G. BRUNNER, *PERSONAL BANKRUPTCIES: TRENDS AND CHARACTERISTICS* (1965); D. CAPLOVITZ, *CONSUMERS IN TROUBLE: A STUDY OF DEBTORS IN DEFAULT* (1974); H. JACOB, *DEBTORS IN COURT: THE CONSUMPTION OF GOVERNMENT SERVICES* (1969); Dolphin, *Characteristics of the Financially Distressed*, *BANKING*, Jan. 1967, at 55; Hermann, *Families in Bankruptcy—A Survey of Recent Studies*, 28 *J. MARR. & FAM.* 324 (1966); Shuchman, *Little Bankruptcies in New England*, 56 *B.U.L. REV.* 685 (1976); Siporin, *Bankrupt Debtors and Their Families*, 12 *SOC. WORK* 51 (1967).

94. See, e.g., D. CAPLOVITZ, *supra* note 93, at 275-79; Anderson, *Coercive Collection and Exempt Property in Texas: A Debtor's Paradise or a Living Hell?*, 13 *HOUS. L. REV.* 84, 126-28 (1975); Countryman, *Consumer Bankruptcy—Some Recent Changes and Some Proposals*, 19 *U. KAN. L. REV.* 165, 166 (1971); Project, *Wage Garnishment in Washington—An Empirical Study*, 43 *WASH. L. REV.* 743, 758-66 (1968); Comment, *Wage Garnishment: Still Driving the Wage-Earning Family to the Wall*, 17 *SANTA CLARA L. REV.* 631, 657-58 (1977).

95. See, e.g., D. CAPLOVITZ, *supra* note 93, at 280-85; H. JACOB, *supra* note 93, at 114; Anderson, *supra* note 94, at 132; Cyr, *Setting the Record Straight for a Comprehensive Revision of the Bankruptcy Act of 1898*, 49 *AM. BANKR. L.J.* 99, 152 (1975); Greenfield, *Coercive Collections Tactic—An Analysis of the Interests and the Remedies*, 1972 *WASH. U.L.Q.* 1, 9; Wallace, *The Logic of Consumer Credit Reform*, 82 *YALE L.J.* 461, 471-72 (1973).

96. See, e.g., Avis, *An Economic Rationale for Statutory Interest Rate Ceilings*, 13 *Q. REV. ECON. & BUS.* 61 (Autumn 1973) (defense of usury ceilings as limiting credit available to high-risk borrowers and hence limiting externalization of collections costs to social insurance programs); *Discussion*, 41 *LAW & CONTEMP. PROB.* 123, 142 (Autumn 1977) (Prof.

With respect to bankruptcy in particular, the revised perception of the costs of financial difficulty was accompanied by concerns over the efficacy of the bankruptcy system as a means of reducing those costs. There was at least a suspicion, confirmed in part by studies, that a substantial number of debtors who were eligible for and would benefit from bankruptcy nonetheless failed to file.⁹⁷ More importantly, even for those who did file, limitations on the scope and effect of the discharge raised questions as to its capacity to relieve existing debt. These questions revolved in the main around the apparently high rates of reaffirmation or revival of debts following discharge, which were in turn regarded as a product of the significant postbankruptcy leverage afforded creditors by security interests, informal collections, and state jurisdiction of dischargeability issues. To the extent that dischargeable obligations survived bankruptcy, or were revived shortly thereafter, many of the problems that were thought to warrant the availability of a discharge appeared to remain unsolved.⁹⁸

A different set of concerns, somewhat opposed to those above, was raised by the absence from the bankruptcy system of any express criterion of need for relief as a condition to the availability of the discharge. The conventional theory for accommodating the tension between the system's creditor payment and debtor relief objectives had long been premised in large part on the "hopeless" state of the debtor's finances. This premise rested on a view that, given his balance sheet and prospects, neither the debtor nor his creditors could have much realistic expectation of significant pay-

Logue, suggesting that discharge may be warranted to limit public assistance externalities); Rendleman, *Bankruptcy Revision: Procedure and Process*, 53 N.C.L. REV. 1197, 1231-35 (1975) (drawing extended analogy between bankruptcy and public welfare programs); Trebilcock & Shulman, *The Pathology of Credit Breakdown*, 22 MCGILL L.J. 415, 458-59 (1976) (suggesting that exemption levels for earnings should be set above amount of public welfare benefits to limit disincentive to work); Project, *supra* note 94, at 766-67 (description of garnishment as preventing efforts of General Relief beneficiaries to become self-supporting); Comment, *Discharge: The Prime Mover of Bankruptcy*, 15 SW. L.J. 308, 326 (1961) (discharge characterized as a buttress to capitalist economy, since it limits likelihood of development of welfare dependent class of poor).

97. See REPORT, *supra* note 5, at 46-47, 76; Rendleman, *supra* note 96, at 1229; Shuchman, *An Attempt at a Philosophy of Bankruptcy*, 21 UCLA L. REV. 403, 412-13 (1973).

98. See, e.g., REPORT, *supra* note 5, at 169, 173-78; S. ENZER, R. DEBRIGARD & F. LAZAR, SOME CONSIDERATIONS CONCERNING BANKRUPTCY REFORM 86-90 (1973); D. STANLEY & M. GIRTH, *supra* note 2, at 329; Lee, *What Shall We Do for the Consumer Bankruptcy?*, 44 J. NAT'L CONF. REF. BANKR. 9, 10-11 (1970); Cowans, *An Agenda for Bankruptcy Reformers*, 43 J. NAT. CONF. REF. BANKR. 3 (1969).

ment even if no discharge were available.⁹⁹ In that context, the term implied both the debtor's present inability to pay debts and a predictive judgment that the inability would continue to exist to some degree for some time in the future. At the same time, although perhaps less strongly, the term implied that discharge would be less appropriate for a debtor with a present ability to pay or whose difficulties were relatively certain to be brief in duration. Nonetheless, perhaps due to the obvious difficulties inherent in defining "ability to pay" and in making confident predictions of future economic condition, the statute contained no test or standard which would limit relief to cases of "hopeless" indebtedness. Rather, eligibility for voluntary bankruptcy required only that the debtor petition for relief and that he surrender all his nonexempt assets for liquidation and distribution to creditors. Neither solvency nor a present or predicted ability to pay were grounds for denial of relief.¹⁰⁰

In commercial or business bankruptcies, the absence of an express-need criterion does not appear to have been particularly disturbing. Because even troubled business entities were likely to have significant assets,¹⁰¹ the Act's requirement of asset surrender served as a crude proxy for any missing need standard. Generally speaking, a business debtor's willingness to offer up his property strongly bespoke both his present inability and his firm belief that things were unlikely to turn around in the foreseeable future.¹⁰² In consumer bankruptcies, however, the use of assets as a proxy for a need standard was far more problematic. The tangible assets of the usual consumer debtor were believed to consist mainly of used consumer goods which were likely to be exempt and, in any event, to

99. See *supra* note 64 and accompanying text.

100. Bankruptcy Act of 1898, ch. 541, § 4a, 30 Stat. 541, 547 (codified as amended at 11 U.S.C. § 301 (1982)); see *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 190-91 (1902) (filing "establishes . . . [inability to pay] so far as a decree in bankruptcy is concerned, and . . . [t]his is not an issuable fact . . . [The bankrupt] may be, in fact, fraudulent and able and unwilling to pay his debts; but the law takes him at his word") (quoting *In re Fowler*, 9 F. Cas. 614, 614 (D. Mass. 1867) (No. 4998)); *In re Fox West Coast Theatres*, 88 F.2d 212 (9th Cir.) (pleading or proof of insolvency unnecessary for voluntary petition), *cert. denied*, 301 U.S. 710 (1937).

101. See D. STANLEY & M. GIRTH, *supra* note 2, at 58, 88 table 5-2 (difference in percentage of asset cases among business and nonbusiness individual bankruptcies).

102. That was particularly so given the notorious overoptimism of business bankrupts regarding their chances of success. See Cyr, *supra* note 95, at 163-64; Furth, *The Critical Period Before Bankruptcy*, 41 YALE L.J. 853, 861-62 (1932); Seligson, *Major Problems for Consideration by the Commission on the Bankruptcy Laws of the United States*, 45 AM. BANKR. L.J. 73, 86 (1971).

have little market value.¹⁰³ The consumer's chief form of wealth was seen, rather, as his potential for future earnings. Income, of course, was not an asset until earned, but the present *capacity* to earn could itself be regarded a present asset—the economist's "human capital."¹⁰⁴ In the context of consumer credit, there was an increasing recognition that the value of that asset was more than an economic construct, since consumer lending was in fact done largely in reliance on the debtor's earning prospects and not on the basis of his tangible property.¹⁰⁵ In bankruptcy, however, the debtor's human capital was not treated as property or as an asset subject to surrender as part of the price of discharge.¹⁰⁶ That exclusion of future income from consideration, taken together with the presumptively minimal value of most consumer goods, tended to place in doubt the reliability of asset surrender as a test of need in consumer cases. A consumer debtor with no prospective inability to pay, it was suggested, might willingly surrender nonexempt assets and would thus have an incentive to avail himself of bankruptcy without regard to need. To the extent that that was the case, it was argued, the creditors' legitimate interest in and reliance on a still-valuable asset would have been frustrated.¹⁰⁷

These concerns and the accompanying doubts regarding the availability and effect of relief measures were expressed during the

103. See MacLachlan, *Puritanical Therapy for Wage Earners*, 68 COM. L.J. 87, 88 (1963); Note, *Discharge Provisions in Consumer Bankruptcy: The Need for a New Approach*, 45 N.Y.U. L. REV. 1251, 1265 (1970).

104. See *Discussion*, *supra* note 96, at 156-59.

105. See, e.g., S. ENZER, R. DEBRIGARD, & F. LAZAR, *supra* note 98, at 7; *Discussion*, *supra* note 96, at 156-58; Driver, *Proposal—To Amend the Bankruptcy Act to Require that Consideration Be Given to the Use of Chapter XIII*, 18 PERS. FIN. L.Q. REP. 41, 42 (1964); Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 480 n.101 (1968); MacLachlan, *supra* note 103, at 89; Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROB. 13, 28-29 (Autumn 1977); Note, *supra* note 103, at 1265; see also AMERICAN SAVINGS & LOAN INST., LENDING PRINCIPLES & PRACTICES 75-76 (1971) (importance of income in decisions as to creditworthiness of consumer borrower).

106. The exclusion of human capital from the reach of creditors in bankruptcy was a necessary consequence of the definition of the estate as essentially including only the debtor's present assets. Bankruptcy Act of 1898, ch. 541, § 70, 30 Stat. 541, 565-66 (codified as amended at 11 U.S.C. § 541 (1982)). It was also a consequence of the Supreme Court's decision in *Local Loan Co.*, 292 U.S. at 242-45, which precluded the enforcement of prebankruptcy liens on postbankruptcy earnings. See *supra* notes 87-88 and accompanying text.

107. See, e.g., S. ENZER, R. DEBRIGARD & F. LAZAR, *supra* note 98, at 7; Cyr, *Bankruptcy Courts in Transition Toward Debtor Rehabilitation*, 22 ME. L. REV. 333, 335-37 (1970); Dolphin, *supra* note 93, at 55; MacLachlan, *supra* note 103, at 90-91; Meth, *Is Bankruptcy Outmoded?*, 19 BUS. LAW. 673 (1964); Weistart, *The Costs of Bankruptcy*, 41 LAW & CONTEMP. PROB. 107, 113 n.10, 121 (Autumn 1977); Note, *supra* note 103, at 1265-67.

1960's and 1970's in wide-ranging debate and in a myriad of proposals for revision of consumer credit regulation generally, and of the bankruptcy system in particular. Notwithstanding the number and variety of contributions to these controversies, each approach tended to follow one of a limited number of patterns determined by the particular critic's assumptions about the operation of the consumer credit system. As related to bankruptcy law, there were essentially two such patterns or "theories" of debtor relief. The first focused on limited consumer competence as the source of consumer financial difficulties; its proponents tended to regard a relatively generous discharge policy as an essential corrective for those difficulties. The second, by contrast, defined the propriety of relief by reference to economic theory and the economics of consumer credit markets. In general, its proponents regarded proposed expansions of the discharge and other relief measures with caution, if not outright hostility.

Consumer incompetence theory was in large part a refinement and extension of the earlier "exploitation" model with its twin assumptions of "amateur" borrowing and "excessive" lending.¹⁰⁸ At times, the theory was framed in moral terms, as by an emphasis on the "suffering" of the financially distressed or the "oppressiveness" of coercive collections.¹⁰⁹ The theory also seemed to express distributive preferences and a corresponding vision of debtor relief as an amelioration of the consequences of poverty.¹¹⁰ But neither moral nor distributive concerns were essential to the central point of the theory, which was that consumer financial difficulties and their attendant social costs were ordinarily a product of the debtor's failure either to accurately judge his repayment capacity or to make adequate provision for adverse changes in his financial

108. See *supra* notes 75-77 and accompanying text.

109. See, e.g., Countryman, *Some Good and Some Bad Features of the Proposed New Bankruptcy Act*, 7 U.C.C. L.J. 213, 224 (1975) (description of creditors as obtaining reaffirmations by trickery and coercion); Cyr, *supra* note 95, at 152 (discharge described as protecting "young marrieds the very integrity of whose domestic and economic existence is threatened," and as permitting "young families to maintain their dignity and integrity").

110. See, e.g., Brendes & Schwartz, *Schlockmeister's Jubilee: Bankruptcy for the Poor*, 40 J. NAT'L CONF. REF. BANKR. 69 (1966); Countryman, *supra* note 94, at 166 (disclosure-style consumer protection "of little value" to low-income, blue-collar consumer bankrupts); Jordan & Warren, *A Proposed Uniform Code for Consumer Credit*, 8 B.C. INDUS. & COM. L. REV. 441, 449 (1967) (rate ceilings and disclosure requirements described as "largely middle-class solutions . . . to what has increasingly become a lower-class problem"); Wallace, *supra* note 95, at 477 (attributing some reform proposals to desire to "reduce the suffering and injustice" occasioned by existing wealth distribution).

circumstances. Those failures were in turn attributed to several causes. First, many consumers were said to underestimate both the risk and the consequences of default, while overestimating the value of immediate credit.¹¹¹ Second, the economic circumstances of low-income consumers were seen as frequently preventing the maintenance of a cushion against even small financial reverses.¹¹² Third, creditors were charged with compounding these difficulties by the aggressive marketing of credit and by the failure to adequately screen consumer credit risks.¹¹³ Thus, default was characterized as the product of personal weakness or of a credit market failure, or both.

Within the framework established by these premises, incompetence theory came in essentially two forms. In the more moderate version, the proper function of the discharge and the primary determinant of its scope was the direct alleviation of the effects of financial failure. This goal was to be accomplished by assuring that the discharge in fact completely extricated the distressed debtor from his existing debt burdens. Proponents of this rescue approach thus argued for enlarged exemptions, limits on the degree to which security interests survived discharge, and broad prohibitions of even informal postbankruptcy collection efforts.¹¹⁴ Given their em-

111. See, e.g., REPORT, *supra* note 5, at 53; Grau & Whitford, *The Impact of Judicializing Repossession: The Wisconsin Consumer Act Revisited*, 1978 WIS. L. REV. 983, 987 n.21 (suggesting possible consumer "hyperproclivity" to credit use); Jordan & Warren, *supra* note 110, at 448 (low-income debtors overcommitted because they are not able to rationally manage finances); Seligson, *supra* note 102, at 111-13; Wallace, *supra* note 95, at 472 (suggestion that debtors may underestimate the probability of default and the gravity of its consequences); Note, *supra* note 103, at 1264 (suggestion that debtors may underestimate the probability of default and the gravity of its consequences). Various empirical studies likewise suggested that among the chief causes of financial difficulties were the debtor's financial management and "overuse" of credit. See, e.g., Hermann, *supra* note 93, at 329; Ryan & Maynes, *The Excessively Indebted: Who and Why*, 3 J. CONS. AFF. 107, 124 (1969).

112. See, e.g., REPORT, *supra* note 5, at 54-55; D. CAPLOVITZ, *supra* note 93, at 58; Siporin, *supra* note 93, at 61; Comment, *supra* note 94, at 658. The lack of a cushion was further suggested by the greater tendency of problem debtors (relative to the population as a whole) to employ credit as a means of meeting current needs, rather than to obtain durables. See Hermann, *supra* note 93, at 326, 328. See generally G. BRUNNER, *supra* note 93.

113. See, e.g., Countryman, *The Bankruptcy Boom*, 77 HARV. L. REV. 1452, 1458-60 (1964); Countryman, *Improvident Credit Extension: A Legal Concept Aborning?*, 27 ME. L. REV. 1 (1975); Herzog, *Bankruptcy Tomorrow*, 45 AM. BANKR. L.J. 57, 62, 65-66 (1971); see also Shuchman, *supra* note 12, at 363 (relative to Israeli creditors' remedies: "[p]rospective creditors might be more prudent if there were not the power to imprison and garnish wages").

114. See, e.g., REPORT, *supra* note 5, at 75-76, 169-75, 177; D. STANLEY & M. GIRTH, *supra* note 2, at 206, 208, 210; Brendes & Schwartz, *supra* note 110; Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678 (1960); Kennedy, *Reflections on*

phasis on the effects rather than the causes of insolvency, rescue proponents ordinarily rejected proposals aimed at differentiating the relief available to debtors according to differences in the sources of their problems.¹¹⁵ In part, this emphasis may have reflected a view that the availability of the discharge had little effect on consumer behavior in incurring debts.¹¹⁶ In addition, efforts to differentiate debtors or forms of relief were regarded both as impractical and as likely to impair the broad relief believed necessary to effectively reduce the costs of failure.¹¹⁷ Similarly, while conceding the theoretical propriety of limiting the discharge to those in need, commentators of the rescue school usually concluded that the matter was primarily a theoretical concern, and that in the real world no workable standard could be devised that would not deny relief to a substantial number of debtors in actual need.¹¹⁸ For rescue theorists, the creditor-payment objectives of the bankruptcy system were immaterial in consumer bankruptcies,¹¹⁹ and concerns with awkward wealth transfer effects were best handled by narrowly drawn exceptions to dischargeability.¹²⁰

In the more sweeping version of incompetence theory, the central point of bankruptcy was the consumer debtor's "rehabilitation."¹²¹ Proponents of this approach shared the rescue theorists'

the Bankruptcy Laws of the United States: The Debtor's Fresh Start, 76 W. VA. L. REV. 427, 445-50 (1974); Lee, *supra* note 98, at 10-11; Comment, *Section 14f(2) of the Bankruptcy Act: Half a Loaf to the Bankrupt*, 14 HOUS. L. REV. 486, 495-99 (1977).

115. See, e.g., Lee, *supra* note 98, at 10.

116. That would certainly have been true to the extent that the difficulties encountered by debtors, even those arising from excess reliance on credit, were regarded as a function of matters essentially beyond their control. See, e.g., REPORT, *supra* note 5, at 55.

117. These points were usually made in objection to rehabilitation proposals. See *infra* notes 121-23 and accompanying text; see, e.g., REPORT, *supra* note 5 at 83; Walker, *Is Chapter XIII a Milestone on the Path to the Welfare State?*, 33 J. NAT'L ASSOC. REF. BANKR. 7 (1959); see also Wallace, *supra* note 95, at 473-74.

118. See, e.g., REPORT, *supra* note 5, at 158-59; D. STANLEY & M. GIRTH, *supra* note 2, at 38-39, 205; Countryman, *Proposed New Amendments for Chapter XIII*, 22 BUS. LAW. 1151, 1153 (1967); Lee, *supra* note 98, at 10.

119. See, e.g., Countryman, *supra* note 94, at 167-68; Shuchman, *The Fraud Exception in Consumer Bankruptcy*, 23 STAN. L. REV. 735, 739 & n.18 (1971).

120. See, e.g., REPORT, *supra* note 5, at 78-79, 80; see also D. STANLEY & M. GIRTH, *supra* note 2, at 208 (suggesting that use of nondischargeability to prefer claims other than those for support would unduly impede "fresh start").

121. See, e.g., S. ENZER, R. DEBRIGARD & F. LAZAR, *supra* note 98, at 8; Cowans, *supra* note 98, at 4-5; Cyr, *supra* note 107, at 338-39, 342-43, 345-46; Herzog, *supra* note 113, at 62-63; Seligson, *supra* note 102, at 105, 110-13; Note, *supra* note 103, at 1269-77. As noted by Judge Lee, the term "rehabilitation" as used in discussions of the "fresh start" suffers from serious ambiguity. Lee, *supra* note 98, at 13 n.12; see also Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 726 (1980). As sometimes

preference for a broadly drawn discharge and usually, although not inevitably, shared an aversion to express need or inability to pay criteria.¹²² Unlike the rescue approach, however, rehabilitation theory regarded the bankruptcy system as an appropriate vehicle for directly addressing the underlying causes of consumer financial difficulties. In part, the theory involved a revival of the distinction between the "improvident" and the "unfortunate" debtor.¹²³ It assumed that a significant and identifiable portion of the consumer bankruptcy population consisted of debtors whose difficulties were caused by financial incompetence, rather than simple economic vulnerability. The importance accorded the distinction was not, however, a matter of the discharge's *ex ante* incentive effects; it related, rather, to concern for the full *ex post* effectiveness of the "fresh start." In particular, rehabilitation theory assumed that the specific deficiencies involved in consumer defaults were capable of being identified and corrected by the institutions that administered the discharge. Indeed, the correction of those deficiencies was regarded as essential to assuring that the debtor's financial difficulties would not recur. Thus, proponents of the theory argued for reforms linking the discharge to the debtor's participation in some type of rehabilitative or therapeutic program appropriate to his circumstances. Precise recommendations as to the nature of the program varied widely, from consumer education through psychological counselling to long-term third party supervision of the debtor's finances, but all shared a relatively strong faith in the powers of training and education.

Set off against the rescue and rehabilitation versions of incompetence theory was the body of commentary in which the propriety and scope of relief measures were defined by economic theory and the economics of credit markets. Central to this approach was the now-familiar premise that contracts arrived at by parties in a competitive market could ordinarily be expected to reflect an optimal mix of contract terms which maximized the welfare of each party and minimized the total cost of the transaction. For the economic theorist, the existence or nonexistence of particular collection rights was an implied term in each credit contract. The content of

used, rehabilitation means no more than the debtor's return to a more or less debt-free condition, and it is in that weak sense essentially synonymous with the discharge from legal liability. More commonly, and as used here, it refers to the personal or psychological "rehabilitation" of the debtor's postbankruptcy values and behavior regarding credit.

122. See, e.g., Cowans, *supra* note 98, at 5-6.

123. See *supra* notes 72-73 and accompanying text.

that term would be expected to directly affect the creditor's costs by affecting his costs of collection and risks of noncollection.¹²⁴ Moreover, it was argued, the impact of those costs would not be borne by creditors but would be directly reflected in the cost of credit to borrowers in the form of interest rates, credit availability, security requirements, and the like. Thus, according to the theory, any expansion in the availability or extent of the bankruptcy discharge would, by narrowing collection rights and increasing creditors' costs, increase the cost of borrowing for consumers, or more precisely, the increased costs caused by borrowers availing themselves of the discharge would be borne by those borrowers who did not.¹²⁵ In the view of economic theory, this debtor-to-debtor subsidy effect of relief measures was necessarily incompatible with distributive explanations offered by those who proposed such measures.¹²⁶ More importantly, the nonwaivability of the discharge was regarded as, in effect, imposing a particular collection rights term and its attendant costs on all credit contracts without regard to the preferences of the parties; that is, each borrower was required to "buy" a particular degree of protection from collections whether or not he wanted it, and whether or not he regarded the protection as worth the increased price. Any increase in the scope of that compelled protection was troublesome to economic theorists because it necessarily involved a departure from the preferences of some consumers, resulting in less-than-optimal credit contracts and hence in decreased social welfare.¹²⁷

Carried to its logical conclusion, economic theory appeared to counsel the abolition of any discharge rights except those agreed to by the parties. Some critics came close to espousing that view.¹²⁸ Others were content simply to reject as theoretically or factually unsound the arguments of relief proponents based on consumer in-

124. See, e.g., R. JOHNSON, COST/BENEFIT ANALYSIS OF CREDITORS' REMEDIES 24-28 (Credit Res. Center, Purdue Univ. Monograph No. 12, 1978); Meckling, *supra* note 105, at 13-17, 21-23, 27-29; Trebilcock & Shulman, *supra* note 96, at 452.

125. See, e.g., Lynch, *Consumer Credit at Ten Per Cent Simple: The Arkansas Case*, 1968 U. ILL. L.F. 592; Meckling, *supra* note 105, at 23-24; Trebilcock & Shulman, *supra* note 96, at 452-53; Weistart, *supra* note 107, at 118-19; R. JOHNSON, *supra* note 124, at 34-35; A.C. SULLIVAN, THE RESPONSE OF COMMERCIAL BANKS TO RATE CEILINGS AND RESTRICTIONS ON REMEDIES ON CONSUMER CREDIT CONTRACTS 20-22 (Credit Res. Center, Purdue Univ., Working Paper No. 32, 1979).

126. See, e.g., Kripke, *supra* note 105, at 479; Weistart, *supra* note 107, at 119.

127. See, e.g., R. JOHNSON, *supra* note 124, at 34-37, 74-75; Meckling, *supra* note 105, at 29.

128. See, e.g., Meckling, *supra* note 105, at 29.

formation deficiencies, inequality of bargaining power, and the "ir-responsibility" of lenders.¹²⁹ More commonly, however, economic theorists sought to identify some function for the discharge that would be at least arguably compatible with efficiency considerations; thus, their operational recommendations tended to center on ways to frame the discharge so that it would serve the identified function in the least disruptive way. As was true of incompetence theory, these economic theories of the discharge came in essentially two versions.

In the first, the discharge was returned to its nineteenth-century role as an aid to the original purpose of the bankruptcy system, facilitating the collection efforts of creditors.¹³⁰ In contrast to the nineteenth-century model, however, the discharge was not conceived as a reward for the cooperative debtor. It was, rather, said to be a device by which creditors could efficiently discover that their debtor's financial circumstances rendered further collection efforts pointless.¹³¹ For the debtor, the advantage to the device would be the cessation of collections. For creditors, the discharge would remove uncertainty as to the value of continued collection effort and permit collection resources to be devoted to more productive uses. From that perspective, the credibility and hence utility of the discharge was directly dependent on its accuracy in identifying debtors who could appropriately be written off as uncollectible. Thus, in contrast to both brands of incompetence theory, this collections approach placed controlling emphasis on the debtor's actual capacity to pay, which included consideration of his future earnings possibilities.¹³² That emphasis was reflected rhetorically in appeals to the moral value of payment and to the creditor-payment objectives of the bankruptcy system.¹³³ Operationally, it blossomed in proposals to limit unconditional discharge to those truly *in extremis*, while affording relief in other cases, if at

129. See, e.g., Cayne & Trebilcock, *Market Considerations in the Formulation of Consumer Protection Policy*, 23 U. TORONTO L.J. 396, 418-19 (1973); Newton, *Economic Rationality of the Poor*, 36 HUM. ORG. 50 (1977); Schwartz, *Seller Unequal Bargaining Power and the Judicial Process*, 49 IND. L.J. 367 (1974); R. JOHNSON, *supra* note 124, *passim*.

130. See *supra* note 32 and accompanying text.

131. See, e.g., *Discussion*, *supra* note 96, at 150-51, 152-54, 170; MacLachlan, *supra* note 103; see also Weistart, *supra* note 107, at 110 (suggesting but not quite adopting this view).

132. Consistent with that emphasis, proponents of this approach did not ordinarily advocate sorting of debtors by the causes of their difficulties.

133. See, e.g., MacLachlan, *supra* note 103; Meth, *supra* note 107.

all, only upon the debtor's completion of a court-supervised payment plan.¹³⁴

The second version of economic theory posited a somewhat different function for the discharge, focusing on its influence at the time of contracting rather than at default. According to the theory, by limiting the debtor's liability at default, the discharge limited the risks the debtor bore at the time of contracting, particularly the risk that the actual condition of his finances when payment came due would fail to meet his expectations at the time he incurred the debt. As an initial matter, the theory held, the limitation increased the risk to the creditor, since the creditor would bear a greater loss if the contingency materialized. With other less risky lending alternatives available, it was pointed out, the creditor would only accept the added risk at a higher price for credit granted to the debtor and others similarly situated. Thus, the theory characterized the implicit discharge term in each credit contract as, in effect, compelling the debtor's purchase of insurance against the risk of adverse changes in his finances while the loan was outstanding, insurance which was paid for by an implicit premium in the price of the loan.¹³⁵ Viewed as insurance, the discharge could be said to perform the socially useful function of interpersonal risk spreading among debtors.¹³⁶ That characterization did not of itself, however, explain the compulsory nature of the risk allocation or define the appropriate contours of the "fresh start." For insurance theorists, both of those matters were ad-

134. See, e.g., Dolphin, *supra* note 93, at 29; Driver, *supra* note 105, at 47-48; MacLachlan, *supra* note 103, Meth, *supra* note 107; Twinem, *American Bar Association Approves Proposed Amendment to Bankruptcy Act*, 19 PERS. FIN. L.Q. REP. 109, 110 (1965). The most widely debated proposals were those that sought to limit "straight" (asset liquidation) bankruptcy to those consumers for whom a Chapter 13 plan would not be feasible. See generally *Hearings on H.R. 1057 and H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Cong., 1st Sess. (1967).

135. See, e.g., K. ARROW, *ESSAYS IN THE THEORY OF RISK-BEARING* 139-40 (1971) (discharge operates as substitute for insurance); R. POSNER, *ECONOMIC ANALYSIS OF LAW* 293 (2d ed. 1977) (discharge as risk allocation similar to corporate limited liability); G. TULLOCK, *THE LOGIC OF THE LAW* 54-55 (1971) (nonwaivability of discharge as limiting risks); Kripke, *supra* note 105, at 485 (discharge analogized to insurance); Weston, *Some Economic Fundamentals for an Analysis of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 47, 59-61 (1977) (discussion of discharge as insurance); see also *Discussion, supra* note 96, at 159-65 (analogy of discharge to risk-allocation function of impossibility doctrine in contract law); Weistart, *supra* note 107, at 110-12 (analogy of discharge to risk-allocation function of impossibility doctrine in contract law). The insurance characterization was not entirely novel. See 2 R. ELY, *PROPERTY AND CONTRACT IN THEIR RELATION TO THE DISTRIBUTION OF WEALTH* 730-31 (1914) (creditors ought not complain over discharge since they receive "in the price of an insurance premium with a higher rate of interest for deferred payments").

136. See, e.g., K. ARROW, *supra* note 135, at 141.

dressed by reference to the problem of "moral hazard." One effect of insurance coverage is to reduce the insured's incentive to avoid the peril insured against, together with a related increase in his incentive to unnecessarily avail himself of the insurance "pay-off."¹³⁷ In the context of bankruptcy, it was suggested, the existence of moral hazard explained at least in part the absence of markets in insurance against the perils dealt with by the discharge, and provided a rationale for intervention to achieve a nonmarket allocation of risks.¹³⁸ In addition, the need to limit moral hazard was viewed as an important determinant of the availability and scope of the discharge, since relatively easy access to relief could be expected to increase both excessive borrowing and excessive resort to bankruptcy.¹³⁹

Throughout the 1960's and 1970's, legislative and judicial development of the doctrines embodying the "fresh start" policy appeared to follow the assumptions and implications of the rescue version of incompetence theory. There were some notable exceptions, as in the 1977 addition of federally guaranteed student loans to the list of nondischargeable obligations.¹⁴⁰ More commonly, however, proposals to strengthen the hands of creditors in consumer bankruptcies (not infrequently attached to reminders of the system's creditor-payment objectives) simply languished for want of congressional interest.¹⁴¹ And when Congress did act, the statutory changes were ordinarily directed to expanding the effect of the discharge or to foreclosing creditors' opportunities to circumvent

137. See *infra* notes 223-27 and accompanying text (full discussion of moral hazard).

138. See, e.g., K. ARROW, *supra* note 135, at 140-43; see also J. LAFFONT, *ESSAYS IN THE ECONOMICS OF UNCERTAINTY* 87-102 (1980) (relative to insurance generally, advantage of government institution as device for acquiring information needed to reduce moral hazard); Pauly, *Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection*, 88 Q.J. ECON. 44, 44 (1974) (advantage of government institution as device for acquiring information needed to reduce moral hazard).

139. See, e.g., Kripke, *Collection Spite, An End to Academic Overreaction, and the Next Curricular Step*, 33 U. PRIT. L. REV. 681, 687 (1972) (amending the views expressed in Kripke, *supra* note 105, at 480 n.101); Trebilcock & Shulman, *supra* note 96, at 465; Weisbart, *supra* note 107, at 121. *But see* Weston, *supra* note 135, at 59-61 (suggesting that bankruptcy law suffers from an "overproduction" of moral hazard controls).

140. Act of Oct. 12, 1976, Pub. L. No. 94-482, § 439(a), 90 Stat. 2141 (formerly codified at 20 U.S.C. § 1087-3 (repealed 1978)). Under the amendment, guaranteed student loans became dischargeable after the expiration of five years from the due date of the debtor's first payment, and they were dischargeable within the five-year period if the bankruptcy court determined that payment would impose "an undue hardship on the debtor or his dependents." *Id.*

141. See *supra* notes 130-34 and accompanying text.

its effects. The 1970 discharge amendments,¹⁴² for example, effectively deprived state courts of jurisdiction to decide the claims of nondischargeability most commonly invoked in consumer cases. Under the amendments, creditors who failed to raise claims of fraud and of "willful and malicious" injury in a bankruptcy case were barred from later litigation of the issue. Moreover, the discharge was not, as it traditionally had been, merely a waivable affirmative defense to such claims in later proceedings. It functioned, rather, as an injunction against any subsequent judicial collections activity and rendered any judgment on the discharged claim "null and void."¹⁴³ The express point of these procedural and doctrinal changes was to compensate for the perceived inability of consumer debtors to enforce their discharge rights after bankruptcy: far too many of them, according to the legislative history (and in accord with the tenets of rescue theory), were too ignorant or too poor to protect their interests after bankruptcy.¹⁴⁴

A similar orientation to broadening the effectiveness of the discharge and reducing the postbankruptcy leverage of creditors was apparent in judicial doctrines as well. Thus, statements of the "fresh start" policy evidenced a subtle shift away from productivity incentives to a far less-focused emphasis simply on complete relief from prebankruptcy claims,¹⁴⁵ an emphasis that did not admit of much in the way of limitations or countervailing policy concerns. That altered vision of the policy was more than merely rhetorical. In *Lines v. Frederick*,¹⁴⁶ for example, the Supreme Court held that a wage earner's nonexempt vacation pay, earned but not yet paid, was nonetheless not subject to creditors' claims in bankruptcy, since it would detract from the "fresh start" if the debtor's postdischarge leisure were burdened with predischarge obligations.¹⁴⁷ Likewise, in *Perez v. Campbell*,¹⁴⁸ the Court held that, at least in some circumstances, the Supremacy Clause precluded enforcement of state motor vehicle financial responsibility laws relative to debtors whose accident liabilities had been discharged in

142. Act of Oct. 19, 1970, Pub. L. No. 91-467, 84 Stat. 990.

143. *Id.* §§ 2, 7, 84 Stat. at 990-92 (amending Bankruptcy Act of 1898, ch. 541, §§ 14(b), 17, 30 Stat. 544, 550-51, as amended).

144. H.R. REP. No. 1502, 91st Cong., 2d Sess. 1-2 (1970), reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS 4156, 4156-57.

145. See, e.g., *Lines v. Frederick*, 400 U.S. 18, 20 (1970).

146. *Id.*

147. *Id.* at 20.

148. 402 U.S. 637 (1971).

bankruptcy. According to the Court, the broad relief contemplated by the "fresh start" policy was incompatible with the post-bankruptcy leverage afforded tort claimants by such otherwise valid statutes.¹⁴⁹

Taken together, these and similar changes in the legal and doctrinal structure of the "fresh start"¹⁵⁰ tended to establish the precedence of rescue theory as a description of the "official" policy of the consumer discharge. The virtually complete (albeit temporary) triumph of that theory came with the enactment of the Bankruptcy Code in 1978.¹⁵¹

As has often been said, the most notable characteristic of the Code in the consumer setting was the generous availability and breadth of the "fresh start" it afforded the bankrupt debtor.¹⁵² There were, to be sure, various statements in the legislative history that offered at least a nod to the view of collections theorists that the consumer bankruptcy system should facilitate payments to creditors.¹⁵³ But in the statute itself, as applied to consumer debtors, expressions of that policy were difficult to find. Thus, as had prior law, the Code imposed no express criterion of need or inability to pay as a precondition to discharge.¹⁵⁴ The drafters were not entirely unresponsive to the problems posed by the human capital of future earnings in consumer cases. Their response, however, took a form consistent with the view of rescue theory that limits on the availability of the discharge would defeat its primary function of effectively extricating the overburdened from their debts.

In particular, the Code offered the consumer debtor a choice of bankruptcy proceedings: Chapter 7, in which the discharge was, as it had been in the past, dependent only on the surrender of nonexempt assets, without consideration of earnings capacity;¹⁵⁵ and

149. *Perez*, 402 U.S. at 649-51.

150. *See, e.g.*, Act of July 12, 1960, Pub. L. No. 86-621, § 1, 74 Stat. 408 (amending Bankruptcy Act of 1898, ch. 541, § 14, 30 Stat. 541, 550 (limiting to business cases the denial of discharge for obtaining credit by use of a false financial statement)).

151. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985)).

152. *See supra* note 8.

153. *See, e.g.*, S. REP. No. 989, 95th Cong., 2d Sess. 12, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5798.

154. *See* 11 U.S.C. § 301 (1982) (commencement of case constitutes an order for relief); *see also* S. REP., *supra* note 153, at 94, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5880 (dismissal provision "does not contemplate . . . that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal").

155. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. at 2604 (codified as

Chapter 13, in which the debtor could substitute earnings for assets as the price or the discharge, retaining even his nonexempt property while carrying out a plan of partial or full repayment of debts over a period of up to five years.¹⁵⁶ The choice between these options was left entirely to the debtor, the sole directive force of the Code being the greater attractiveness of Chapter 13 for some kinds of debtors.¹⁵⁷ Thus, there were only minimal express constraints on the amount of earnings required to be devoted to payments under a Chapter 13 plan.¹⁵⁸ Similarly, the Chapter 13 discharge included all of the debtor's liabilities except tax liabilities and family support obligations,¹⁵⁹ while in Chapter 7 at least some claims that had traditionally been nondischargeable (such as some tax obligations, and liabilities for fraud or for malicious injuries) continued to survive bankruptcy.¹⁶⁰ But these and other attractions of Chapter 13 operated solely as incentives, and the choice between earnings and assets remained the debtor's.

The influence of rescue theory apparent in the Code's cautious handling of the human capital problem was evident as well in the statutory provisions defining the scope and effect of the discharge in both Chapter 7 and Chapter 13 cases. Most of all, those provi-

amended at 11 U.S.C. §§ 701-66 (1982 & Supp. II 1984)).

156. *Id.* at 2645 (codified as amended at 11 U.S.C. §§ 1301-30 (1982 & Supp. II 1984)).

157. The choice remained the debtor's because there could be no involuntary petitions under Chapter 13. *See* 92 Stat. at 2559 (codified at 11 U.S.C. § 303(a) (1982)). A Chapter 7 case could not be converted to a Chapter 13 case except on the debtor's request. *See* 92 Stat. at 2606 (codified at 11 U.S.C. § 706(c) (1982)). The greater attractions of Chapter 13 included not only a broader discharge, *see infra* notes 159-60 and accompanying text, but also a stay of collection actions directed against codebtors of the bankrupt debtor, 92 Stat. at 2645 (codified at 11 U.S.C. § 1301 (1982)) (amended 1984), and a stay of enforcement action by holders of security interests in (or other liens on) the debtor's property. *Id.* at 2570 (codified at 11 U.S.C. §§ 362(a)(4), 1301 (1982) (§ 1301 amended Supp. II 1984)); *see also infra* notes 159-60 and accompanying text.

158. *See* 92 Stat. at 2649 (codified at 11 U.S.C. § 1325(a)(4) (1982 & Supp. II 1984)) (requiring that the plan provide for payments having a present value at least equal to what the creditor would have received under Chapter 7); *see also infra* notes 185-95 and accompanying text (discussing use of "good faith" requirement, 92 Stat. at 2648 (codified at 11 U.S.C. § 1325(a)(2) (1982)), to require payments beyond the § 1325(a)(4) minimum).

159. Family obligations were expressly made nondischargeable. 92 Stat. at 2650 (codified at 11 U.S.C. § 1328(a) (1982)) (excepting from Chapter 13 discharge the support obligations described in § 523(a)(5)). Tax liabilities, while technically dischargeable in Chapter 13, were effectively nondischargeable by reason of their status as priority claims, 92 Stat. at 2584 (codified at 11 U.S.C. § 507(a)(6) (1982)) (renumbered as (a)(7), Supp. II 1984), since the Code required that each plan provide for payment of priority claims in full. *Id.* at 2648 (codified at 11 U.S.C. § 1322(a)(2) (1982)).

160. *See Id.* at 2590, 2610 (codified as amended at 11 U.S.C. §§ 523(a) & 727(b) (1982 & Supp. II 1984)).

sions manifested an overriding concern with assuring the practical effectiveness of the relief afforded by the discharge. Thus, the injunctive effect introduced by the 1970 amendments was extended beyond judicial collections to forbid "any act" by a creditor to recover a discharged debt.¹⁶¹ Similarly, the *Perez*¹⁶² doctrine was codified and expanded as a general prohibition of governmental discrimination against debtors who had filed bankruptcy or whose debts had been discharged.¹⁶³ Likewise, the range of nondischargeable debts in Chapter 7 cases was smaller than it had been under the Act,¹⁶⁴ and exemption rights were bolstered by affording the debtor the power to avoid nonpossessory, nonpurchase money liens on exempt property.¹⁶⁵

At the same time, these evident concerns with the effectiveness of the discharge were accompanied by provisions that, consistently with rescue theory, manifested a lack of faith in the average debtor's economic competence. Thus, the long-standing nonwaivability of the right to discharge¹⁶⁶ was accompanied by new provisions rendering unenforceable any prebankruptcy waivers of exemption rights or lien avoidance powers, state law to the contrary notwithstanding.¹⁶⁷ Even more striking in that regard were the provisions governing reaffirmations. Under the Code, the debtor was disabled from entering any enforceable reaffirmation after discharge, and postbankruptcy agreements entered into prior

161. *Id.* at 2592 (codified at 11 U.S.C. § 524(a)(2) (1982 & Supp. II 1984)).

162. *Perez v. Campbell*, 402 U.S. 637 (1971) (discussed *supra* notes 148-49 and accompanying text).

163. 92 Stat. at 2593 (codified as amended at 11 U.S.C. § 525 (Supp. II 1984)).

164. In particular, the Code abolished the nondischargeability of wage claims and of liabilities for criminal conversation, seduction, and breach of a promise to marry accompanied by seduction. *Id.* at 2591 (codified as amended at 11 U.S.C. § 523(a) (1982 & Supp. II 1984)); see *supra* notes 46-47 and accompanying text. In addition, the Code eliminated "provability" as an element of dischargeability, see *supra* note 39 and accompanying text, and substituted a broadly drawn definition of "claim" as including any right to payment. 92 Stat. at 2550 (codified at 11 U.S.C. § 101(4) (1982)); see also *Ohio v. Kovacs*, 469 U.S. 274 (1985)). Thus, previously nondischargeable (because not "provable"), unliquidated pure tort claims became subject to discharge. Liabilities for fines and penalties, which were ordinarily not regarded as provable "debts" under the Act, see *supra* note 39, came within the Code definition of "claim" but were added to the list of specific exceptions from discharge. 92 Stat. at 2591 (codified at 11 U.S.C. §§ 523(a)(7) (1982)).

165. 92 Stat. at 2589 (codified at 11 U.S.C. § 522(f) (1982)).

166. Under the Act, prebankruptcy waivers of discharge were denied enforcement as contrary to public policy. See 7 H. REMINGTON, *supra* note 51, § 2997. That rule was made statutory by the Code. 92 Stat. at 2610 (codified at 11 U.S.C. § 727(a)(10) (1982)) (discharge to be granted unless court approves written postfiling waiver).

167. 92 Stat. at 2588 (codified at 11 U.S.C. § 522(e) (Supp. II 1982)).

to discharge could be enforced only if approved by the court on a finding that reaffirmation was in the debtor's "best interest" and would not impose an "undue hardship."¹⁶⁸

E. *The Retreat from Rescue Theory: The 1984 Bankruptcy Amendments Act*

As had been true of the 1898 Act, the adoption by the Code of a specific approach to debtor relief by no means served to end discussion of the matter. The quality and direction of the postenactment debates were shaped by several related developments that, while perhaps foreseeable, were nonetheless not foreseen. Prime among these was an apparently sudden and undoubtedly large increase in the number of consumer bankruptcy filings almost immediately following the Code's effective date.¹⁶⁹ While the existence or extent of any causal relation between the Code and the increased filings was a matter of some dispute,¹⁷⁰ the timing was at least enough to command serious attention. Accompanying the increased filings was a spreading concern (or at least suspicion) that some significant portion of consumers resorting to bankruptcy might be doing so in the absence of "real need," obtaining a discharge notwithstanding a capacity to repay and an absence of financial distress.¹⁷¹ At the same time, the case reports began to in-

168. *Id.* at 2592 (codified as amended at 11 U.S.C. § 524(c), (d) (1982 & Supp. II 1984)). In 1984, the requirement of judicial consent was abolished as to reaffirmations by debtors with counsel. 11 U.S.C. § 524(c), (d) (Supp. III 1985).

169. See BANKRUPTCY STATISTICAL TABLES, *supra* note 92, at iii (196,976 nonbusiness cases filed in fiscal year 1979, the last full year governed by the Act; in fiscal year 1980, 314,856 debtors filed nonbusiness cases; and in fiscal year 1981, 452,145).

170. Compare *Bankruptcy Reform Act of 1978, Hearings Before the Subcomm. on Courts of the Comm. on the Judiciary (part 1)*, 97th Cong., 1st Sess. 18 (1981) (statement of Andrew Brimmer estimating "conservatively" that "between 136,000 and 150,000 'excess' bankruptcies" followed in the five quarters after enactment of the Code) [hereinafter *Reform Act Hearings*] and A.C. SULLIVAN, ECONOMIC FACTORS ASSOCIATED WITH PERSONAL BANKRUPTCIES 16 (Credit Research Center, Purdue Univ., Working Paper No. 47, 1983) ("[a]bout half" of 1982 filings (i.e., about 200,000 filings) attributable to the increased generosity of the Code) and Shepard, *Personal Failures and the Bankruptcy Reform Act of 1978*, 27 J. L. & Econ. 419, 435 (1984) (effect of Code to double the annual number of filings) with GAO STUDY, *supra* note 2, at 16-17 (Code accounts for no more than 12% of total 1982 filings and could be less if factors such as attorney advertising could be estimated). See also A.C. SULLIVAN, ASSET EXEMPTIONS AND PROPENSITY TO FILE PERSONAL BANKRUPTCY (Credit Research Center, Purdue Univ., Working Paper No. 44, 1982) (concluding that higher exemption levels increase tendency to file bankruptcy); Woodward & Woodward, *Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study*, 57 AM. BANKR. L.J. 53 (1983) (finding no correlation between exemption levels and bankruptcy rates).

171. See, e.g., *Future Earnings Hearings*, *supra* note 2, *passim*. At the center of the sus-

dicare both the apparent manipulability and the attractiveness of the Code's broadened "fresh start," while also heightening consciousness of the general absence of enforceable limits on access to its benefits.¹⁷²

These concerns were evident in a number of settings but they crystallized in particular around two specific statutory issues: whether to impose some variety of need criterion in Chapter 7 cases, and whether to adopt a more stringent minimum-payments requirement in Chapter 13 cases. In the debates over both issues, the underlying assumptions and theoretical frameworks that had evolved in preCode analyses were evident yet again, but with some significant differences. The most obvious change in the academic commentary was a widening acceptance of the terminology and, to a lesser extent, the implications of pre- and postCode economic critiques. There were, to be sure, continued contributions by unreconstructed rescue or rehabilitation theorists, for whom the central concerns of discharge policy were distributive justice, the irresponsibility of creditors, or the economic vulnerability of debtors.¹⁷³ There was likewise a continuing production of rhetoric framed in terms of moral arguments, addressing either the obligations of just debts¹⁷⁴ or the putative "wage slavery" of the excessively indebted.¹⁷⁵ More commonly, however, the postCode dispu-

picion was the widely cited "Purdue Study," the authors of which concluded that "depending on the assumptions made [regarding living expenses and repayment periods], 15 percent to 30 percent of bankruptcy debtors probably could repay all of their nonmortgage debts out of their future income." CREDIT RESEARCH CENTER, KRANNERT GRADUATE SCHOOL OF MANAGEMENT, CONSUMER BANKRUPTCY STUDY Vol. I, CONSUMERS' RIGHT TO BANKRUPTCY: ORIGINS AND EFFECTS 72 (PURDUE UNIVERSITY MONOGRAPH No. 23 (1982)) [hereinafter CONSUMER BANKRUPTCY STUDY]. Not infrequently, the conclusion was repeated in terms solely of the high end of the range, and without the qualifying language. See, e.g., *Future Earnings Hearings*, supra note 2, at 19 (testimony of Robert Johnson, director of the Purdue study: "We did find that . . . 29 percent could have repaid all of their nonmortgage debts in full in a 60-month period."). The methodology and conclusions of the study are extensively criticized in Sullivan, Warren & Westbrook, *Limiting Access to the Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WIS. L. REV. 109 [hereinafter *Limiting Access*]; see also Sullivan, *Reply: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1069 (defense of the study) [hereinafter *Reply*]; Sullivan, Warren & Westbrook, *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1087 [hereinafter *Rejoinder*].

172. See, e.g., cases cited *infra* note 185.

173. See, e.g., *Future Earnings Hearings*, supra note 2, at 129-34; Ayers, supra note 3; Countryman, supra note 3; Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*, 30 UCLA L. REV. 327 (1982).

174. See, e.g., *Future Earnings Hearings*, supra note 2, at 219 (statement of Paul G. Tongue, Chase Manhattan Bank); *Reply*, supra note 171, at 1076-77; Young, *The "Straight" Bankruptcy Ripoff*, 35 PERS. FIN. L.Q. REP. 131 (1981).

175. See, e.g., *Future Earnings Hearings*, supra note 2, at 141-42 (statement of Vern

tants were likely to share at least some common assumptions, although in ways that sharpened the focus of their differences.

One common theme was an increasing acceptance (if only for the sake of argument) of the risk-allocation or insurance characterization of the discharge posited by economic theorists,¹⁷⁶ together with a related tendency to incorporate as accurately the economists' views of the debtor-to-debtor transfer effects of relief measures.¹⁷⁷ A byproduct of this development was increased attention to explaining the compulsory aspect of the discharge "insurance," that is, to offering justifications for the rules of nonwaivability governing particular facets of the "fresh start."¹⁷⁸ It was suggested that interference with debtors' insurance choices might be warranted in order to limit the externalities related to collections—productivity losses or social insurance costs¹⁷⁹—or due to the perceived limits on the capacity of consumer debtors to rationally account for the risks of default in credit decisions.¹⁸⁰

Countryman suggesting that the effect of limiting access would be "to enact a mass peonage statute"); *Limiting Access*, *supra* note 171, at 1146 ("We should not permit purveyors of high risk credit to lure the undisciplined further into debt and then to use the great, expensive engine of the law to collect their debts by making the undisciplined live for five years at the poverty level."). Efforts to assimilate the burdens of the indebted to the condition of slaves (and hence to characterize relief as the moral equivalent of abolition) have been a part of bankruptcy debates for more than a century. *See, e.g.*, CONG. GLOBE, 27th Cong., 1st Sess. 318 (1841) (remarks of Rep. Roosevelt quoted *supra* note 25).

176. *See, e.g.*, Eisenberg, *supra* note 8, at 981-83; Jackson, *supra* note 5, at 1399-401; *Limiting Access*, *supra* note 171, at 1142; Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 776 (1983); LoPucki, "Encouraging" Repayment Under Chapter 13 of the Bankruptcy Code, 18 HARV. J. ON LEGIS. 347, 386-87 (1981); Rendleman, *supra* note 8, at 726; *Reply*, *supra* note 171, at 1070-73.

177. *See, e.g.*, Harris, *supra* note 173, at 364 n.203; LoPucki, *supra* note 176, at 386-87; *Rejoinder*, *supra* note 171, at 1096. Notably, at least some commentators with a bent toward economic analysis tended to be less confident than their peers about the incidence of costs. *See, e.g.*, *Reform Act Hearings*, *supra* note 170, at 42 (testimony of Jonathon Landers suggesting that "in many cases" lenders are unable to pass on costs to other consumers); Jackson, *supra* note 5, at 1421, 1427 n.111 (noting that the extent to which costs of discharge are borne by debtors as a group is a matter of "some debate").

178. *See, e.g.*, Jackson, *supra* note 5, at 1404-24; Kronman, *supra* note 176, at 776, 778, 785-86; Rea, *Arm-Breaking, Consumer Credit, and Personal Bankruptcy*, 22 ECON. INQUIRY 188 (1984). Notably, with the exception of Professor Jackson (and as pointed out by him, *supra* note 5, at 1394), commentators who addressed the issue of compulsion did not tend to extend their analysis to derive guidance as to the specific contours of discharge rights.

179. *See, e.g.*, Jackson, *supra* note 5, at 1401-04, 1418-24; *Limiting Access*, *supra* note 171, at 1133-34, 1141-42.

180. *See, e.g.*, Farber, *Contract Law and Modern Economic Theory*, 78 NW. U.L. REV. 303, 335-38 (1983); Jackson, *supra* note 5, at 1408-18; *see also* Kronman, *supra* note 176, at 785-86 (arguing that changes in personality and goals over time render earlier decisions irrational from later perspective, and that relief from performance is appropriate to limit demoralization attendant on enforced pursuit of goals that have become irrational or abhorrent).

Within the framework of their common assumptions, the differences between the various approaches to the "fresh start" were narrowed in large part to differences over the moral hazard or incentive effects of the discharge. In particular, these differences related to the existence or significance of discharge-created incentives for the debtor either to overextend himself in the first place or, once indebted, to resort to bankruptcy in the absence of need. For the heirs of rescue theory, as for the predecessors, the former incentives were *de minimis*, and while the latter were more plausible, it remained in their view neither possible nor desirable to address them by means of limits on the availability or the breadth of the discharge. Rather, it was argued, the risk-distribution function of the "fresh start" could be accomplished only by means of a broadly drawn and readily accessible discharge.¹⁸¹ For the post-Code economic theorists, by contrast, both kinds of moral hazard were real. And, while concerns with prebankruptcy incentives to incur debt were somewhat muted,¹⁸² the impact of the Code's provisions on "unnecessary" filings was regarded as particularly troublesome.¹⁸³ The control of those incentives, it was argued, was essential to the proper functioning of the discharge system and could be accomplished only by limiting the availability or attractiveness of relief in bankruptcy.¹⁸⁴

The legal system's response to these conflicting visions of the "fresh start" was largely ambiguous. For the judiciary, the dispute was played out in several contexts, but the tensions inherent in the "fresh start" policy were probably most obvious in the brief but lively controversy over the so-called "*de minimis*" Chapter 13 plan. Under such a plan, a debtor would propose to pay nominal amounts, or even nothing, to his creditors.¹⁸⁵ The Code itself re-

181. See, e.g., *Future Earnings Hearings*, *supra* note 2, at 129-35 (statement of Ellen Broadman, Consumers Union); Ayers, *supra* note 3; Harris, *supra* note 173, at 351-60; *Limiting Access*, *supra* note 171, at 1141; LoPucki, *supra* note 176, at 387-88; Rendleman, *supra* note 8, at 749-50. See generally Countryman, *supra* note 3.

182. See, e.g., *Future Earnings Hearings*, *supra* note 2, at 12 (testimony of James Barr, Credit Union National Association, that discharge is appropriate "even [for those debtors] who may have arrived at that condition [of financial difficulty] due to the unwise use of credit"). But see Eisenberg, *supra* note 8, at 979-80; Shepard, *supra* note 170, at 437.

183. See, e.g., *Future Earnings Hearings*, *supra* note 2, *passim*.

184. See, e.g., Brimmer, *Economic Implications of Personal Bankruptcies*, 35 PERS. FIN. L.Q. REP. 187, 191 (1981); Eisenberg, *supra* note 8, at 976-88; Evans & Johnson, *Proposals for Consumer Bankruptcy Reform*, 37 BUS. LAW 1117 (1982); *Reply*, *supra* note 171, at 1071-73; Young, *supra* note 174.

185. See, e.g., *In re Johnson*, 6 Bankr. 34 (Bankr. N.D. Ill. 1980); *In re Berry*, 5 Bankr.

quired only that the present value of any objecting creditor's proposed receipts under the plan be at least equal to the amount which he would have received under Chapter 7,¹⁸⁶ a requirement usually referred to as the "best interests of creditors" test. For the asset-poor but income-earning consumer debtor, the proposed payment of nothing or next to nothing could easily satisfy that standard, leaving his income free and affording him the benefit of Chapter 13's substantial advantages over Chapter 7 in such matters as the scope of the discharge and the treatment of secured claims.¹⁸⁷ According to a number of objecting creditors, however, a nominal payments plan that satisfied the "best interests" test would nonetheless violate the Chapter 13 requirement of "good faith,"¹⁸⁸ since it would permit a debtor to sacrifice neither assets nor income, yet capture benefits that were legislatively intended to be bought with earnings.

The matter was ultimately addressed by Congress in the 1984 Bankruptcy Amendments Act,¹⁸⁹ but in the interim the courts of appeals (with one exception) arrived at a consensus of sorts.¹⁹⁰ Those courts firmly eschewed any reliance on particularized or *per*

515 (Bankr. S.D. Ohio 1980). The *de minimis* plans generated an immense body of law review commentary and thus may have posed less threat to the interests of creditors than they did to the forests of the Pacific northwest. Among the more helpful discussions are Cyr, *The Chapter 13 "Good Faith" Tempest: An Analysis and Proposal for Change*, 55 AM. BANKR. L.J. 271 (1981); LoPucki, *supra* note 176; Vukowich, *Reforming the Bankruptcy Act of 1978: An Alternative Approach*, 71 GEO. L.J. 1129, 1135-38 (1983); Note, "Good Faith" and Confirmation of Chapter 13 Composition Plans: Analysis and a Proposal, 65 MINN. L. REV. 659 (1981); see also W. DRAKE & J. MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE § 11.04 (1983).

186. 92 Stat. at 2649 (codified at 11 U.S.C. § 1325(a)(4) (1982)).

187. See *supra* note 157 and accompanying text.

188. 92 Stat. at 2649 (codified at 11 U.S.C. § 1325(a)(3) (1982)).

189. Bankruptcy Amendments Act of 1984, *supra* note 7.

190. See *In re Hines*, 723 F.2d 333 (3d Cir. 1983); *Flygare v. Boulden*, 709 F.2d 1344 (10th Cir. 1983); *Johnson v. Vanguard Holding Corp.*, 708 F.2d 865 (2d Cir. 1983); *Kitchens v. Georgia R.R. Bank & Trust Co.*, 702 F.2d 885 (11th Cir. 1983); *United States v. Eustus*, 695 F.2d 311 (8th Cir. 1982); *Deans v. O'Donnell*, 692 F.2d 968 (4th Cir. 1982); *Goeb v. Heid*, 675 F.2d 1386 (9th Cir. 1982); *Ravenot v. Rimgale*, 669 F.2d 426 (7th Cir. 1982). The exception was the District of Columbia Circuit, which concluded that the "good faith" limitation was (like its predecessors under the Act) addressed to misconduct in securing approval of the plan, rather than to its contents, and that payment levels were therefore irrelevant to confirmation. *Barnes v. Whelan*, 689 F.2d 193, 198-99 (D.C. Cir. 1982). Plans that proposed to make *no* payments to creditors (as opposed to some amount, however small), raised distinct problems, since they arguably failed to meet the eligibility requirement for Chapter 13 that the debtor have "income . . . sufficiently stable and regular to enable such individual to make payments under a plan." 92 Stat. at 2552 (formerly codified at 11 U.S.C. § 101 (1982), presently codified at 11 U.S.C. § 101(27) (Supp. III 1985)) (emphasis added); see also *Tenny v. Terry*, 630 F.2d 634 (8th Cir. 1980).

se tests of the relation between payment levels and "good faith," holding instead that the inquiry was whether the debtor's plan was compatible with the "purposes and spirit" of Chapter 13.¹⁹¹ Among those purposes, it was said, were both the "fresh start" and "payments to creditors."¹⁹² Notably, the facts universally cited as material to the "good faith" inquiry included not only payment levels but also the amount of the debtor's surplus income beyond expenses and plan payments, as well as benefits he would derive from provisions peculiar to Chapter 13.¹⁹³ A nominal-payments plan, it was held, might at times be compatible with the Chapter's "purposes and spirit." At least to some extent, however, the availability of the Chapter's benefits could indeed be made dependent on the debtor's surrender of some surplus income to his creditors. The decision as to which of those principles would apply to any given plan was left to the "discretion" of the trial courts, for decision on a "case-by-case" basis.¹⁹⁴

To the extent that the *de minimis* decisions rejected claims of a necessary link between Chapter 13 relief and the level of a debtor's payments to his creditors, they appeared to be in full accord with the theoretical underpinnings of the Code's failure to limit the accessibility of the consumer "fresh start." At the same time, to the extent that, in the name of payments to creditors, they permitted relief to be conditioned on the state of the debtor's income or his apparent capacity to pay, the decisions necessarily involved a retreat from the full implications of that failure. The courts' inability to reconcile the essential conflict of these considerations was most evident in their utter failure to suggest a means of sorting the "good" *de minimis* plans from the "bad"; trial courts were carefully told what factors to consider, but offered no analytical framework for assessing those considerations.¹⁹⁵

A similar ambivalence marked the eventual legislative response to the post-Code debates, which took the form of Code amendments contained in the Bankruptcy Amendments Act of 1984.¹⁹⁶

191. *Ravenot*, 669 F.2d at 431.

192. *See, e.g., Deans*, 692 F.2d at 972.

193. *See, e.g., id.; Kitchens*, 702 F.2d at 888-89.

194. *Ravenot*, 669 F.2d at 431.

195. *Cf. W. DRAKE & J. MORRIS, supra* note 185 § 11.04, at 11-10 (noting the difficulties posed by the vagueness of the standard, but concluding that the appellate decisions "should be sufficient to guide the bankruptcy courts").

196. Bankruptcy Amendments Act of 1984, *supra* note 7. The amendments directed to consumer bankruptcies are extensively reviewed in Morris, *Substantive Consumer Bank-*

That enactment incorporated some provisions enlarging the scope and effect of the discharge, most notable among them an expansion of the prohibition against governmental discrimination to include private employers as well.¹⁹⁷ Apart from those limited expansions, however, the dominant character of the amendments in consumer cases was a somewhat hesitant effort to narrow the availability of the discharge. The amendments stopped far short of embracing proposals to impose some variety of express inability-to-pay standard of eligibility for relief.¹⁹⁸ Instead, the matter was addressed by two related modifications of the Code. First, in Chapter 7 consumer proceedings, the courts were empowered to dismiss a case on a finding that the granting of relief would be a "substantial abuse" of Chapter 7's provisions.¹⁹⁹ The relevance of that phrasing to the debtor's need for relief was arguably suggested by the addition of an income and expense statement to the list of schedules required to be filed with Chapter 7 petitions.²⁰⁰ Second, in Chapter 13 cases, plan confirmation over the objection of the trustee or the holder of an impaired claim was conditional on the debtor's devoting "all" of his "projected disposable income" for three years to payments under the plan.²⁰¹

The Chapter 13 amendment had an obvious impact on the question of *de minimis* plans. More fundamentally, the two amendments taken together had the net effect of permitting the accessibility of the "fresh start" to be limited (for the first time in American bankruptcy law) by a judicial assessment of the debtor's need for relief. As were the courts of appeals before them, however, the drafters were neither prepared to define the concept of need

ruptcy Reform in the Bankruptcy Amendments Act of 1984, 27 WM. & MARY L. REV. 91 (1985).

197. 11 U.S.C. § 525(b) (Supp. III 1985).

198. See, e.g., *Future Earnings Hearings*, *supra* note 2, at 6 (National Coalition of Bankruptcy Reform proposal to permit Chapter 7 relief for individuals "only if [the debtor] cannot pay a reasonable portion of his debts out of anticipated future income"); *Reform Act Hearings*, *supra* note 170, at 84-85 (consumer credit industry proposal to except from Chapter 7 discharge any "contractual consumer debts," with provision for case-by-case allowance of discharge "in whole or pro rata part" on a judicial finding that "the debtor's failure or inability to repay such debts is due to circumstances for which the debtor should not justly be held accountable").

199. 11 U.S.C. § 707(b) (Supp. III 1985).

200. *Id.* § 521(1).

201. *Id.* § 1325(b)(1). "Disposable income" was in turn defined as the amount of income received by the debtor in excess of that "reasonably necessary to be expended" for the support of the debtor and his dependents and for the operation of the debtor's business, if any. *Id.* § 1325(b)(2).

nor even to require its consideration in every case. The standard was, rather, framed in statutory phrasings of amorphous or at least ambiguous content; and in Chapter 7 cases the trial courts were merely authorized, and not required, to apply the standard as phrased. In short, Congress having briefly experimented with a relatively unequivocal vision of the "fresh start" policy, appears to have become troubled by what it wrought and to have retreated to the familiar comforts of statutory obscurity.

III. THE "FRESH START" AND THE BANKRUPTCY CODE: AN INTERPRETIVE THEORY

The evolution of the "fresh start" policy and its legislative embodiments suggests, if nothing else, that it is a bit of an oversimplification to speak of that policy in the singular. It is apparent, rather, that the idea of the "fresh start" has long incorporated and been shaped by a complex multiplicity of policy concerns, which have been founded in turn upon equally complex and often shifting combinations of assumptions about creditors, debtors, credit markets, and the social function of bankruptcy. As did prior incarnations of the policy, the Code provisions governing the availability and effect of the discharge necessarily express a particular vision of those concerns and assumptions. At the same time, there are questions under the Code that can be answered sensibly only by reference to statutory purposes and policies. Thus, for the judiciary, the task of deriving a relatively clear and coherent theory of the "fresh start" from its legislative expression is an integral, indeed unavoidable, part of administering the statute.

The task of describing the content of the "fresh start" is complicated, however, by the historical variety and complexity of the policy. Of course, one can readily enough catalog the various concerns and assumptions that have been thought to be material in the past and that appear to have some bearing on the present state of a debtor's discharge rights. That was essentially the approach taken by the courts of appeals in the *de minimis* plan decisions, instructing trial courts to take into account a number of competing considerations: the debtor's ability to pay, the level of payments to creditors, the circumstances in which particular debts were incurred, and so on.²⁰² But, as becomes clear when one attempts to apply those decisions to particular cases, a mere listing of the rele-

202. See *supra* notes 190-95 and accompanying text.

vant considerations falls well short of providing an interpretively useful definition or theory of the "fresh start." The problem is that the full implications of any given consideration are likely to be incompatible both with other considerations and with the Code itself. Simply lumping competing or opposed concerns together suggests that each may be limited by the others, but it offers no means for sorting out how or in what degree any such adjustments are to be made. Thus, in order to provide genuine guidance in the interpretation of the Code, a judicial theory of the "fresh start" must not merely identify the components of the policy. It must, in addition, specify the relationships between those components, organizing the disparate strands of the "fresh start" into a coherent and integrated account of the debtor-relief objectives of bankruptcy as they exist under the Code.

The starting point for such an interpretive theory is the Code itself. The empirical assumptions and policy concerns underlying the Code's "fresh start" can be identified by two lines of inquiry. First is an analysis of the scope and effect of the Code's discharge provisions as they operate in fact, which may or may not correspond with various theories as to how they ought to operate. Second is an examination of the Code's limitations on the waivability of the "fresh start" protections, and an identification of the empirically plausible explanations for those limits.²⁰³ These lines of inquiry are pursued in the first two sections of this part. In each case, the analysis provides a framework against which to test the present relevance *vel non* of the various theories and concerns historically advanced as determinative of the bankruptcy system's debtor relief objectives. In addition, as set out in the final section of this part, the analyses taken together provide a reasonably detailed and integrated description of the assumptions and policy considerations that define the Code's particular vision of the consumer "fresh start," which is to say, the assumptions and considerations that should guide the interpretation and application of specific elements of the Code's debtor relief structure.

203. Thus, as suggested by Professor Jackson's analysis, the same lines of inquiry as are appropriately addressed in formulating a normative theory of discharge are equally useful in framing the positive theory suggested here. Jackson, *supra* note 5.

A. *The Discharge and the Risk of Repayment Difficulties*

1. The Discharge as an Allocation of Risks

The first source of any useful description of the Code's "fresh start" policy is an identification of what the Code's discharge does in fact. In that regard, there is significant value in the insight afforded by the economic theorists' insurance characterization.²⁰⁴ The immediate and obvious effect of the discharge is, of course, to release the debtor from at least the legal obligation to pay part or all of the existing money claims against him. More fundamentally, however, the existence and availability of the discharge operate to allocate risks.

Any dischargeable liability arises out of some prebankruptcy transaction creating a debtor-creditor relationship between the debtor and the holder of the claim. Whatever the nature of the transaction (a loan, an automobile accident, the earning of taxable income), the executory nature of the debtor's obligation necessarily creates the possibility that, when payment comes due, circumstances will exist that impair his willingness or ability to pay. If that possibility becomes a reality, one or both of the parties will bear some portion of the loss occasioned by the circumstances: the debtor to the extent that he pays or suffers the consequences of nonpayment imposed by state collections law, and the creditor to the extent of nonpayment. Legal rules specifying the extent to which the debtor will or will not be liable operate to allocate that loss when it occurs, but in so doing they allocate the risk of the loss prior to its occurrence. Thus, if the debtor is and will remain liable notwithstanding a particular contingency (as, for example, destruction of property purchased on credit²⁰⁵), he bears the risk that the contingency will occur. Conversely, to the extent that certain circumstances (as, for example, illegality or impossibility of performance) will excuse the debtor from liability, the creditor bears the risk that those circumstances will in fact come to pass.²⁰⁶ Even absent circumstances of nonliability or excuse, the risks borne by the debtor are limited, and those borne by the creditor are correspondingly increased by limits on the creditor's legal ability to enforce his claim. Exemptions, for example, or the prohibition of such rem-

204. See *supra* notes 135-39, 176 and accompanying text.

205. See U.C.C. §§ 2-509, 9-207(2)(b) (1977).

206. See generally Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

edies as imprisonment for debt, limit the debtor's loss and relieve him of the risk that his liberty or basic personal property will be called upon to satisfy his liabilities.²⁰⁷

As do rules of nonliability or excuse and limits on coercive collections, the rules governing the availability and effect of the bankruptcy discharge allocate to those creditors holding dischargeable claims some part of the risk that, prior to payment, the debtor's circumstances will adversely affect his ability or desire to pay. In part, of course, the discharge simply duplicates or incorporates the effect of nonbankruptcy rules (such as exemptions) that would limit the risks borne by the debtor even without a functioning bankruptcy system.²⁰⁸ But the incorporation of nonbankruptcy rules affecting the relative risks of debtor and creditor by no means exhausts the effect of the Code's "fresh start." For that reason, the risk allocation particularly attributable to the discharge can be more precisely defined by the degree to which it adds to the debtor's nonbankruptcy protections, relieving him or his property of liability for claims that would be collectible outside bankruptcy.

Those nonduplicative effects are of three kinds. First, and most significant, the Code discharge limits the debtor's payment burden to the value of his existing nonexempt assets²⁰⁹ or, in Chapter 13 cases, to the amount of his disposable income over three years,²¹⁰ thereby freeing his entire postbankruptcy property from otherwise enforceable claims. Second, by enjoining any postbankruptcy collection activity²¹¹ and forbidding governmental and employment discrimination against debtors,²¹² the Code frees the debtor himself and at least some of his postbankruptcy activities from the burdens of prebankruptcy liabilities. Third, as to the debtor's assets

207. In addition, certain apparently immutable principles of biology (that is, those regarding one's capacity to extract blood from turnips or stones) will allocate the risk of nonpayment to creditors no matter what the legal rule of liability.

208. See 11 U.S.C. § 502(b)(1) (Supp. III 1985) (claim unenforceable under nonbankruptcy law not allowable in bankruptcy); *id.* § 522(b) (debtor may choose to hold exempt any property exempt under state law, and if state law so provides, debtor is limited to nonbankruptcy exemptions).

209. See *id.* § 541(a) (property of the estate composed of debtor's interests as of the commencement of the case); *id.* § 726(a) (distribution of property of the estate to creditors); *id.* § 522(b) (debtor's exemptions).

210. *Id.* § 1306(a) (1982) (property of the estate in Chapter 13 includes debtor's § 541 property and property acquired during pendency of case); *id.* § 1325(b) (Supp. III 1985) (requirement for plan confirmation that, if creditor objects, debtor must devote all of his "projected disposable income" for three years to plan payments).

211. *Id.* § 524(a) (Supp. III 1985).

212. *Id.* § 525.

existing at the time of bankruptcy, the Code expands the available nonbankruptcy protections of exempt property by permitting the debtor to avoid some categories of otherwise enforceable liens on that property.²¹³

Thus, as an allocation of the risk that the debtor's desire or ability to pay will be impaired prior to payment, the discharge limits the debtor's possible loss in such circumstances to the value of his then-owned nonexempt property or disposable income, and it places the risk on creditors to the extent that they hold dischargeable claims that would be capable of satisfaction either out of the debtor's postbankruptcy assets or (by reason of security interests) out of his prebankruptcy exempt property. Cast in terms of the economic theorists' insurance characterization, the discharge provides the debtor with credit insurance coverage in an amount equal to his dischargeable liabilities less his nonexempt assets at bankruptcy (or less three years of disposable income in Chapter 13 cases). The peril or risk insured against, as defined by the none-too-precise Code limits on the availability of relief, is a change (financial or otherwise)²¹⁴ in the debtor's circumstances prior to payment that renders payment or the collections consequences of nonpayment more burdensome to him than whatever burdens might accompany his resort to bankruptcy.

2. The Analytic Framework of Risk and Insurance

To a degree, a description of the discharge as allocating risks merely restates its obvious effect in allocating losses. But the risk-allocation perspective implicit in the insurance characterization is not entirely redundant. Its primary advantage is that it provides an analytic framework that both illumines some aspects of the Code's discharge structure and focuses one's questions as to others. The possibility of uncertain future losses is a common enough phenomenon both in law and in everyday life, and the strategies available for dealing with such possibilities are eminently familiar. Faced with a risk, one can retain it and bear the loss in the event that it materializes. One can take steps to reduce the risk by reducing either the probability that the loss will occur or the severity

213. *Id.* § 522(f) (1982).

214. A change, if only of the debtor's mind, is an essential element of the peril insured against, since a debt incurred without an intent to repay would be nondischargeable as fraudulently incurred. *See id.* § 523(a)(2)(A) (Supp. III 1985).

of the loss in the event that it does occur. Finally, one can transfer the risk (and hence the loss) to someone else. These strategies will ordinarily be employed in combination, with the particular mix of retention, reduction, and transfer dependent at least presumptively on the relative cost and efficacy of each as a means of minimizing the total expected loss.²¹⁵

One variety of risk transfer is insurance, in which the insured exchanges a small but certain present loss (the premium) for the insurer's assumption of the risk of a larger but uncertain future loss. As a strategy for dealing with risk, however, insurance ordinarily involves not merely risk shifting by the insured, but also the combination or pooling of risks by the insurer.²¹⁶ The significance of pooling is that it serves to reduce risk. Viewed as a present cost, risk has two components: the present value of the loss, and the distinct burden of uncertainty as to its occurrence. A simple transfer of those costs to the insurer (or to anyone else) would not ordinarily result in a net reduction in either component.²¹⁷ When, however, a transferred risk is pooled by the transferee with a large number of similar risks transferred by others, the transfer is not the complete effect of the transaction. First, to the extent that premiums are the source of payments when the peril insured against occurs, pooling substitutes a number of small losses for a single large loss. That substitution is ordinarily regarded as effecting a net reduction in the severity of the total loss, since it avoids the personal and economic dislocations that are usually associated with individual losses of catastrophic magnitude.²¹⁸ Second, if a sufficiently large number of risks are combined by the insurer, pooling reduces the uncertainty component of risk. While uncertainty remains as to the occurrence of any particular insured loss, the expected level of total losses in the insured pool achieves a statistical predictability approaching certainty.²¹⁹ Thus, pooling affects a net

215. See generally M. GREENE, *RISK AND INSURANCE* 11-15 (4th ed. 1977); R. MEHR & E. CAMMACK, *PRINCIPLES OF INSURANCE* 23-29 (1980); Ehrlich & Becker, *Market Insurance, Self-Insurance and Self-Protection*, 80 J. POL. ECON. 623 (1972).

216. Indeed some purists would limit the use of the terms "insurance" and "self-insurance" to instances of risk pooling. See, e.g., M. GREENE, *supra* note 215, at 12.

217. Uncertainty as to a loss is a cost only to the extent that the individual bearing the risk is risk averse. Thus, to the extent that a risk is transferred to a person with less risk aversion than the transferor, the transfer alone would serve to reduce the net cost. Conversely, net costs would be increased by a simple transfer to a transferee with greater risk aversion.

218. See, e.g., M. GREENE, *supra* note 215, at 61.

219. This effect is a function of the law of large numbers. See generally *id.* at 28-37;

reduction in uncertainty by converting the insured parties' collection of uncertain losses into a combination of certain losses both for the insured (in premium payments) and for the insurer (in expected total payouts).

In a perfect world, each insurance premium would accurately reflect the precise degree of risk presented by the particular person insured and would be determined by adding the present value of the loss (the "pure premium") and the insurer's costs of administering the insurance (his "loading costs").²²⁰ Thus, the payout in the event of a covered loss would amount to more than a simple wealth transfer from other insured persons to the party suffering a loss. Rather, it would constitute the second half of an exchange, the premium payment having accurately compensated the other insured parties and the insurer for the subsequent payment. Needless to say, however, it is not a perfect world. First, it is in fact frequently impossible or prohibitively costly to accurately ascertain the precise degree of risk presented by each insured.²²¹ As a result, insurance inevitably involves, to some degree, coverage of similar but nonidentical risks without differentiation as to the premium paid by each insured. If the premium is set to cover the risk of the average-risk insured, higher-risk insureds receive an uncompensated transfer in the form of coverage subsidized by the premium payments of lower-risk insureds in the same pool.²²² Second, to the extent that the insured can affect the probability or severity of the loss, the existence of insurance coverage will in some circumstances alter his incentives in a manner that tends to increase the net loss. Thus, insurance coverage may tend to reduce the insured's incentive to take loss-avoidance measures, since it is not he, but the insurer, who derives the benefit of any reduction in risk resulting from the use of such measures.²²³ Also, in the event that the peril insured against does occur, insurance coverage creates an incentive to exaggerate the loss. Since the premiums have already been paid there is no added cost to the insured for maximizing his

E. VAUGHAN & C. ELLIOTT, *FUNDAMENTALS OF RISK AND INSURANCE* 19-24 (2d ed. 1978); Pauly, *The Economics of Moral Hazard: Comment*, 58 *AM. ECON. REV.* 531 (1968).

220. M. GREENE, *supra* note 215, at 577.

221. *Id.* at 579.

222. *See id.*; Hirshleifer & Riley, *The Analytics of Uncertainty and Information—An Expository Survey*, 17 *J. ECON. LIT.* 1375, 1386-90 (1979).

223. *See generally* Arrow, *The Economics of Moral Hazard: Further Comment*, 58 *AM. ECON. REV.* 537 (1968); Ehrlich & Becker, *supra* note 215, at 641-43; Hirshleifer & Riley, *supra* note 222, at 1390-91; Pauly, *supra* note 219.

claim and hence the insurance payoff.²²⁴ These problems of "moral hazard" can be addressed in a variety of ways: contractual requirements that the insured take certain avoidance measures; monitoring, to reduce exaggerated claims *ex post* and to facilitate *ex ante* the setting of premiums that accurately reflect the risk created by the insured's conduct; and deductibles and coverage limitations, which place a portion of the cost on the insured and thus afford him an incentive both to reduce the risk and to refrain from unnecessary or exaggerated claims.²²⁵ In addition, forms of moral hazard that involve the insured's intentional creation of the loss (for example, liabilities for criminal activity, arson committed by the owner in fire insurance, or voluntary job loss in unemployment insurance) are often simply excluded from coverage. In part, such exclusions reflect a judgment that an accurate premium for the risks involved would equal or exceed the amount of the loss.²²⁶ In part, too, especially relative to criminal liabilities, the exclusions rest on a view that the social value of assuring adequate deterrence of the conduct in question precludes the use of any device whereby the actor can avoid the consequences of his activity.²²⁷ In any event, the effect of moral hazard is to impair the loss-reduction effects of risk pooling, since it increases total risk if not controlled, and the available means of control necessarily involve a reduction in the degree of loss spreading.

3. The Discharge as Insurance: Some Similarities and Some Questions

In part, the relevance of the foregoing principles to the risk-allocation effect of the bankruptcy discharge may be apparent. It is, for example, relatively easy to characterize some limits on the discharge as a response to moral hazard problems. Thus, the requirement of asset or income surrender as a condition of relief is readily seen as a kind of deductible, forcing the debtor to bear part of the loss in order to limit his incentive to exaggerate his claim (that is, his need for relief) or to forgo risk-reducing behavior.²²⁸ In like

224. See E. VAUGHAN & C. ELLIOTT, *supra* note 219, at 9; Pauly, *supra* note 219, at 532-34.

225. See generally Hirshleifer & Riley, *supra* note 222, at 1391; Holmstrom, *On Moral Hazard and Observability*, 10 BELL J. ECON. 74, 80-81 (1979); Pauly, *supra* note 219, at 535-36.

226. See J. LONG & D. GREGG, PROPERTY AND LIABILITY INSURANCE HANDBOOK 195 (1965).

227. See 6B J. APPLEMAN & J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4252 (1979); R. KEETON, BASIC TEXT ON INSURANCE LAW 287-88 (1971).

228. See Jackson, *supra* note 5, at 1428, 1428 n.14. Cf. Eisenberg, *supra* note 8, at 977

manner, nondischargeable fines, penalties, and malicious injury liabilities²²⁹ can be regarded as the functional equivalent of perils excluded from coverage due to the debtor's complete control over the occurrence of the loss and due to the enhanced social importance of maintaining the deterrent effect of such liabilities.²³⁰ Similarly, the nondischargeability of fraudulently incurred obligations²³¹ can be attributed to the effect of the debtor's conduct in impairing the ability of the creditor-insurer to monitor the debtor's actual state of affairs *ex ante* in order to establish an accurate premium for the insurance implicit in the loan. Likewise, the common theme of the grounds for outright denial of discharge, almost all of which involve the debtor's noncooperation in or interference with the bankruptcy process, can be viewed as an effort to limit the debtor's ability to avoid the system's *ex post* moral hazard controls, whether in the form of monitoring or of deductibles.²³² But the parallels between insurance and the discharge are not always complete; in part, the degree to which the two are comparable varies, rather, according to the nature of the claims that are subject to discharge.

Thus, the insurance characterization appears to be most accurate relative to discharge of claims held by creditors in the business of consumer lending (banks, credit unions, finance companies, and the like), which claims also constitute, as it happens, the larg-

("Debtors are always asked to sacrifice something, to pay what they reasonably can.")

229. 11 U.S.C. § 523(a)(6), (7) (1982).

230. See Jackson, *supra* note 5, at 1440-46.

231. 11 U.S.C. § 523(a)(2), (4) (Supp. III 1985).

232. *Id.* § 727(a). Denial is permissible if the debtor, in connection with his own case or the case of an insider, has: conveyed or concealed property within the year prior to bankruptcy with the intent to defraud creditors; unjustifiably concealed, destroyed, or failed to keep books; given false testimony in the proceeding; failed to satisfactorily explain his financial condition; disobeyed a lawful court order; or received a discharge within the last six years (subject to exceptions if the prior discharge was under Chapter 13). *Id.* All grounds but the six-year bar involve the debtor's interference either with the court's monitoring of his condition or (in the case of fraudulent conveyances) with the enforcement of the "deductible" of asset surrender. But see Jackson, *supra* note 5, at 1441-42 (attributing the grounds for denial of discharge to the efficiency of the sanction in advancing a more general interest in deterring the underlying conduct); see also *supra* notes 229-30 and accompanying text. Even the six-year bar to repeated discharge in Chapter 7 appears to be directed to the reduction or moral hazard, by raising the debtor's deductible to the cost of a Chapter 13 proceeding in any case in which the debtor has (by his prior filing) demonstrated risk that is out of the ordinary. See *infra* note 295. That explanation seems preferable to a view that the bar is designed to operate for the debtor's benefit, by enhancing his postbankruptcy credit, since the exceptions to the bar tend to seriously undermine that supposed benefit. Jackson, *supra* note 5, at 1443 n.149.

est part of the obligations discharged in consumer bankruptcy cases.²³³ The risk of future impairment of the debtor's willingness or ability to repay inheres in every such lending transaction. The discharge places a portion of that risk on the lender and severely limits the borrower's ability to contract otherwise. The lender may be able to shift some part of the discharge risk to the borrower (by means of security requirements, for example)²³⁴ or to third parties (for example, co-signers, nonrecourse assignees, or credit insurers). He can take steps to reduce the size or probability of the loss (by limiting the amount loaned, for example, or by the use of more stringent creditworthiness standards). But, as long as he is willing to lend, there will ordinarily be some irreducible minimum of risk that he will continue to bear. For the lender, the residual nontransferred risk and the costs of transfer and reduction are all a part of the cost of lending. Given the apparently high elasticity of supply relative to demand in credit markets, those costs will ordinarily be recouped in the cost of loans to borrowers; the risk, that is, will be one determinant of credit availability, interest rates, and other terms of lending.²³⁵ Further, because the common use of credit-

233. See CREDIT RESEARCH CENTER, KRANNERT GRADUATE SCHOOL OF MANAGEMENT, CONSUMER BANKRUPTCY STUDY, VOL. II, PERSONAL BANKRUPTCY: CAUSES, COSTS AND BENEFITS 28-29 (Purdue University Monograph No. 24 1982) [hereinafter CONSUMER BANKRUPTCY STUDY, Vol. II]; GAO STUDY, *supra* note 2, at 26; Reply, *supra* note 171, at 1074; Shuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288, 296-303 (1983) [hereinafter *Nine States Study*]; Shuchman, *New Jersey Debtors 1982-1983: An Empirical Study*, 15 SETON HALL L. REV. 541, 566-75 (1985) [hereinafter *New Jersey Study*].

234. His capacity to do so will be limited in part by the debtor's nonwaivable power to avoid nonpossessory, nonpurchase money security interests in exempt property. 11 U.S.C. § 522(f) (1982).

235. The degree to which consumer credit availability, rates, and other lending terms are generally responsive to changes in costs does not appear to have been extensively tested or studied, and the question appears to have some room for controversy. Compare, e.g., Meckling, *supra* note 105, at 19-21 (consumer credit supply "virtually perfectly elastic") with Weston, *supra* note 135, at 48-51 (questioning the point); see also Discussion, *supra* note 96, at 130-34; *supra* note 177. Nonetheless, the ease with which available funds can be shifted among segments of the credit market (as illustrated by the large-scale disintermediation experienced by depository institutions in the late 1970's), together with experience as to some forms of law-generated costs, see, e.g., Crafton, *An Empirical Test of the Effect of Usury Laws*, 23 J.L. & ECON. 135 (1980); Lynch, *supra* note 125, make it reasonable to assume, at least as to financial institutions, that the supply of credit is ordinarily responsive to changes in costs, and that increased costs are ordinarily borne by borrowers rather than lenders. Whether or to what extent any particular change in bankruptcy law affects creditors' costs is a distinct empirical question, and one that presumably varies according to the particular change. See, e.g., Shuchman & Jantscher, *Correlation of Bad Debt Losses and Nonbusiness Bankruptcy Rates*, 77 COM. L.J. 358 (1972); Woodward & Woodward, *supra* note 170.

screening devices permits the grouping of borrowers into relatively specific risk classes, the premium paid by any particular borrower will reflect, with a fair degree of accuracy, the level of risk involved in his individual transaction.²³⁶ In short, in the context of formal or professional consumer lending, the operation of the discharge is in many respects indistinguishable from the compelled purchase of credit insurance by borrowers. The risk of each borrower's future inability or unwillingness to pay is transferred to the lender for a premium implicit in the cost of the loan, and the lender pools that risk with other similar risks, thereby spreading losses among borrowers. Moreover, due to the segmentation of the market and the individualization of risk assessment for each transaction, each borrower's premium more or less accurately compensates for the risk transferred, with only minimal opportunities for subsidization by the lender or by other borrowers.

When one turns from professional lending to other forms of contractual consumer credit, the situation departs from the insurance model in a number of respects, depending on the creditor's volume of lending, the degree of individual credit screening, and the economics of the creditor's business. In large scale retail sales credit, for example, if the seller and lender are the same entity,²³⁷ risk pooling and loss spreading should occur in much the same manner as in insurance, but there appears to be a somewhat greater likelihood that the premium paid by the borrower for discharge will be subsidized by (and a portion of the losses will be distributed to) cash buyers of goods, due to the apparently greater elasticity of demand for credit relative to the elasticity of demand for goods.²³⁸ Similarly, to the extent that the lender does not segment his market and that credit screening is not particularly individualized (as in many forms of short-term service credit), the discharge should

236. See Boggess, *Screen-test Your Credit Risks*, 45 HARV. BUS. REV., Nov.-Dec. 1967, at 113; Orgler, *Evaluation of Bank Consumer Loans with Credit Scoring Models*, 2 J. BANK RES. Spring 1971, at 31, 36-37; Sexton, *Determining Good and Bad Credit Risks Among High- and Low-Income Families*, 50 J. BUS. 236 (1977); *The Credit Scoring Movement*, 3 CREDIT, no.9, Sept. 1977, at 28.

237. To the extent that the seller, while formally the lender, purchases credit loss insurance or assigns his consumer accounts on a nonrecourse basis to financial institutions, the situation is indistinguishable from that in which the debtor borrows directly from those institutions.

238. See W. DUNKELBERG, *THE TRANSFER IMPLICATIONS OF CONSUMER CREDIT REGULATION* 27-32 (Credit Research Center, Purdue Univ., Working Paper No. 29, 1979); Dunkelberg & Smiley, *Subsidies in the Use of Revolving Credit*, 7 J. MONEY, CREDIT & BANKING 469, 471, 489 (1975).

still result in risk pooling and loss distribution. There is, however, a greater likelihood of premium subsidization, not only by cash customers but by other credit customers as well. Finally, in informal consumer-to-consumer lending (that is, the loan by family member or friend), neither risk pooling nor loss distribution seems a likely outcome of the risk allocation established by the discharge, given the presumably small number of loans held by each lender. At the same time, the sparsity of the loan pool limits the possibilities for subsidization of the debtor's coverage, first because of the lender's opportunity to evaluate the risk and second because the only available subsidizer is the lender himself.

Notwithstanding the differences among them, in the various contractual settings in which the discharge operates it is thus probable both that the creditor will have been compensated for the risk transfer effected by the discharge and that the debtor will have borne some part of the compensation cost himself. Moreover, when the contract creditor is a business creditor, the effect of the discharge appears to include, at least ordinarily, an insurance-like pooling of risks and spreading of losses that would otherwise be borne by the debtor alone.

By contrast, when the holder of a dischargeable obligation is a nonbusiness involuntary creditor (an automobile injury plaintiff, for example), the effect of the discharge departs significantly from the features ordinarily characteristic of insurance. Such a creditor can, of course, take steps to reduce the risk allocated to him by the discharge (as by increased care in driving prior to any accident and by aggressive collection activity afterward), and he can transfer a part of the risk to third parties (as by the purchase of uninsured motorists coverage under his own automobile insurance policy). But whatever his response to the risk, the involuntary character of the transaction and the consequent absence of bargaining over the terms of the liability preclude him from passing the cost of his response to the debtor.²³⁹ In addition, because there are frequently practical limits to an involuntary creditor's capacity to insure the complete risk allocated by the discharge,²⁴⁰ one has substantially less reason to expect that the risk will be pooled or the loss distributed over a relatively large group. Thus, as to involuntary nonbusi-

239. See Jackson, *supra* note 5, at 1422.

240. See M. GREENE, *supra* note 215, at 343-44 (uninsured motorists coverage usually limited to minimum liability limits established by particular state's financial responsibility law).

ness claims, the discharge operates as insurance only in a limited sense, and its effect is more often simply the uncompensated transfer of the discharge risk from debtor to creditor with only occasional reduction in net losses by means of pooling and distribution.

As noted above, debts owed to those in the business of lending constitute the largest share of obligations discharged in consumer bankruptcies. The more inclusive class of contractual obligations to business creditors of all kinds appears to account for more than ninety percent of discharged obligations.²⁴¹ Involuntary claims of nonbusiness creditors, on the other hand, seem to be a highly infrequent, indeed rare, phenomenon.²⁴² Thus, in respect to loss pooling and the incidence of costs, the effect of the Code's discharge in practice is largely indistinguishable from the imposition of compulsory credit insurance as to most discharged obligations. As to all but a few discharged obligations, it mimics insurance in those respects except for the degree to which one might expect any given debtor's premium payment to be subsidized by the creditor's other customers. Of course, the limited empirical significance of the remaining group of dischargeable claims (that is, liabilities to involuntary nonbusiness creditors) does not warrant one in simply ignoring them. Moreover, even in the context of professional contract lending, there are other aspects of the Code's discharge that appear at least facially to depart from the analytic framework suggested by the insurance characterization.

Relative to moral hazard reduction, for example, the Code's discharge structure is remarkable for its moderate approach to the control of undesirable prebankruptcy incentives. In particular, with the exception of fraud, malicious injury, and similar claims, as described above, the Code is essentially devoid of limitations on discharge based on the debtor's behavior leading to his financial difficulties. Even moral hazard as reflected in reckless prebank-

241. See sources cited *supra* note 233.

242. None of the post-Code empirical studies reports any dischargeable tort liabilities among the samples of bankrupt consumer debtors. See sources cited *supra* note 233. At a minimum, that suggests that the number is at least too small to merit a category distinct from each study's "Miscellaneous" or "Other" category. But the *Nine States Study*, *supra* note 233, appears to break its count of "Miscellaneous Unsecured Debt" into individual types, *id.* at 299-301, 300 table X, and that breakdown reflects no tort liabilities. The *Brookings Study*, D. STANLEY & M. GIRTH, *supra* note 2, reported that automobile accident liabilities were "rarely" found in its sample of nonbusiness debtors under the Act. *Id.* at 48. That result may have been affected, however, by the somewhat narrower dischargeability of such liabilities under the Act. See *supra* notes 39, 164 and accompanying text.

ruptcy "overindulgence" in credit is thus a subject that does not appear to have particularly concerned the drafters. At the same time, there are substantial limits on the scope of the discharge (most notably the nondischargeability of tax and family obligations²⁴³) that have no immediately apparent relationship to moral hazard reduction or other insurance considerations.

Similarly, when measured against the ordinary structure of insurance arrangements, the Code is strikingly vague in its definition of the perils insured against. As already noted, eligibility for relief under the Code depends neither on the occurrence of any particular contingency (catastrophic illness, for example, or loss of income) nor on any express standard of need or inability to pay. Rather, the availability of discharge is dependent on essentially nothing more than the debtor's choice to file a petition.²⁴⁴ Framed in the context of the insurance characterization, the insured debtor's decision to make a claim (file a petition) will ordinarily be treated as conclusively establishing that the (unidentified) perils insured against have in fact occurred.

Given the descriptive accuracy of the insurance characterization in most contexts, these apparent departures from the insurance model in the existing structure of the discharge are even more striking. As described in the following section, however, an examination of the distinct question of compulsion, that is, the policy underpinnings of the rules of nonwaivability that in effect require the purchase of insurance in each credit transaction, provides a basis for explaining these otherwise anomalous aspects of the Code's "fresh start." In addition, the implications of the insurance characterization and the justifications for nonwaivability, taken together, provide a framework for evaluating the present relevance of various other policy concerns historically advanced as influencing the scope and effect of discharge rights.

B. *The Discharge as Compelled Insurance*

1. The Rationale for Rules of Nonwaivability

A conception of the bankruptcy "fresh start" as *compelled insurance* is founded on the stringent rules limiting the debtor's ca-

243. 11 U.S.C. § 523(a)(1) & (5) (Supp. III 1985).

244. See *supra* note 154 and accompanying text. The role of the "substantial abuse" test, see 11 U.S.C. § 707(b) (Supp. III 1985), as imposing an eligibility standard is discussed *infra* notes 367-415 and accompanying text.

capacity to waive or otherwise enforceably limit in advance the availability of the discharge or the scope of its protections for exempt property or for future income.²⁴⁵ As discussed above, insurance (whether or not compelled) is by no means the only nor always the best method for dealing with untoward risks. The ordinary response to risk is, rather, a combination of strategies: insurance or other forms of risk transfer, self-insurance, and preventive activities with the optimum mix as to any given risk determined by the perceived relative costs and benefits of each component.²⁴⁶ Because each possible response is a substitute for the others, the nonwaivability of discharge rights has two additional effects beyond compelling each borrower to purchase and each lender to sell insurance as an implicit term in the loan contract. First, by placing the creditor in the position of insurer, the discharge increases that party's incentives both to engage in preventive activities himself and to require preventive steps on the part of the debtor. Second, the combination of compelled insurance and the enhanced likelihood of creditor-compelled prevention effectively limits the debtor's opportunities to rely on self-insurance as a substitute for those strategies in dealing with the risks covered by the discharge.

Compelled contract terms (whether express or, like the discharge, implicit in the form of nondisclaimable rights or duties) and other forms of interference with the capacity of parties to choose alternative arrangements are not, of course, unknown to American contract law. That law is, however, generally founded on strongly held assumptions about the social, economic, and ethical value of individual autonomy in exchange relationships.²⁴⁷ As an apparent departure from those principles of autonomy, the nonwaivability of discharge rights may not be unique, but it does warrant some explaining.

Notably, until recently neither courts nor commentators found it necessary to engage in extensive defense of limiting the power of debtors to bargain away their discharge rights. In the conventional view, it is simply self-evident that if debtors could contract out of the availability of bankruptcy, they would do so: creditors would inevitably and routinely demand waiver clauses in loan agreements, debtors would just as inevitably sign them, and the institution of discharge together with its value to debtors and society

245. See *supra* notes 166-67 and accompanying text.

246. See *supra* note 215 and accompanying text.

247. See E. A. FARNSWORTH, *CONTRACTS* 3-10 (1982).

would be "nullified."²⁴⁸

Stated in that stark form, of course, the explanation is incomplete. Even if it were correct that creditors would routinely exact discharge waivers it would not necessarily follow that the values of insurance would be lost. Under some circumstances, self-insurance is a sensible (that is, cost-effective) substitute for insurance or prevention.²⁴⁹ Moreover, if the insurance compelled by the discharge had a value to debtors greater than its cost to providers (that is, more cost-effective to debtors than self-insurance or prevention), one could reasonably expect there to be sufficient demand to support at least some market in insurance substitutes for the waived discharge protections. In fact, there are existing markets in credit insurance and various forms of private income insurance that afford coverage for many of the same perils (loss of employment, for example) that are effectively insured against by the discharge.²⁵⁰ Thus, the stated premise that debtors would waive discharge if given the chance is not by itself enough to explain the point of nonwaivability rules that compel insurance, increase levels of cred-

248. *Federal Nat'l Bank v. Koppel*, 253 Mass. 157, 159, 148 N.E. 379, 380 (1925). See also J. MACLACHLAN, *HANDBOOK OF THE LAW OF BANKRUPTCY* 98 (1956) ("The policy of the Bankruptcy Act in relation to discharges would obviously be defeated if creditors could prevail by a routine of exacting such waivers . . .").

249. Due to the existence of loading costs, nonsubsidized market insurance inevitably has a price higher than the present value of the loss. For the risk-averse insured the extra cost is offset by a reduction in risk, but the reduction is not necessarily equivalent in value to the amount by which the cost exceeds the pure premium. See Ehrlich & Becker, *supra* note 215, at 637-41; Pauly, *supra* note 219, at 531-32.

250. See generally C. HUBBARD, *CONSUMER CREDIT LIFE AND DISABILITY INSURANCE* 7-27 (1973). This is not to imply that there are existing or extensive markets in insurance for the entire range of risks allocated to creditors by the discharge. As noted, moral hazard severely limits the insurability of some perils, such as voluntary job loss in employment insurance. It has likewise been suggested that the related phenomenon of adverse selection (that is, the tendency of insurance to attract a disproportionate level of high-risk insureds in circumstances in which insurers are less able than the insured to identify individual differences in risk and thus unable to discriminate effectively in premium setting) may limit the insurability of credit risks to the extent that debtors cannot credibly signal or communicate their risk level to an insurer. See Rea, *supra* note 178. Nonetheless, there are existing markets in disability income insurance, see C. HUBBARD, *supra* at 16-18, 31-32 (credit disability insurance); E. VAUGHAN & C. ELLIOTT, *supra* note 219, at 242-54 (accident and illness income insurance), and there have been recent efforts to market credit insurance covering income interruptions due to other causes. See *Your Money: Debt Insurance After Job Loss*, N.Y. Times, Mar. 26, 1983, at 30, col. 1. Similarly, there is a well-established market in insurance for medical and health care costs. See E. VAUGHAN & C. ELLIOTT, *supra* note 219, at 255-72; see also *CONSUMER BANKRUPTCY STUDY*, Vol. II, *supra* note 233, at 37 (medical bills are the single factor most frequently cited by debtors as leading to bankruptcy); *Nine States Study*, *supra* note 233, at 295 ("unanticipated medical expenses play a major role in the family finances of more than half the personal bankrupts").

itor-generated prevention, and limit the debtor's opportunities to substitute self-insurance in place of either. The explanation, rather, necessarily implies two additional assumptions: first, that debtors, having waived discharge, would not resort to market insurance or prevention in its place; and second, that there would be something wrong with that situation. Put another way, the rules of nonwaivability must rest on a view that debtors, left to their own devices, would underinsure and that they would thereby excessively rely on self-insurance in dealing with the risks covered by the discharge.

The idea of "excessive" reliance implies, of course, that there is some external standard of value against which to measure an individual's insurance preferences. One standard is easy enough to identify. For the economically rational borrower, the choice of strategies in dealing with default risks is a function of relative costs and benefits. Because each strategy is a substitute for the others, it is rational to prefer self-insurance only to the extent that a dollar's worth of self-insurance buys greater protection than a dollar's worth of insurance prevention. Moreover, as long as the costs and benefits of each strategy are borne by the parties to the transaction (that is, in the absence of externalities), choices made in accordance with that model of "expected utility" should at least presumptively optimize the social gain from the transaction.²⁵¹

Thus, to speak of "excessive" self-insurance relative to credit risks is to posit a divergence between borrowers' actual decisions and the assumptions of expected utility. In particular, the imposition of a standard distinct from individual choices reflects one of two possible judgments about the quality of those choices. On the one hand, it can mean that, in the absence of compulsion, the insurance decisions of debtors would be irrational, in the sense that the debtors' choices would fail to accurately reflect their actual preferences (that is, the relative values they in fact attach to the various alternatives).²⁵² Or, on the other hand, it can mean that the

251. See generally K. ARROW, *supra* note 135, at 177-85, 199-202; Ehrlich & Becker, *supra* note 215. As a descriptive tool, of course, the expected utility model is valuable in describing or predicting aggregate market behavior rather than individual behavior. In the context of consumer credit risk choices there may be reason to doubt the model's descriptive power even as to aggregate behavior. See *infra* notes 254-63 and accompanying text. Whether or not that is the case, the model remains valuable as a working normative standard of "rationality" in individual and aggregate decisions regarding risk, due to both its coherence and comprehensiveness in accounting for the elements of risk.

252. Irrationality in that sense may be the product of inaccurate (because insufficient or

decisions, although individually rational, would nonetheless be nonoptimal from a social perspective because of the capacity of borrowers to externalize to others the costs of some alternatives and not others. The former approach assumes that borrowers would excessively self-insure because they would mistakenly underestimate the relative benefits of insurance or the relative costs of self-insurance. The latter approach assumes that borrowers would estimate correctly but that they would nonetheless excessively self-insure because they could externalize the costs of self-insurance to a greater degree than they could the costs of market insurance or prevention.

From almost the first entry of consumers into the bankruptcy system, the perceived deficiencies in consumer credit decisions have usually been regarded as problems of irrationality rather than as a function of externalities.²⁵³ Very often that perception has rested on little more than strong intuitions that a substantial portion of borrowers tend to discount excessively the risk of financial difficulties, systematically underestimating both the probability of adverse changes in their circumstances and the gravity of the costs, especially the nonmonetary costs, in the event of default. In recent years, those intuitive judgments have received significant support

misperceived) information as to the probability or expected value of a future loss, or it may be a function of errors in evaluating even accurate information. Central to the idea is a divergence between the individual's actual choice and the choice he would make if fully and accurately informed. Cf. Tversky & Kahneman, *Extensional Versus Intuitive Reasoning: The Conjunction Fallacy in Probability Judgment*, 90 PSYCHOLOGICAL REV. 293, 304 (1983). The concept thus addresses the quality of the process by which one chooses a course of action to advance one's preferences, rather than the quality of the preferences themselves. To the extent that one speaks of another's preferences as themselves "irrational," the complaint is directed not to rationality *vel non* but to the noncorrespondence of those preferences with some substantive standard of value. Judgments of that kind are not unknown in debates over the use of consumer credit, especially those regarding credit use among low-income consumers. See Newton, *Economic Rationality of the Poor*, 36 HUM. ORGANIZATION 50, 50 (1977) (suggesting that claims of economic irrationality among poor consumers rest in substantial part on class biases as to the values pursued). Nonetheless, because any particular conception of "rationality" in the content of values is essentially idiosyncratic (and hence arbitrary as applied to others), and because the legal enforcement of credit "rationality" in that sense is fundamentally at odds with the American legal system's general approach to contractual exchange, see *supra* note 247 and accompanying text, it provides a meager foundation for constructing a systematic explanation of discharge rights. For that reason, it is treated as irrelevant here.

253. See *supra* notes 75-77, 111-13, 144, 166-68, and accompanying text. A concern with externalized productivity costs has been an important aspect of bankruptcy debates since the last century, see *supra* notes 23, 55, and accompanying text, but that concern has been framed in terms of the effect of credit decisions on society, rather than in terms of the incentives created by the possibility of externalization.

from empirical studies of insurance decisions and from more general examinations of the psychology of decisionmaking under conditions of uncertainty.²⁵⁴ Central to the psychological theories is the observation that, consciously or otherwise, people tend to act on estimates of the probability of uncertain future events. These estimates are formed using a variety of intuitive mental shortcuts or judgmental "heuristics" to evaluate limited information and to reduce complex probability estimations to simpler and more manageable judgments.²⁵⁵ While these heuristics are valuable in simplifying decision processes, each has a number of built-in biases that lead to systematic errors in judgment regarding the likelihood of uncertain outcomes.²⁵⁶ One result of such biases appears to be a

254. See generally JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (D. Kahneman, P. Slovic & A. Tversky eds. 1982); R. NISBETT & L. ROSS, HUMAN INFERENCE: STRATEGIES AND SHORTCOMINGS OF SOCIAL JUDGMENT (1980); P. SCHOEMAKER, EXPERIMENTS ON DECISIONS UNDER RISK: THE EXPECTED UTILITY HYPOTHESIS (1980). As what appear to be among the first systematic efforts at rigorously testing the degree to which individual behavior corresponds to the standards of the expected utility model, the psychological studies have increasingly become a part of evaluating legal rules addressed to risk taking by consumers. The relevance of the studies both to consumer credit decisions and to warranty terms is explored in Schwartz & Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387 (1983), and (in more abbreviated form) in Farber, *supra* note 180, at 331-33, 336-38. Their relevance to the credit risks dealt with by the bankruptcy discharge, in particular, is discussed in Jackson, *supra* note 5, at 1410-18. For an argument as to their relevance to commercial behavior, see Gerla, *The Psychology of Predatory Pricing: Why Predatory Pricing Pays*, 39 Sw. L.J. 755 (1985).

255. Thus it has been observed that people tend to decide whether a particular outcome is likely to occur by ordering the available evidence according to mental models (such as stereotypes, prototypes, or schemata), and by assessing the degree to which the outcome would be "representative" of the model. "Representativeness" may be in turn a function of similarities between model and outcome or it may reflect causal or correlational beliefs. "Thus, an outcome is representative of a model if the salient features match or if the model [is believed to have] a propensity to produce the outcome." Tversky and Kahneman, *supra* note 252, at 296. Likewise, probability judgments are strongly influenced by the ease with which particular instances or occurrences of an outcome can be brought to mind (the "availability" heuristic). See Tversky & Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1127-28 (1974). And, in some circumstances, people tend to make probability estimates by starting from an initial value (the "anchoring" heuristic) and by adjusting from that value to reach a final judgment. *Id.* at 1128-30.

256. Thus, the process of adjusting from an initial anchoring estimate, *supra* note 255, typically tends to involve too little in the way of adjustment. As a result, the final estimate tends to be biased toward the starting point, a bias that effectively accords excessive weight to the information first available and insufficient weight to information acquired later. Similarly, the "availability" heuristic, *supra* note 255, tends to result in excessive weighting of outcomes that are more readily called to mind or mentally retrievable than others. While retrievability may depend in part on frequency or probability, it may be affected as well by other factors, such as recency or emotional impact, that are unrelated to probability (as in the "common experience that the subjective probability of traffic accidents rises temporarily

pervasive tendency to underestimate the likelihood of very low-probability events.²⁵⁷ Another result is a similar tendency toward unrealistic optimism, manifested in judgments that overestimate the probability of pleasant outcomes and underestimate the probability of unpleasant ones.²⁵⁸

In the specific context of the risks associated with consumer credit use, there is a low probability of default for even the least credit-worthy borrower able to obtain a loan; high-risk debtors tend to be a "high risk" only relative to other debtors.²⁵⁹ As a result, both the low probabilities and the unpleasant outcomes involved may well lead debtors to systematically underestimate at

when one sees a car overturned by the side of the road," Tversky & Kahneman, *supra* note 255 at 1127). And, because the "representativeness" heuristic, *supra* note 255, places great weight on "typical" characteristics, its use tends to result in judgments that ignore the insufficiency of the available data as a basis for judgment. Remarkably small samples, for example, are given great weight, and limitations on the reliability or predictability of the available data tend to be ignored. *See id.* at 1126 (noting, for example, that a generally favorable description of a business will lead to predictions of high profitability without regard to the reliability of the description or the relevance of its particulars to future performance). *See generally id.* at 1124-30.

257. *See* H. KUNREUTHER, DISASTER INSURANCE PROTECTION: PUBLIC POLICY LESSONS 12-17, 182-84 (1978); Kahneman & Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263, 275, 282-83 (1979). It has been suggested that this tendency may be a function of the biases accompanying the use of the availability heuristic, *supra* note 256, in that "there may be some critical probability threshold below which people ignore the threat that a large loss may occur. This threshold may exist because people have limited attention capacity and must be selective about the problems to which they allocate their scarce 'attention resources.'" P. SCHOEMAKER, *supra* note 254, at 68.

258. *See* Tversky & Kahneman, *supra* note 255, at 1129; Weinstein, *Unrealistic Optimism About Future Life Events*, 39 *J. PERSONALITY & Soc. PSYCHOLOGY*, July-Dec. 1980, at 806. In part the tendency to excessive optimism is attributable to the anchoring heuristic, *supra* note 255, one consequence of which is a bias both toward overestimating the probability of conjunctive events (that is, those that depend for their occurrence on the occurrence of several other events) and toward underestimating the probability of disjunctive events (that is, those occurrences which depend on the occurrence of any one of several other events). Because the successful completion of a plan ordinarily depends on the success of its several parts, the tendency to overestimate the probability of conjunctive events leads to overestimation of the likelihood of success. Likewise, because a plan can go awry if *any* of a number of adverse events occurs, the tendency to underestimate the probability of disjunctive events leads to excessive discounting of the risk of failure. *See* Tversky & Kahneman, *supra* note 255, at 1129. The tendency toward optimism may also be a consequence of the use of other heuristics to the extent that the occurrence of unfavorable events is associated with negative stereotypes (representativeness) with which the actor does not identify or to the extent that the actor's prior experience does not include the event in question (availability). *See* Weinstein, *supra* at 807-08.

259. *Cf.* Benston, *Risk on Consumer Finance Company Personal Loans*, 32 *J. FIN.* 593, 606 (1977) (consumer finance companies, which have considerably higher loss rates and operating expenses than other consumer lenders, experience average net losses due to default of about \$1.30 per \$100 of loan outstanding).

the time of borrowing the likelihood of events, such as severe illness or loss of employment, that might render repayment difficult.²⁶⁰ To the extent that debtors do underestimate such risks, even actuarially fair market insurance and, to a lesser degree, preventive activities will tend to appear unduly costly relative to their perceived benefits. Self-insurance, on the other hand, will appear unrealistically attractive, since the perceived cost of that strategy will be the erroneously overdiscounted present value of the risk. While these implications of the widespread existence of cognitive biases have not yet been empirically tested in the context of credit decisions, the tendency to underinsure against low-probability perils has been observed both experimentally and in field studies of other insurance decisions.²⁶¹ To that extent, both theory and data lend support to the long-standing intuitive rationale for nonwaivability that, given the opportunity, debtors would systematically and irrationally tend to substitute self-insurance for the protections afforded by the discharge or available in a more cost-effective form by way of market insurance or prevention.

The role of cognitive biases in risk decisions also tends to make less plausible the alternative view that bankruptcy rules of nonwaivability are designed to reduce the incentive for the debtor to externalize the costs of self-insurance. There are, to be sure, sound reasons for believing that, in the event of default, a putatively self-insured debtor would not necessarily bear the entire cost

260. That would be particularly the case to the extent that the heuristics involve the placing of excessive emphasis on the debtor's situation at the time he obtains the loan. For example, in the absence of prior experience with difficulties leading to default (experience that would militate against his obtaining the loan), the availability heuristic would lead to excessive weighting of the debtor's past ability to pay. See Hassler, Myers & Selden, *Payment History as a Predictor of Credit Risk*, 47 J. APPLIED PSYCHOLOGY 383 (1963). In addition, because possible impairment of his future ability to pay involves disjunctive events (that is, his ability can be affected by the occurrence of any of several events, such as illness, accidents, or economic layoff from employment, each of which has an individually low probability), the tendency to underestimate disjunctive probabilities, see *supra* note 258, would likewise lead to excessive discounting of the risks of repayment difficulties.

261. See, e.g., H. KUNREUTHER, *supra* note 257; Kunreuther & Slovic, *Economics, Psychology, and Protective Behavior*, 69 AM. ECON. REV. PAPERS AND PROCEEDINGS 64 (1979); Schoemaker & Kunreuther, *An Experimental Study of Insurance Decisions*, 46 J. RISK & INS. 603 (1979); Slovic, Fischhoff, Lichtenstein, Corrigan & Combs, *Preference for Insuring Against Probable Small Losses: Insurance Implications*, 44 J. RISK & INS. 237 (1977). But see Hogarth & Kunreuther, *Ambiguity and Insurance Decisions*, 75 AM. ECON. REV. 386 (1985) (suggesting that failure to insure against low-probability high-loss events is a function of insurers' unwillingness to insure rather than of consumers' unwillingness to pay premiums).

of his decision to self-insure,²⁶² and for a rational debtor those possible externalities would create incentives for excessive reliance on self-insurance at the time of borrowing. Certainly, when financial difficulties have in fact occurred, one could reasonably expect that the debtor's choice among the then-available options would be guided by the perceived relative costs and benefits of each. His conduct at that point might well be influenced by his ability to externalize some costs and not others. But the existence of such an incentive effect *prior to default* depends on an assumption that the ability to externalize the costs of self-insurance would be correctly understood and rationally calculated by debtors at that time. It is, however, by no means clear either theoretically or empirically that the capacity to externalize losses normally plays a significant role in *ex ante* decisions to favor self-insurance over market insurance. The existence of cognitive biases suggests, rather, that those decisions are based on erroneously low estimates of the probability of default. To that extent, the incentive created by the possibility of externalizing the costs of failure should be correspondingly reduced: for the debtor who substantially underestimates the risk of financial difficulties *ex ante*, the perceived value of a future low-cost bailout will also be substantially, albeit mistakenly, discounted.²⁶³

The view that the possible externalization of debtors' self-insurance costs has limited significance as to prebankruptcy incentives does not imply that externalities are wholly irrelevant to discharge policy. On the contrary, the existence of some external costs appears to be an integral part of a coherent justification for the nonwaivability of discharge rights. The mistakes generated by cognitive biases have an influence over the entire range of decisions involving risk and insurance. Yet, legal intervention to correct those errors of judgment is markedly infrequent. Even within the specific context of the risks accompanying credit use, the disabling effects of nonwaivability rules do not reach the full range of deci-

262. See *infra* notes 270-78 and accompanying text.

263. See Kunreuther & Slovic, *supra* note 261, at 66 (concluding that tendency to underinsure against natural disasters is unaffected by expectations of postdisaster government assistance).

The tendency to underestimate the risk will also affect the debtor's choice of a means of self-insurance: that is, his choice between accounting for the risk by increasing present savings, on the one hand, and accomplishing that end by relying on future income, on the other hand. To the extent that the present value of the risk is excessively discounted, the debtor will mistakenly "under-save" and, by default, rely excessively on future income or property to deal with the loss.

sions potentially affected by cognitive distortions. Debtors are effectively precluded from self-insuring only to the extent of the exempt property and future income protected in bankruptcy. Beyond that limited degree of compulsion, their insurance decisions are untrammelled by nonwaivability rules, notwithstanding that cognitive errors can easily distort those decisions as well.²⁶⁴ Standing alone, the likelihood of irrational insurance choices by consumer debtors cannot explain the limited scope of legal interference with those choices.²⁶⁵ By contrast, a concern for minimizing the possible externalization of some self-insurance costs provides a sensible justification for legal interference where it has occurred.

The most frequently identified external costs of consumer financial difficulties result from the impact of collections activity on the debtor's incentive or ability to maintain an optimal level of gainful employment. The causal relation between financial difficulties and underemployment or unemployment has been identified in various ways: as the result of the debtor's choice to forego full employment that would benefit the collecting creditor rather than himself;²⁶⁶ as stemming from the involuntary loss of employment following mul-

264. Thus, for example, a debtor remains free to impair exemptions by the use of purchase money security interests, even though there is no reason to distinguish between purchase money and nonpurchase money interests in terms of the degree to which he is likely to underestimate the risk of future financial difficulties. Similarly, he is free to place his nonexempt property at risk, notwithstanding that there is again no reason to expect that distortions in his estimation of the risk would vary according to the property involved.

265. The limited scope of the intervention effected by nonwaivability rules also tends to limit the descriptive power of theories that attribute the rules to a kind of collective "self-paternalism," that is, a choice to limit our freedom of choice in circumstances where there is a general recognition that our failure to correctly estimate the consequences will lead to decisions that on reasoned reflection we believe are likely to be mistakes (a position summed up in the view that "I'm for it because I might need it some day"). See, e.g., G. TULLOCK, *supra* note 135, at 53-55; Jackson, *supra* note 5, at 1414-15. If the systematic underestimation of the risks associated with credit use warranted a general rule precluding reliance on self-insurance on that ground, one would expect the preclusion to be more or less coextensive with the occasions of underestimation. As described above, however, the preclusion is in fact far narrower than the range of opportunities for such mistakes. Self-paternalist explanations are usually offered as normative justifications as, for example, in Professor Jackson's use of a Rawlsian "veil of ignorance" as the premise of his suggestions in this regard. See Jackson, *supra* note 5, at 1410, 1414-15. It may be worth noting, however, that the limited attractions of the discharge, due to its limited scope, do not appear to make it a particularly "good buy" for the great majority of the population. From that perspective, self-paternalist motives seem implausible as a descriptive matter, whatever the normative position. Cf. Rodgers, *Explaining Income Redistribution*, in *REDISTRIBUTION THROUGH PUBLIC CHOICE* 165, 189-90 (H. Hochman & G. Peterson eds. 1974) (discussing implausibility of similar self-paternalist "insurance" explanations for public assistance programs).

266. See, e.g., *Discussion*, *supra* note 96, at 151-53; Jackson, *supra* note 5, at 1421-23; Rendleman, *supra* note 8, at 726.

tiple garnishments;²⁶⁷ or, less directly, as the product of an impaired ability to work attributable to the health and psychological costs that accompany financial distress.²⁶⁸ Whatever their source, the employment consequences of default are costs that a self-insured debtor has in theory opted to bear, mistaken though he may have been as to their nature or probability. In fact, however, it has long been suggested that debtors would not fully bear all of the costs involved if allowed to self-insure. In the classic view, the employment consequences of default have been depicted as externalizing costs to society in the form of the loss of the debtor's productivity.²⁶⁹ More recently, those employment consequences have been viewed as imposing external costs by increasing the need for debtors to resort to the benefits of various social insurance or public assistance "safety net" programs.²⁷⁰

As to productivity losses, it is doubtful that the costs are in fact externalized under ordinary circumstances, since most decreases in productivity are usually internalized to the debtor in the form of lower income.²⁷¹ Moreover, to the limited extent that productivity

267. See, e.g., authorities cited *supra* note 92.

268. See, e.g., Weistart, *supra* note 107, at 111; authorities cited *supra* note 95.

269. See *supra* notes 23, 82, 180, and accompanying text.

270. See *supra* notes 96, 180, and accompanying text. A third form of externalization that has been suggested at times is the externalization to the debtor's family of the employment costs of payment or collection. See, e.g., F. NOEL, *supra* note 16, at 186-87; *Discussion*, *supra* note 96, at 142-43; Jackson, *supra* note 5, at 1419. While the existence of such externalities is plausible, they provide at most a highly limited explanation for the preclusion of self-insurance effected by the existing nonwaivability of discharge rights. In particular, if the object of discharge were to protect family members from bearing the employment costs of collection, one would expect family obligations to be generally nondischargeable. Instead, the Code limits the dischargeability of such obligations only to the extent that they involve the support of family members. A rule that leaves family members with the consequences of the debtor's financial difficulties beyond that level is (as described *infra* notes 300-01 and accompanying text) compatible with a concern for social insurance costs, but it does not suggest a particularly strong concern for limiting externalization of costs to the family members themselves in the absence of social insurance externalities. See *id.*

271. That would not be the case to the extent that the debtor's wage rate prior to a decrease in productivity understated the value of his labor to society, since the social loss in productivity would then be greater than the decline in the debtor's income. While divergences between wage rates and social value no doubt exist, there appears to be no reason to suspect that they involve a systematic understatement of productivity in wage rates. See generally Jackson, *supra* note 5, at 1420 n.88. Moreover, in the context of contract credit, the risk of a collections-generated decline in the debtor's productivity should ordinarily be accounted for in the cost of the loan, see *supra* note 235 and accompanying text, so that the cost of the decline will ordinarily be internalized to the debtor in any event. See *Discussion*, *supra* note 96, at 152-53. There are, no doubt, circumstances in which internalization in this form may be less than complete. See *supra* notes 238-40 and accompanying text. But that is least likely as to the most common kinds of dischargeable obligations. See *supra* notes 233-

losses can be externalized, nonwaivability rules are a clumsy instrument for dealing with the problem.²⁷² Empirical studies indicate that the chief beneficiaries of the discharge system, and thus presumably the primary targets of nonwaivability rules, are contract debtors with low to moderate incomes,²⁷³ for whom the opportunities to externalize lost productivity costs are the most limited.²⁷⁴

By contrast, the limitations imposed on self-insurance by the nonwaivability of the discharge are readily compatible with a concern for the possible externalization of default costs to the social insurance system.²⁷⁵ By and large, the default risk for any given

36 and accompanying text. Nor is there any reason to believe that the availability of discharge ameliorates the externalization: if the cost to the debtor fails to account for the risk of a decline in productivity, it will equally fail to account for the risk of complete discharge.

272. In circumstances in which the debtor's wages understate the social value of his employment, it has been suggested that the debtor's substitution of lower paying employment in response to collections activity would be less costly to the debtor than to society, due to the role of nonpecuniary benefits as a part of the measure of value. See Jackson, *supra* note 5, at 1422-23. In particular, the suggestion is, if the value to the debtor of the nonpecuniary benefits of a lower-paying job exceeds the social value of those benefits (as measured by their value to workers at the margin), a shift to the lower-paying job may cost the debtor less in lost total compensation than it will cost society in lost productivity. *Id.* at 1423. As that description suggests, however, social cost is no more likely to exceed individual cost than individual cost is likely to exceed social cost in circumstances in which the debtor's shift to lower-paying employment is an involuntary consequence of garnishment or of the health or psychological consequences of collection activity. In those cases, that is, because the substitution is not the product of incentives, one can as readily expect that the value to the debtor of the nonpecuniary benefits of the substitute employment would be the same as or less than the value of those benefits to society. Thus, a systematic excess of social cost over individual cost should occur, if at all, only in the context of employment costs incurred by a voluntary shift in employment, and then only in the even more limited context of the debtor for whom it is possible to obtain a lower-paying job that affords nonpecuniary benefits of a greater value to him than their value to workers at the margin. In short, to the extent that the concern is with externalities of this sort, the problem appears to be one of fairly narrow dimensions. And, as suggested *infra* note 274, it appears to be least significant among debtors who are the likeliest candidates for discharge.

273. See GAO STUDY, *supra* note 2, at 23, 29; *New Jersey Study*, *supra* note 233, at 551 table 11; *Nine States Study*, *supra* note 233, at 290 table B.

274. To the extent that any externalization of lost productivity costs is a function of the creditor's inability to shift the cost to the debtor at the time the liability is created, see *supra* note 271, contract debts are the least likely occasions for the problem to arise. See *supra* notes 233-40 and accompanying text. To the extent that the externalization is a result of differences in values ascribed to the nonpecuniary benefits of lower-paying substitute employment, see *supra* note 272, low-income debtors have the least opportunity to make the substitution; because they begin with already low incomes, they are less apt than others to be in a position to seek employment at even lower pay, whether or not the new employment offers nonpecuniary compensation that is highly valuable to the debtor.

275. As used here, references to the social insurance system are meant as a shorthand label for the entire range of government-sponsored benefit programs that are intended to

borrower tends to have an inverse correlation with his levels of income and wealth.²⁷⁶ Even in the absence of discharge rights, for the low-risk, high-income borrower, the existence of a significant income and wealth cushion would substantially decrease the possibility either that financial reversals would result in a loss of employment due to collections activity or that it would be possible for him to resort to social insurance benefits in the event that they did.²⁷⁷ For the high-risk, low-income borrower, on the other hand, significantly less protection would be afforded by his available income and wealth.²⁷⁸ In the event of an adverse change in the bor-

assure the general availability of a minimum income or standard of living. The term includes the various public assistance or income maintenance programs (such as general relief, aid to families with dependent children, supplemental security income, and the like), as well as programs affording subsidized assistance for particular basic living needs, such as food stamps, medicaid, or emergency food and housing assistance. To the extent that the likely beneficiaries of a government-sponsored income or other benefit program pay (directly or indirectly) a nonsubsidized, risk-related premium for their benefits (as may be the case, for example, relative to some forms of workers' compensation), a debtor's resort to the benefits as a consequence of collections costs should ordinarily involve only limited externalization, since the risk of such claims is at least generally internalized to the beneficiaries by means of premium payments. Thus, the primary concern here is with social "insurance" for which the "premium" is largely metaphorical (as in references to tax payments as a premium for public assistance) or in which the "premium" is unrelated to risk. As to those forms of social insurance, the transfer of collections costs to benefit costs will far more frequently be at the public's expense, rather than at the debtor's. Finally, it should be noted that, as the above parenthetical partial listings suggest, social insurance benefits of this kind are far more extensive than those simply afforded by income maintenance programs. For a more complete listing, one need only thumb through any recent edition of the *Catalog of Federal Domestic Assistance*. See U.S. GEN. SERV. ADMIN., CATALOG OF FEDERAL DOMESTIC ASSISTANCE (20th ed. 1986).

276. The correlation (which is, of course, a product of the relationship between ability to repay and the availability of resources for repayment) is most evident from the importance accorded income and wealth in credit-granting decisions. See Dunkelberg, *A Lower Rate Maximum for Retail Credit: The Impact on Consumers*, in 6 THE NATIONAL COMM'N ON CONSUMER FINANCE, TECHNICAL STUDIES 18-19 (1974) (discussing dominant role of income and income-correlated characteristics in credit standards); see also *id.* at 12 (greater likelihood of default among low-income borrowers).

277. That is not to say that it would be wholly unlikely or impossible for the affluent debtor to convert collections costs to social insurance costs in the event of financial difficulties. While income maintenance and other "safety net" programs frequently impose financial need criteria for eligibility, that is not inevitably the case as to the range of social insurance benefits. The services provided by subsidized community mental health or family service agencies, for example, are at times available to the public generally, and it would thus be possible for the psychological costs of collections to be transferred in part to such agencies by high-income borrowers. Moreover, even a debtor with substantial income is capable of losing that cushion in fairly short order, and of becoming thereby eligible even for those benefits as to which there are financial need criteria. The difference is one of likelihood, rather than of absolute possibilities.

278. See CREDIT RESEARCH CENTER, KRANNERT GRADUATE SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, MONOGRAPH No. 22, CRC 1979 CONSUMER FINANCIAL SURVEY 320 (1981)

rower's circumstances, the immediate costs would thus be far more likely to include loss of employment, and it would also be more likely to result in his resort to social insurance benefits. Absent a nonwaivable discharge, in short, it might be meaningful to speak of the low-risk debtor's decision to self-insure as true self-insurance, since the debtor and his property will ordinarily bear the costs of default. For the debtor with a significant income and wealth cushion, self-insurance may be unwise, but it *is* self-insurance. The high-risk debtor, however, has a relatively small capacity to bear the loss, and any decisions to "self-insure" in his case would in fact frequently involve not simply self-insurance, but also the externalization of collections-generated costs to the social insurance system.

Thus, in the same way that concerns with consumer judgment deficiencies suggest a basis for intervening in consumer insurance choices, a concern for the externalization of a limited class of collections costs tends to explain the limited scope of that intervention. In particular, the primary effect of nonwaivability rules is to limit the opportunity for troubled debtors to externalize the costs of default following a decision to self-insure. By compelling *ex ante* the substitution of implicit market insurance and preventive activities in place of self-insurance, it internalizes to the parties the risks associated with credit transactions.²⁷⁹ The discharge thereby

(data on relative holdings of liquid assets among income groups); Dunkelberg, *supra* note 276, at 10 (also relative holdings of liquid assets data); authorities cited *supra* note 112.

279. The compulsion of preventive activities as a substitute for self-insurance is accomplished indirectly, by placing the risk on creditors and thereby affording them an incentive either to limit the risk themselves (by limiting credit extensions) or to require risk-limiting behavior on the debtor's part as a condition of the loan. In that regard, it has been suggested that the available data on heuristic biases in risk judgments argue against shifting credit risks from debtors to creditors, since people should be less prone to error "when assessing their own behavior than when evaluating others' actions." Schwartz & Wilde, *supra* note 254, at 1444. From that perspective, it is claimed, the frequency of mistaken underestimations of risk may be increased by the nonwaivability of debtor protections. In reply, it has been argued that, even if creditors would be more prone to cognitive errors as an initial matter, there is greater reason to expect "market constraints" to correct errors made by creditors than by debtors (that is, the probability that competition will tend to "weed out" firms that systematically err in judging risk). Jackson, *supra* note 5, at 1417-18 & n.77. More fundamentally, the premise that debtors are less likely to err seems to be erroneous in itself. Individual credit grantors are far more likely than individual debtors to have experienced credit defaults in their history: for lenders, default is a part of doing business, while for borrowers it is a substantial impediment to acquiring a loan. Thus, to the extent that the tendency to risk underestimation is a function of the availability heuristic, *see supra* note 260, one would expect the wider experience of creditors to limit the intensity of the bias. *Cf.* Weinstein, *supra* note 258, at 813 (noting that increased awareness of the failures of others tends to reduce biases toward optimism). Moreover, as to cognitive biases generally, it appears that there is a greater tendency to employ statistically sound heuristics (that is, those

provides the debtor with an alternative, arguably more attractive, means for maintaining a minimum level of assets and income in the event of payment difficulties, without the necessity of transferring collections costs to the social insurance system. At the same time, the coverage of the insurance compelled by the discharge is limited to those protections that are of value in decreasing the debtor's need or incentive to rely on social insurance programs.

For example, because collections efforts directed at earnings are the most likely cause of externalizable unemployment costs, the discharge affords virtually complete protection to the debtor's postbankruptcy income and to the property acquired with that income. A similar concern appears to define the contours of the Code's other postbankruptcy protections. The prohibition of private employment discrimination²⁸⁰ directly limits postbankruptcy unemployment costs. Less directly, the prohibition of governmental discrimination,²⁸¹ the injunction against informal collections,²⁸² and the restraints on the debtor's capacity to reaffirm²⁸³ limit externalization by limiting activities that have historically been perceived as likely to resurrect the debtor's financial difficulties shortly after bankruptcy.²⁸⁴ By contrast, other adverse postbankruptcy conduct, such as impaired credit and other forms of private "discrimination," which appear to entail no particular employment or social insurance consequences, remain unregulated.²⁸⁵

in which biases toward error are muted or absent) as one's experience with the particular kind of event increases. See Nisbett, Krantz, Jepson & Kunda, *The Use of Statistical Heuristics in Everyday Inductive Reasoning*, 90 *PSYCHOLOGICAL REV.* 339, 347, 354-55 (1983) (describing the process and attributing it to the role of experience in enhancing the salience not only of the distribution of events, but also of the role of chance factors in affecting outcomes). To the extent that that is the case, one should expect creditors to be less likely than debtors to err in risk assessments because their experience makes it more likely that they will rely on statistically sound heuristics in reaching their judgments. And, indeed, the common use of statistically validated credit-screening devices, see *supra* note 236, suggests that to be the case.

280. 11 U.S.C. § 525(b) (Supp. III 1985).

281. *Id.* § 525(a).

282. *Id.* § 524(a)(2).

283. *Id.* § 524(c), (d) (1982 & Supp. III 1985).

284. See, e.g., S. REP. NO. 989, *supra* note 153, at 80; REPORT, *supra* note 5, at 177, H.R. REP. NO. 565, 95th Cong., 1st Sess. 162-65 (1977).

285. In 1973, the Commission on the Bankruptcy Laws of the United States proposed the enactment of a rule forbidding "discriminatory treatment [against a person] because he, or any person with whom he is or has been associated, is or has been a debtor or has failed to pay a debt discharged in a case under the Act." REPORT, *supra* note 5, pt. 2, at 143-44. While that phrasing appeared to encompass private as well as governmental discrimination, the Commission's explanatory note described its proposal as a protection from "discriminatory treatment under federal or state law," *id.* at 144 (emphasis added), and the Commis-

Similarly, the Code affords only the minimal protection of ex-

sion's Executive Director later described the reach to private conduct as an inadvertent error in drafting. There were those, however, who regarded at least some postbankruptcy expressions of private hostility toward debtors as incompatible with the "fresh start" policy. See, e.g., S. ENZER, R. DEBRIGARD & F. LAZAR, *supra* note 98, at 186; Comment, *Postdischarge Coercion of Bankrupts by Private Creditors: Girardier v. Webster College*, 91 HARV. L. REV. 1336, 1340-45 (1978). As originally enacted, the Code forbade only governmental discrimination, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2593 (codified as amended at 11 U.S.C. § 525 (1982 & Supp. II 1984)), an approach described as a codification of *Perez v. Campbell*, 402 U.S. 637 (1971) (discussed *supra* notes 148-49 and accompanying text). See S. REP. No. 989, *supra* note 153, at 81. In somewhat bolder fashion, however, the legislative history contained a statement that the statutory rule was "not exhaustive" and that it permitted "further development [by the judiciary] to prohibit actions by governmental or quasi-governmental organizations that perform licensing functions . . . or by other organizations that can seriously affect the debtors' livelihood or fresh start, such as exclusion from a union." *Id.* Notwithstanding that invitation and apart from occasional dicta, see, e.g., *Terry v. Gordon's Jewelry Co.*, 7 Bankr. 880, 881 (Bankr. E.D. Va. 1980), the reported decisions under the Code were essentially unanimous in holding that, unless it amounted to an effort to collect a discharged debt, which would violate the discharge injunction, private "discriminatory" conduct was not prohibited by the Code. See, e.g., *Barbee v. First Va. Bank-Colonial*, 14 Bankr. 733, 735-36 (Bankr. E.D. Va. 1981); *In re Coachlight Dinner Theatres of Nanuet, Inc.*, 8 Bankr. 657, 658-59 (Bankr. S.D.N.Y. 1981). *But cf.* *Blackwelder Furniture Co. v. Drexel Heritage Furnishings, Inc.*, 7 Bankr. 328, 334-35, 338-39 (Bankr. W.D.N.C. 1980) (preliminary injunction ordering suppliers to deal with business in Chapter 11, where substantial question was held to exist as to whether refusal to deal was unlawful discrimination contrary to "the letter or policy" of the Bankruptcy Code). As a doctrinal matter, a hesitant approach was hard to avoid, since § 525 was by its terms limited to government action, and *Perez* (which Congress envisioned as the seed for "further development") was decided under the supremacy clause, U.S. CONST., art. VI, cl. 2, a constitutional restraint on state law, rather than on private conduct. In 1984, the Bankruptcy Amendments Act extended the express prohibitions of § 525 to include the conduct of "private employer[s]" and precluded "terminat[ing] the employment of, or discriminat[ing] with respect to employment against" debtors or persons associated with them "solely because" they had filed bankruptcy or had failed to pay a discharged debt. 11 U.S.C. § 525(b) (Supp. III 1984).

Given the express extension to a particular form of private conduct (and the interpretive canon, *expressio unius est exclusio alterius*), one can reasonably doubt the continuing existence of whatever force the 1978 call for "further development" might once have had. Moreover, even if one were prepared to put aside doctrinal difficulties and principles of statutory construction, the considerations discussed in the text above suggest that a substantial degree of caution is still warranted in judicial prohibition of other forms of private discrimination under the "fresh start" rubric. In particular, because the postbankruptcy "fresh start" protections appear to be focused on limiting postbankruptcy social insurance costs, the inquiry as to particular kinds of private "discrimination" should be directed to the degree to which the conduct at issue can be expected to impair the debtor's postbankruptcy capacity to provide for himself. With the exception of employment discrimination, however, it is difficult to imagine forms of private conduct that can be expected (or that have been shown) to have any significant effect in that direction. In the absence of such a nexus between the conduct and the debtor's livelihood, the "fresh start" appears to offer no reason for intervention. See also *infra* notes 348-57 and accompanying text (discussing the role of postbankruptcy moral costs in reducing moral hazard). At the same time, the considerations suggested above suggest a fairly flexible construction of the terms "private employer" and "employment" in the existing express prohibition, in order to assure that their scope in-

emptions to the debtor's property existing at bankruptcy.²⁸⁶ Some degree of protection in that area may well be required in order to render the discharge more attractive than resorting to the social insurance system²⁸⁷ and to limit the debtor's need for immediate postbankruptcy credit. But a requirement that the debtor surrender property beyond that basic level is, in addition to its utility in reducing moral hazard, a cost that is unlikely to have an adverse impact on the debtor's capacity for self-support. Likewise, the debtor's power to avoid nonpurchase money liens in exempt property²⁸⁸ can be attributed both to assuring the attraction of discharge relative to social insurance and to limiting the postbankruptcy leverage of lienholders. The latter concern, indeed, suggests a rationale for the lack of a similar power as to purchase money liens:²⁸⁹ because the property secured by a nonpurchase money lien is far more likely to be of minimal value relative to the amount of the debt, the holder of such a lien is more likely than his purchase money counterpart to employ repossession rights, not to realize the market value of the collateral, but rather to induce payments from the debtor's postbankruptcy income.²⁹⁰

2. Consumer Competence, Social Insurance Costs, and the Contours of the Code's "Fresh Start"

An understanding of the underlying assumptions about the quality of consumer risk decisions and the externalized costs of those decisions has value beyond explaining the nonwaivability of dis-

cludes actors (such as labor unions) whose relationship to the debtor is central to his continued earning power, whether or not the relationship falls within a strict definition of "employment."

286. See *supra* note 209 and accompanying text.

287. See *In re Beck*, 4 Bankr. 661, 663 (Bankr. C.D. Ill. 1980); Trebilcock & Shulman, *supra* note 96, at 458-59.

288. 11 U.S.C. § 522(f) (1982).

289. It may be that the distinction in avoidability between purchase money and nonpurchase money liens reflects a perceived difference in the degree to which deficiencies in consumer risk judgments will affect the decision to place exempt property at risk. Because purchase money interests are created in the course of the acquisition of the property, see U.C.C. § 9-207 (1978), it may be that the possibility of the property's loss in the event of default would have greater salience to the debtor than the possible loss when the property is already owned and has no particular connection to the loan.

290. See *Head v. Home Credit Co.*, 4 Bankr. 521, 524 (Bankr. D. Tenn. 1980). That difference in practical utility between the two kinds of security interests appears to have played a substantial role in the Federal Trade Commission's recent promulgation of a rule prohibiting the taking of nonpurchase money interests in certain forms of basic property. 16 C.F.R. § 444.2(a)(1) (1986).

charge rights. In addition, the assumptions tend to place in perspective other aspects of the "fresh start" policy embodied in the existing structure of the discharge under the Bankruptcy Code. As discussed above, for example, the grounds for denial of discharge and the nondischargeability of some debts can sensibly be viewed as responsive to moral hazard problems.²⁹¹ As responses to moral hazard, however, those limitations are remarkably mild. Outright denial of discharge is essentially confined to cases of interference in or noncooperation with the monitoring activities of the bankruptcy proceeding,²⁹² and the moral hazard forms of nondischargeability are limited to fines, penalties, and fraudulently or maliciously incurred liabilities.²⁹³ Thus, with the exception of crimes, fraud, and malicious injuries, the debtor's prebankruptcy conduct leading to financial difficulties appears to be largely irrelevant to the availability or scope of relief under the Code.²⁹⁴ That general lack of concern for affording the debtor an incentive to be cautious in the creation of credit obligations and the corresponding focus on his circumstances and incentives at the time of bankruptcy would ordinarily be difficult to explain. It is more readily understandable, however, when viewed as a manifestation of the assumption that, due to the distortion of consumer risk and insurance decisions by cognitive biases, the *ex ante* incentive created by limitations on the discharge is severely limited. As a result, the primary concern is to limit the debtor's incentive to resort to social insurance benefits at the time financial difficulties arise.²⁹⁵

291. See *supra* notes 228-32 and accompanying text.

292. See *supra* note 232 and accompanying text.

293. See *supra* notes 229-31 and accompanying text. As to these liabilities, the role of deficiencies in judgment regarding risk is presumably substantially limited, since the full liability is a direct and immediate consequence of the conduct, and estimations of later *ability* to pay (whether or not mistaken) do not usually figure largely in the decision to act. For that reason, there may be substantially greater reason to expect that the liabilities serve a valuable deterrent function *ex ante*.

294. Moreover, nondischargeability is defined by reference to the debtor's prebankruptcy conduct only in Chapter 7 cases, since the § 523(a) moral hazard kinds of claims are fully dischargeable in Chapter 13. See 11 U.S.C. § 1328(a) (1982); see, e.g., *Johnson v. Edinboro State College*, 728 F.2d 163 (3d Cir. 1984).

295. Those concerns may also place in perspective the difference between Chapter 7 and Chapter 13 as to the dischargeability of malicious injury claims and the like, see *supra* note 294, a difference that has been described as "puzzling," Jackson, *supra* note 5, at 1440 n.147, and as "ludicrous," *In re McMinn*, 4 Bankr. 150, 154 (Bankr. D. Kan. 1980) ("If . . . it is the intent of Chapter 13 to absolve debtors of the liability for such acts, then that intent is ludicrous and the malaise apparently affecting our society is indeed understandable."). See also *Future Earnings Hearings*, *supra* note 2, at 37-38, 45-58 (testimony and statement of Claude L. Rice, arguing that plan confirmation in Chapter 13 should require

In the same vein, the existence of cognitive biases suggests an explanation for the lack of Code provisions limiting the quality or extent of the discharge rights available to "improvident" debtors, as opposed to those who are merely "victims" of external events.²⁹⁶ As the insurance characterization suggests, the failure to insure against external catastrophes can be regarded as no less a form of "improvidence" than is "overindulgence" in "easy" credit, since both kinds of conduct involve excessive reliance on self-insurance in place of market insurance or preventive activities.²⁹⁷ And in

that the debtor propose to pay § 523(a) claimants at least the amount that as a practical matter they would have been able to collect after discharge if the debtor had filed under Chapter 7 instead).

The difference in treatment may be less puzzling if one thinks of nondischargeability as a coverage limitation addressed to moral hazard concerns and if one recalls that deductibles and coinsurance can be used to serve a similar function. *See supra* note 225 and accompanying text. In Chapter 13 cases, the deductible (or cost to the debtor of relief) is almost inevitably higher than it is in Chapter 7 cases. At a minimum, the debtor's payments to creditors in Chapter 13 must be at least equal to what he would pay in Chapter 7. 11 U.S.C. § 1325(a)(4) (1982). In addition, under the 1984 amendments, the debtor must (if an impaired creditor objects) devote to plan payments an amount equal to his entire projected disposable income over three years, that is, the amount by which his income exceeds that "reasonably necessary" for his family's support. *Id.* § 1325(b) (Supp. III 1985). And, beyond that additional financial cost, Chapter 13 can usually be expected to entail greater nonmonetary burdens, since performance of the plan ordinarily requires that the debtor subject himself and his finances to external examination and control for at least three years, in contrast to the relatively brief duration of the ordinary Chapter 7 case. The extent of those burdens may be evidenced in part by the high failure rate of Chapter 13 plans, even prior to the 1984 amendments. *See supra* note 2. In any event, because the point of both deductibles and coverage limitations is a reduction in moral hazard, the higher deductible under Chapter 13 may serve to maintain a kind of rough equivalence with the more stringent coverage limitations of Chapter 7. At the same time, a concern with social insurance costs suggests the propriety of affording *some* form of relief even from liabilities that involve significant levels of moral hazard in their creation. While liabilities for theft, assault, and drunk driving can serve an important deterrent function, even thieves, brawlers, and drunks are nonetheless capable of transferring collections costs to the social insurance system. *See supra* note 293. A desire to limit postliability incentives of that kind (and a recognition that preliability incentives to avoid undesirable conduct can be maintained without a lifetime of liability, *cf.* OHIO REV. CODE ANN. §§ 2913.02(B), 2929.11(D) (Anderson Supp. 1985) (two-year maximum sentence for grand theft)), affords a sensible foundation for the rough trade-off between deductibles and coverage limitations manifested in the differences between Chapter 7 and Chapter 13.

296. *See supra* notes 70-73, 121-23 and accompanying text.

297. One quick intuitive reaction to the statement in text is, of course, that the "victim's" decision to self-insure may be the product of economic necessity and not of judgment deficiencies, since it frequently involves not choice but simply an inability to afford the premiums for market insurance. *Cf.* Shapiro, *Disability: The Forgotten Insurance*, N.Y. Times, Oct. 21, 1984, at F11, col. 1 (noting that disability income insurance "does not come cheap"). But that reaction misses the role of prevention as an alternative to self-insurance in limiting risk. To the extent that a debtor's liabilities include preclaimity contract obligations, his inability to afford market insurance is immaterial to the question of whether he

both cases the role of judgment deficiencies as the source of that excessive reliance suggests the limited point of discharge constraints intended to create *ex ante* insurance incentives.

A concern for limiting the externalization of default costs to government assistance programs similarly aids in explaining the non-moral hazard limitations of the existing "fresh start." In particular, nondischargeable tax liabilities and family obligations do not appear to raise particular moral hazard problems, and yet both are thoroughly excepted from discharge under both Chapter 7 and Chapter 13.²⁹⁸ What sets these debts off from other allowable claims is the likelihood that release of the debtor will do little to limit the transfer of collections costs to the public. In the case of taxes, the likelihood is a certainty. As to family obligations, the usual nonbankruptcy standards for establishing the level of the debtor's obligation (the debtor's ability and the dependent's or spouse's needs)²⁹⁹ make it relatively predictable that the deprivation of the debtor's support will frequently result in increased public assistance costs. Indeed, to the extent that nonbankruptcy standards fail to adhere to that focus, the statute requires that labels be disregarded and that dischargeability be defined by reference to whether the claim is "actually in the nature of" support.³⁰⁰ The

has made a rational trade-off between prevention (that is, foregoing credit) and self-insurance in dealing with the risk of a calamity impairing his payment ability. The reaction also misses the difference in available methods of dealing with even unavoidable decisions to self-insure, that is, reliance on future income versus committing present income to the risk by preferring savings over consumption. *See supra* note 261. From that perspective, the only "victim" without a choice is the one who cannot afford market insurance *and* whose financial difficulties would be the same regardless of his precalamity credit, consumption, and savings choices.

298. Notably, these are the only nondischargeable obligations with no apparent relation to moral hazard. That they are also the only obligations excepted from discharge both under Chapter 7 and under Chapter 13 may tend to support the view that the differential dischargeability of other § 523(a) claims is a function of moral hazard considerations. *See supra* note 295.

299. *See, e.g.*, OHIO REV. CODE ANN. § 3105.18(B) (Anderson 1980).

300. 11 U.S.C. § 523(a)(5)(B) (1982 & Supp. III 1985). Thus, the status of a particular obligation as "support" is a federal question decided in large measure by whether it was intended to be used for the spouse's or the dependent's living expenses and whether it was in fact necessary for that purpose. *See, e.g.*, Long v. Calhoun, 715 F.2d 1103 (6th Cir. 1983). Because the spouse or dependent may well have met his or her needs by borrowing or by resorting to public assistance, *see infra* note 301 and accompanying text, it is appropriate to disregard the parties' relative circumstances at the time of bankruptcy in deciding the dischargeability of arrearages. *See, e.g.*, Boyle v. Donovan, 724 F.2d 681 (8th Cir. 1984). It is likewise appropriate to disregard present circumstances in deciding the dischargeability of current "support" obligations (as long as the parties have the ability to seek modification of the original decree under state law standards that correspond to the bankruptcy meaning of

same orientation is evident in the provision that support obligations become dischargeable when they are assigned, unless the assignment is to a government agency that has provided public assistance to the debtor's spouse or child.³⁰¹ In each case, as with taxes, the effect of permitting discharge would not be to reduce the externalized social cost; it would, rather, simply shift the cost from one government pocket to another.³⁰²

"support"), not because the circumstances are irrelevant but simply as a matter of comity. *Cf. Boyd v. Robinson*, 31 Bankr. 591, 596 (D. Minn. 1983) (preference for abstention in favor of state courts in domestic relations matters). At the same time, it seems inappropriate to decide the status of arrearages by reference to the parties' circumstances at the time the support decree was entered, rather than at the time the particular payment came due, *see, e.g., Boyle*, 724 F.2d 681, since it is at the latter time that the parties' relative needs and abilities will influence the likelihood of resort to social insurance benefits by spouse or dependent. On the other hand, because the parties ordinarily will have the ability to seek a nonbankruptcy modification of the original decree on the basis of future changes in circumstances, those circumstances should be less relevant to the issue of the allowability (and hence dischargeability) of "support" payments due in the future.

301. 11 U.S.C. § 523(a)(5)(A) (1982 & Supp. III 1985). The difference between the assignment of support to a private party and simply borrowing to cover living expenses is that, in the latter event, the spouse's or dependent's ability to meet his or her needs remains impaired by the outstanding credit obligation. *See supra* note 300; *cf. Rombold v. Department of Human Resources*, 34 Bankr. 396 (Bankr. D. Or. 1983) (distinguishing between outright assignments and assignments for collection).

302. Other liabilities to the government (which are generally dischargeable) do not ordinarily involve the same externalization problems as would be involved in the discharge of tax liabilities and assigned support obligations. To the extent that the debtor's obligation is contractual, the government's claim is not significantly different from that of private actors in the relevant market, at least in terms of the capacity to internalize the costs to transactions involving the debtor or other contractual partners who are similarly situated. As to noncontractual claims, there is less ability to pass the cost to the debtor, but there is still a capacity to localize the risk to particular functions and to take risk-reducing steps to limit the loss. This may be less costly than the debtor's resort to social insurance would be under a regime of nondischargeability. Relative to taxes, by contrast, there is no particular function to which the risks or losses can be internalized, and relative to assigned support payments, the only available strategy of risk reduction would be a reduction in public assistance to the debtor's spouse or dependents.

Student loans (the one form of nondischargeable government claim other than taxes and assigned support obligations) do not involve these difficulties. Rather, their nondischargeability appears to be a function of the second form of moral hazard, the incentive to resort to discharge in the absence of need. *See infra* notes 303-09 and accompanying text. Given that student loans are a means of increasing the debtor's wealth by adding to his human capital, one has greater reason than in the case of consumption credit to assume that the borrower's circumstances have improved since the time the debt was incurred. That approach is, indeed, compatible with the structure of the student loan exception, which effectively establishes only a presumption of nondischargeability capable of being rebutted by a showing of "undue hardship" or by the passage of time. *See* 11 U.S.C. § 523(a)(8) (1982 & Supp. III 1985). A similar rebuttable presumption of nondischargeability in circumstances that strongly suggest the existence of moral hazard is employed relative to obligations for eve-of-bankruptcy "luxury goods" purchases. *Id.* § 523(a)(2)(C).

The assumptions underlying nonwaivability rules also tend to explain the absence of precise standards of eligibility for relief.³⁰³ If the intent is to preclude reliance on self-insurance only to the extent that "self-insurance" is in fact likely to be "social insurance," relief should be available only when the debtor's circumstances render payment of his debts sufficiently burdensome or collections activity sufficiently aggressive that his reliance on social insurance benefits will become either necessary or desirable. Ideally, that objective could be accomplished by expressly defining eligibility for relief in terms corresponding to the likelihood of such externalization, as by requiring some particular degree of indebtedness in excess of income or assets. As a practical matter, however, it is simply not possible to ascertain with any precision the point at which collections costs are likely to be externalized as to any given debtor. In part, that difficulty is a function of the variety of causes of externalizable social insurance costs.³⁰⁴ In part, too, it can be traced to the variety of social insurance programs to which collections costs might be transferred.³⁰⁵ What appears to be most important in this respect, however, is the role played by the non-monetary burdens of payment and collections activity. Any definitions of "need" or "inability-to-pay" framed wholly in financial terms would fail to capture the situation of debtors for whom the psychological, health, or even moral costs of payment, whether coerced or voluntary, are sufficiently grave as to result in a decline in employment and in a consequent resort to social insurance benefits.³⁰⁶ Because those nonmonetary costs tend to be highly idiosyncratic, varying widely from debtor to debtor both in gravity and in the extent to which they can be expected to occur, and because

303. See *supra* note 245 and accompanying text.

304. See *supra* notes 266-68 and accompanying text.

305. See *supra* note 275.

306. For discussions of the nonmonetary costs of financial difficulties, see authorities cited *supra* note 95; see also Kinsey & Lane, *The Effect of Debt on Perceived Household Welfare*, 12 J. CONSUMER AFF. 48 (1978); Liem & Rayman, *Health and Social Costs of Unemployment*, 37 AM. PSYCHOLOGIST 1116 (1982); Siporin, *supra* note 93, at 51-52; Trebilcock & Shulman, *supra* note 96, at 417-18. Payment may involve substantial nonmonetary costs to the debtor even in the absence of financial difficulties, as would be the case where a change in values had rendered morally troublesome the objectives pursued in the original choice to borrow. See Kronman, *supra* note 176, at 785-86. As to a debtor who is not in financial difficulties, there is less reason to be concerned with the possibility of his externalizing payment costs to the social insurance system because the availability of social insurance benefits tends generally to depend on financial need criteria. That is not inevitably the case, however, as is suggested *supra* note 275. In addition, even in the absence of current financial difficulties, the nonmonetary burdens of payment, if sufficiently severe, may themselves lead to financial problems by impairing the ability or motive to work.

they are not susceptible of measurement in any useful terms, they cannot be incorporated into an administratively workable standard of need.

Given these considerations, the absence of express need criteria governing access to the Code's discharge is hardly surprising: financial criteria would be too narrow, and nonfinancial tests would be incoherent. The Code's solution is, rather, the indirect method of reliance on the costs of discharge and on the limited scope of its benefits as a control on access.³⁰⁷ Thus, the discharge is designed to be attractive only to those debtors for whom the financial or other burdens of payment or collections activity are particularly severe, and for whom the possibilities of externalization of those burdens are correspondingly large. Because the debtor is himself the best judge of the gravity and extent of the default costs he suffers, his choice to substitute the costs of discharge can be taken as establishing need, as long as those discharge costs bear some relation to the objective of limiting social insurance costs. As suggested above, the limited protection of present assets in bankruptcy appears to be directed to that relationship.³⁰⁸ In the main, however, reliance on the incentive effects of costs and benefits is not, and as to nonmonetary costs cannot be, much more precise than express standards would be. The indirect approach has the advantage, however, of appearing to work in practice, as is suggested by the socioeconomic characteristics of consumer debtors under the Code, the great majority of whom are, as described in one recent study, "the near poor—families barely getting by and always at the brink of actual poverty."³⁰⁹

Finally, the deficiencies in consumer insurance decisions and the problem of externalized costs provide a rationale for the otherwise troublesome general dischargeability of most tort liabilities. As already discussed, the discharge of liabilities to involuntary nonbusiness creditors constitutes "insurance" for the debtor only in the sense that dischargeability shifts the risks created by his conduct from the debtor to potential tort plaintiffs.³¹⁰ Unlike insurance, the

307. See Eisenberg, *supra* note 8, at 980.

308. See *supra* notes 286-87 and accompanying text.

309. *New Jersey Study*, *supra* note 233, at 545. See *id.* at 558 (debtors' mean incomes "only marginally" higher than Bureau of Labor Standard's "lower living budget"); *Nine States Study*, *supra* note 233, at 306 (62% of debtors in sample reported income lower than "lower living budget").

310. See *supra* notes 239-40 and accompanying text.

risk transfer does not routinely involve the spreading or distribution of risks. More importantly, the liability does not depend on a voluntary transaction between the parties, and the debtor pays no "premium" for the protection afforded him. As noted by various commentators, that externalization of the debtor's insurance costs to tort plaintiffs is problematic because, in theory, it disrupts the incentive structure established by nonbankruptcy tort rules, thereby increasing the net social cost of noncontractual injuries and accidents.³¹¹ Those difficulties with the dischargeability of tort liabilities are far less compelling, however, if one assumes that a consumer debtor's failure to rely on insurance against accident liabilities is likely to be less the product of incentives to underinsure created by the discharge than a function of deficiencies in his ability to accurately estimate the risk of such liabilities.³¹²

That the capacity to externalize costs ordinarily has a limited incentive effect on a consumer debtor's *ex ante* insurance decisions (as appears to be assumed by the rationale for nonwaivability of the discharge) makes more understandable the focus of the discharge on costs and incentives that exist after the tort liability has been created. At that point, the social cost of the injury itself is the same whether or not the liability is dischargeable. At the same time, however, the availability of discharge can reduce the debtor's then-existing incentive to externalize to the public the employment costs caused by the tort plaintiff's collections activity. In that respect, with only limited attention given to preliability insurance incentives, contract obligations and tort liabilities are essentially indistinguishable; to the extent that minimizing the externalization of collections costs warrants the dischargeability of one, it likewise warrants the dischargeability of the other. In both cases the effect of permitting discharge is the same: correction of the consumer debtor's tendency toward excessive reliance on self-insurance *ex ante*, but only to the degree necessary to limit his *ex post* incentives to externalize the costs of self-insurance to the social insurance system.

311. See, e.g., Keeton & Kwerel, *Externalities in Automobile Insurance and the Underinsured Driver Problem*, 27 J.L. & ECON. 149 (1984); Note, *Tort Creditor Priority in the Secured Credit System: Asbestos Times, the Worst of Times*, 36 STAN. L. REV. 1045 (1984).

312. Cf. Arnould & Grabowski, *Auto Safety Regulation: An Analysis of Market Failure*, 12 BELL J. ECON. 27 (1981) (study of systematic underestimation of risk in demand for and use of automobile safety devices); Robertson, *Car Crashes: Perceived Vulnerability and Willingness to Pay for Crash Protection*, 3 J. COMMUNITY HEALTH 136 (1977) (similar study of risk underestimation).

C. *Other Considerations and Constraints*

The description set out above outlines the major elements of the "fresh start" policy in its existing form under the Code: the character of the discharge as a form of implicit insurance for debtors, established by a nonbargainable allocation of a part of the risk of an adverse change in the debtor's circumstances; the problems of moral hazard that inhere in any insurance relationship; and the assumptions about consumer insurance choices, incentive effects, and externalities that appear to be reflected both in the nonwaivability of discharge rights and in the particular contours of those rights under the Code. At the same time, however, the description does not exhaust the complete range of concerns historically set forth as important influences affecting the shape of the consumer "fresh start." As described in Part II, both the existence of the discharge and particular limits on its scope have been justified at various times by reference to other considerations as well: the rehabilitation of debtors, the advancement of distributive preferences, the enforcement of moral standards, and the furtherance of the bankruptcy system's debt collection functions. Whether and in what way these other considerations are relevant to the present state of the "fresh start" policy depends, however, on the extent to which they are compatible with the existing expression of that policy in the Bankruptcy Code. From that perspective, the description set out above provides not only an explanation of the Code's discharge but also a framework against which to measure the present relevance of these other considerations.

1. Debtor Rehabilitation

As described in Part II, a vision of the "fresh start" policy as incorporating concerns for debtor rehabilitation (in its strong or therapeutic sense) depends on the twin assumptions, first, that limited economic competence is at the root of the financial difficulties experienced by an identifiable portion of consumer bankrupts, and second, that the institutions administering the discharge are capable of correcting that root cause.³¹³ To a degree, the first of those assumptions does mesh with a portion of the rationale for nonwaivability of discharge rights, that consumer insurance decisions are commonly and systematically distorted by errors in judg-

313. See *supra* text accompanying notes 122-23.

ment generated by cognitive biases. Indeed, both a failure to insure against external economic events and "overindulgence" in credit use can be regarded as products of the same underlying deficiencies in judgment regarding risk.³¹⁴ To that extent, the existence of cognitive biases might superficially suggest a broader role for therapeutic intervention than that contained in the commonly proposed model of relief for "victims" and rehabilitation for the "irresponsible."

The second assumption of rehabilitation theory, however, cannot so readily be accommodated to the existing structure of the discharge. As it stands, the bankruptcy system is utterly devoid of the kinds of institutional arrangements one would expect to find if therapy were seriously a concern in the process: there are no consumer education classes, no social workers, no debt counselling sessions, nor even established procedures for referral to community service agencies that might provide such assistance.³¹⁵ Their absence is not surprising, since one repeatedly noted aspect of the heuristics at the source of consumer judgment deficiencies is that they are not particularly amenable to correction, whether by training, education, or even experience.³¹⁶ That limited mutability of cognitive biases underscores as well the difficulties with less formal, ad hoc efforts at incorporating judicially devised "therapy" into the administration of the Code's "fresh start." Even if the tendency for errors in risk decisions were readily capable of modification, one might well doubt the competence of judges, or other amateur therapists, to act as agents of change.³¹⁷ Given the tendency's

314. See *supra* notes 296-97 and accompanying text.

315. The Code does require that a consumer debtor be advised at filing by the clerk, 11 U.S.C. § 342(b) (1982 & Supp. III 1985) and by his attorney, see Form 1, ¶ 7 & exhibit B, 11 U.S.C. app. — Bankr. Rules (Supp. III 1985), of the bankruptcy options available to him, and it likewise requires that he be advised at discharge relative to the effect of any reaffirmation. 11 U.S.C. § 524(d)(1)(A) (1982). Advice of that kind is not, of course, the kind of counselling contemplated by rehabilitation proponents.

316. See Einhorn & Hogarth, *Behavioral Decision Theory: Processes of Judgment and Choice*, 32 ANN. REV. PSYCHOLOGY 53, 77-80 (1981); Tversky & Kahneman, *supra* note 255, at 1130. As discussed *supra* note 279, there is a degree to which experience appears to dilute the force of biases in predicting outcomes by increasing the salience both of chance factors and of the distribution of events. What that suggests, however, is that worthwhile therapeutic experience in the context of default risks is the experience of failure, rather than of "successful" financial management (whether or not accomplished under "rehabilitative" supervision).

317. Notably, the chief proponents of judicial "therapy" have tended to be bankruptcy judges, see, e.g., sources cited *supra* note 121, while skepticism regarding the efficacy of rehabilitation has tended to characterize the views of others in the legal community. See, e.g., D. BAIRD & T. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 742-43

resistance to curative measures, efforts of that kind can most often be characterized as pointless. Indeed, to the extent that the imposition of putatively "rehabilitative" constraints adds to the costs of discharge, it may in some circumstances defeat the objective of relief by increasing the attractions of social insurance relative to bankruptcy.

2. Distributive Preferences

It is similarly difficult to reconcile the existing structure of the "fresh start" with the assumptions necessarily implied in distributive explanations for the relief afforded by the discharge. To a degree, of course, the historical vision of debtor relief as effecting a wealth transfer from creditor to debtor³¹⁸ (and, perhaps, the appeal of that vision in some quarters) can be readily enough understood. It may be that it is possible and appropriate in some circumstances to advance distributive preferences by the manipulation of legal rules governing debtor-creditor relations.³¹⁹ But, as suggested by the discussion above,³²⁰ the discharge afforded by the Code can rarely be expected to accomplish distributive transfers from creditors to debtors. Indeed, the only circumstance in which such a transfer is likely to occur is the case of nonbusiness involuntary creditor, that is, the individual tort plaintiff.³²¹ In the more common context of contract credit, the creditor is the least likely source of any wealth transfers to the debtor, and the distributive effects of the discharge, if any, take the form of debtor-to-debtor or cash-customer-to-debtor transfers.³²² The debtor-to-debtor transfers, moreover, are only partially distributive in effect. Because the transaction giving rise to each such transfer involves the prior exchange of the discharge's insurance coverage for a premium which constitutes the source of the transfer, the transfer effected by the discharge can fairly be called distributive only to the extent of any subsidization of the cost of credit, that is, to the extent that

(1985); D. STANLEY & M. GIRTH, *supra* note 2, at 64 (noting that Chapter 13 debtors under the Act ordinarily had worse postbankruptcy debt payment records than did "straight" bankrupts); *Limiting Access*, *supra* note 171, at 1146.

318. See *supra* note 62 and accompanying text.

319. See Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563 (1982); Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472 (1980).

320. See *supra* notes 233-42 and accompanying text.

321. See *supra* notes 239-40 and accompanying text.

322. See *supra* notes 235-38 and accompanying text.

any given debtor's cost of credit fails to accurately reflect his particular level of risk. While such subsidies certainly do occur, they are likely to be least extensive in the most common transactions giving rise to dischargeable obligations, namely loans by those in the business of consumer finance.³²³ Further, even when subsidies of that kind exist, the individuation of credit screening and the segmentation of consumer credit markets tend to limit their effect to debtors with similar indicia of risk, which indicia commonly reflect the individual debtor's income and wealth characteristics.³²⁴ Thus, any subsidization of the cost of credit for high-risk, low-income borrowers will most frequently be at the expense of other high-risk, low-income borrowers, while the cost of any subsidies to low-risk, high-income borrowers will usually be borne by others with similar risk and income characteristics. In short, the distributive effects of the discharge are severely limited in the frequency of their occurrence, and to the extent that they do occur they appear to follow a pattern that can be rationalized only by reference to some highly unconventional, and as yet unidentified, theory of distributive justice.³²⁵

That distributive concerns are empirically an implausible basis for the availability of the discharge does not necessarily imply that they are wholly irrelevant to the structure of the Code's "fresh start." Indeed, it has at times been suggested that such concerns are significant less as an explanation for the discharge than as a source of at least some constraints on its operation.³²⁶ From that perspective, the distributive effects relevant to discharge policy are those involving regressive or otherwise distributively undesirable transfers, which can be minimized by particular limitations on the availability or scope of relief in bankruptcy. As is true of distributive explanations of the discharge itself, however, distributive explanations for its limits find little expression in the Code as it exists.

For the most part, neither the grounds for denial of discharge nor the catalog of nondischargeable debts includes claims the dis-

323. See *supra* notes 235-36 and accompanying text.

324. See *supra* note 276 and accompanying text.

325. Of course, to the extent that various social insurance programs reflect efforts at wealth redistribution, one can speak of the discharge as carrying out distributive ends by limiting the burdens on those programs. But that does not appear to be the meaning intended by those who offer distributive explanations for the availability of relief. See, e.g., C. FRIED, *CONTRACT AS PROMISE* 108-09 (1981).

326. See *supra* notes 65, 120 and accompanying text.

charge of which would ordinarily entail distributively awkward consequences. To be sure, there are exceptions, most notably the nondischargeability of malicious tort liabilities in Chapter 7 cases³²⁷ and of family obligations both in Chapter 7 and in Chapter 13.³²⁸ While the classes of creditors thus protected may arguably correspond to favored distributive classes, however, the correlation nonetheless does not comfortably support an inference that the special protections spring from distributive concerns. In each instance, the limitation of discharge can be readily explained on nondistributive grounds. At the same time, there is no apparent distributive basis for distinguishing between the protected creditors and other equally appealing candidates for distributively motivated limits on the discharge whose claims are nonetheless fully dischargeable. To the extent, for example, that the discharge of tort liabilities is distributively problematic, it is neither more nor less so in cases of negligence than in cases of malicious injury, but negligence claims are dischargeable while malicious injury liabilities are not. As noted above, the disparity in treatment can be sensibly understood on nondistributive grounds as reflecting a difference in relative degrees of moral hazard.³²⁹ If, however, the protection accorded malicious injury claimants is attributed to distributive preferences, the failure to similarly protect negligence plaintiffs becomes simply arbitrary. The ad hoc quality of distributive explanations and the availability of more coherent alternative rationales characterize other arguably distributive limits on the discharge as well.³³⁰ In each case, whether or not distributive pref-

327. 11 U.S.C. § 523(a), (b) (1982); 11 U.S.C. § 523(a)(9) (1982 & Supp. III 1985).

328. 11 U.S.C. § 523(a)(5) (1982 & Supp. III 1985); 11 U.S.C. § 1328(a) (1982).

329. See *supra* notes 229-30 and accompanying text.

330. Thus, the dischargeability of support claims assigned to private parties, see *supra* text accompanying note 301, should impair to some degree the marketability of those claims and hence their value to the spouse or dependent. From the standpoint of distributive preferences, it is difficult to see the point of distinguishing between assigned and retained claims or, if that distinction is to be made, between claims assigned to private parties and those assigned in return for public assistance benefits.

The discussion in the text is not intended to suggest that no aspects of the Code are fairly explainable as ad hoc exceptions to general policies. Certainly, there are contexts in which such makeshift explanations are inescapable. See, e.g., 11 U.S.C. § 365(b)(3) (1982 & Supp. III 1985) (special rules governing rejection of shopping center leases). The point is the narrower one that available explanations consistent with an inclusive and coherent policy framework are ordinarily to be preferred if possible to those of the ad hoc variety. In part that is simply a matter of aesthetic preference, but it has a more pragmatic foundation as well. Because any ad hoc explanation, by its nature, is limited to its particular context, none offers assistance in dealing with questions of interpretation and application in other contexts. Thus, even if one were to conclude, for example, that the nondischargeability of mali-

erences ought to shape or limit the "fresh start," there is little reason to believe that they do.

3. Moral Norms

While neither rehabilitation nor distributive concerns are well represented in the existing structure of the discharge, moral explanations are a more complex matter.³³¹ In the narrow context of the scope of the discharge, such explanations can readily be offered to describe particular exceptions to dischargeability. In particular, it is not difficult to suggest a moral basis for the nondischargeability of fraud and malicious injury claims,³³² given the existence of widely held standards regarding the ethical status of the conduct involved. Likewise, to the extent that the prohibitions of the criminal law can be said to reflect moral norms,³³³ similar judgments as to the debtor's fault in incurring the obligation can be suggested as underlying the nondischargeability of fines and penalties.³³⁴ These fault-based liabilities are not, however, entirely excepted from discharge; to the contrary, unlike family obligations and tax liabilities, they remain fully dischargeable in Chapter 13 cases.³³⁵ From the perspective of moral explanations, this difference in treatment is anomalous, since the blameworthiness of the conduct creating the liability is presumably the same in either event.

Even if one regards the exceptions as founded in moral judg-

icious injury claims reflects a somewhat arbitrary distributive preference for battery plaintiffs, the point would be interesting but not terribly instructive as to the contours of the general policies that constitute the "fresh start." Since identifiable general policies of the "fresh start" are crucial in Code interpretation, explanations that contribute to a working general picture are not only more comfortable but more useful as well.

331. In part, the complexity is a function of the elusiveness of "morality" as a distinct category of explanation. Distributive preferences, for example, presumably spring quite often from judgments as to the moral quality of existing wealth distributions. Likewise, even pure economic efficiency analyses have been dressed at times in moral garb. As used here, the reference is to explanations founded in what are (or are claimed to be) widely accepted notions of right and wrong, of personal responsibility, or of interpersonal "justice" that are only remotely related, if at all, to considerations of efficiency or equality. In short, the category is in many respects a residuary catchall, and its imprecision reflects that function. Cf. Calabresi & Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1080 (1972) ("Justice notions attach to other societal preferences which can only with difficulty be explained in terms of either efficiency or wealth distributional preferences These other justice notions . . . we are unable to describe in general terms . . .").

332. See 11 U.S.C. § 523(a)(6), (7) (1982).

333. See, e.g., P. DEVLIN, *THE ENFORCEMENT OF MORALS* 1-25 (1965).

334. See 11 U.S.C. § 523(a)(6), (7) (1982).

335. See *supra* notes 294-95 and accompanying text.

ments, however, their treatment under the Code can be more precisely characterized not as a case of moral fault precluding the debtor's release from liability, but rather as a matter of such fault limiting the insurability of the debtor's conduct. As noted above, the general uninsurability of intentional losses and criminal penalties is ordinarily based on a desire to assure the existence of incentives to avoid such losses.³³⁶ In that context, the difference in scope of the discharge between Chapter 7 and Chapter 13 can be understood as reflecting an assumption that the greater cost to the debtor of a Chapter 13 proceeding provides an adequate substitute for the limited incentive effects of the exclusions in Chapter 7.³³⁷ What these considerations suggest is that, even if one regards the exceptions as founded in moral judgments as to the debtor's fault, those judgments are nonetheless subordinate under the Code to concerns with the limited power of *ex ante* incentives and with the *ex post* externalization of collections costs. Moral judgments may provide a basis for creating or increasing incentives to avoid particular conduct, but it is the existence and quality of the incentives, rather than the moral judgment, that determines the availability of relief.

Beyond the limited concern with fault-based liabilities, a vision of moral norms as relevant to the "fresh start" also arises in a more general way, in the view that limits on the availability or extent of the discharge are warranted out of regard for the moral value of one's obligation to pay one's "just debts."³³⁸ Central to such moral explanations is a characterization of the discharge as an exception to the general enforceability of that moral duty, an exception that can be justified only by some morally acceptable excuse for nonperformance or by a countervailing moral duty of forbearance on the creditor's part. The existence of moral principles of that kind is, of course, difficult to dispute. Whatever may be the case as to the accidental injuries,³³⁹ as to contract debts there is certainly no shortage of well developed accounts of the moral character of the underlying promissory obligations.³⁴⁰ Indeed, it is safe

336. See *supra* notes 226-27 and accompanying text.

337. See *supra* note 295.

338. See, e.g., authorities cited *supra* note 311.

339. Compare, e.g., Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537 (1972) with R. POSNER, *supra* note 135, at 119-59. See generally G. CALABRESI, *COSTS OF ACCIDENTS* 24-33 (1970).

340. See, e.g., H. ARENDT, *THE HUMAN CONDITION* 243-47 (1958); I. KANT, *GROUNDWORK OF THE METAPHYSICS OF MORALS* 70-71, 89-90, 97 (H. Paton Trans. Harper Torchbooks ed.

to say that, while there may be substantial disagreement as to its legal significance,³⁴¹ the moral obligation to keep one's promises is a virtually universal ethical precept. Likewise, while forbearance or other forms of altruism are rarely transformed into legal obligations,³⁴² their moral value is a principle almost as widely accepted as the moral duty of payment.³⁴³ At the same time, however, it is difficult to describe the Code's "fresh start" or its limits in those terms. If the general moral duty of payment is to be enforced in the absence of grounds for excuse or forbearance, those grounds—the debtor's need or the difficulties of performance—should be central to the availability of release from the duty.³⁴⁴ Yet, as described above, the Code is strikingly devoid of standards defining the perils insured against.³⁴⁵ There are no express standards of eligibility, no requirements of need or inability, and no specifications of the particular circumstances triggering the right to relief. To the contrary, the availability of discharge under the Code is essentially a matter of the debtor's choice. For the debtor prepared to bear its costs, the decision to file bankruptcy is virtually conclusive of questions regarding the necessity or propriety of the decision. That absence of a standard of need has been, of course, the object of intense criticism in recent years, much of it framed in terms of moral obligation.³⁴⁶ As the existence of such criticism suggests, however, limits on the availability of the discharge in its present state have little apparent relation to the limits of morally legitimate excuses for nonpayment. Nor is the absence of such a relationship entirely surprising, even from the perspective of moral obligation. At least relative to contract liabilities, the release obtained by the debtor is the product of a prior

1964); J. RAWLS, A THEORY OF JUSTICE 342-50 (1971); Raz, *Promises and Obligations* in LAW, MORALITY AND SOCIETY 210 (P. Hacker & J. Raz, ed. 1977).

341. Compare, e.g., P. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 649-59 (1979) with C. FRIED, *supra* note 325, at 7-27.

342. See generally THE GOOD SAMARITAN AND THE LAW (Ratcliffe ed. 1966); Landes & Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83 (1978); see also H. Arendt, *supra* note 340, at 243 ("forgiving . . . —perhaps because of its religious context, perhaps because of the connection with love attending its discovery—has always been deemed unrealistic and inadmissible in the public realm").

343. See, e.g., C. FRIED, RIGHT AND WRONG 114-31 (1978); J. RAWLS, *supra* note 340, at 338-39. See generally J. FISHKIN, THE LIMITS OF OBLIGATION *passim* (1982).

344. Cf. J.L. AUSTIN, PHILOSOPHICAL PAPERS 128, 129 (1961) (equating ethics with the study of excuses).

345. See *supra* note 244 and accompanying text.

346. See, e.g., authorities cited *supra* note 174.

exchange in which, absent fraud, the risks of nonpayment were accounted for. In that context, the moral foundation of the creditor's claim to payment is somewhat dubious. Rather than being morally entitled to payment, he has already been paid.³⁴⁷

Notwithstanding these difficulties, the language of moral rights and obligations has long had an undeniable rhetorical significance in disputes over the appropriate shape of discharge rights. The staying power of that rhetoric suggests a somewhat different role for moral norms in the structure of the "fresh start." As described above, the absence of specific standards defining eligibility for bankruptcy can be understood as the product of the intractable difficulties inherent in identifying the degree of protection required to effectively minimize the externalization of collections costs.³⁴⁸ One consequence of an indiscriminating policy is, however, the opportunity that it creates for debtors to resort to the discharge when financial or other burdens of payment are slight and the risks of externalization are low. Given the impracticability of direct control by way of specific standards, that form of moral hazard cannot be eliminated, but it can be reduced. The primary means of doing so is the imposition of costs on the insured debtor in order to limit the ease with which relief can be sought.³⁴⁹ While the costs may impose financial burdens, as in the requirement that the debtor surrender assets or income as a condition of relief, there are other, nonmonetary, controls. One variety of such nonmonetary costs is the "stigma" (that is, the postbankruptcy loss of creditworthiness or social standing) traditionally thought to be associated with bankruptcy.³⁵⁰ A second form of control is the debtor's own sense of moral obligation regarding the payment of dischargeable debts.³⁵¹ To a degree, of course, and particularly relative to

347. The debtor himself may not be the source of the payment, but from the perspective of the creditor's moral claims, that is immaterial. From the perspective of those who are the source of the payment (primarily other borrowers), the role of exchange in the creation of the liability likewise suggests a somewhat more limited range for moral argument, since the contribution of those other borrowers to the debtor's loss has in some degree been compensated for by the similar insurance coverage afforded them. That would not be the case, of course, to the extent that the compulsory nature of the insurance limits the existence of perfect equivalence between the premium paid by any other borrower and the value to him of the risk reduction accomplished by the availability of discharge. See *supra* note 217.

348. See *supra* notes 303-09 and accompanying text.

349. See *supra* note 225 and accompanying text.

350. See, e.g., *Perry v. Commerce Loan Co.*, 383 U.S. 392, 395 (1966); Cover, *supra* note 69, at 90-91; LoPucki, *supra* note 176, 373-78.

351. See *Arrow*, *supra* note 223, at 538; Shuchman, *supra* note 97, at 456.

postbankruptcy credit, the stigma of bankruptcy is simply the product of economic judgments.³⁵² But to the extent that it goes beyond that and reflects community moral standards, it shares common features with the debtor's own internalized moral judgments. In both cases, the role of moral standards is not to provide a rationale for limits on the availability of relief. It is, rather, the standards themselves that are the limits. Whether individually held or socially imposed, the very existence of such standards adds to the costs of claiming relief and thus raises the threshold degree to which the debtor must find payment burdensome before he will choose discharge as an alternative.

The role of moral norms as instrumental in the reduction of moral hazard is not, however, an unmixed blessing. Both the existence and the extent of postbankruptcy social stigma have long been matters of doubt.³⁵³ Moreover, even when they do exist, neither stigma nor individual moral standards are terribly susceptible of measurement in any meaningful way.³⁵⁴ At the same time, as already noted, there are substantial difficulties involved in identifying the precise degree of relief from payment burdens that is required to minimize the externalization of the employment costs of collections activity.³⁵⁵ A primary consequence of these uncertainties is the limited predictability of the incentive effects of moral standards. At an extreme, it can probably be said with confidence that a universal posture of unqualified moral hostility to use of the discharge would defeat its social function, both by excessively limiting its use and by imposing externalizable postbankruptcy costs even on those who did use it. Short of that, however, the extent to which moral norms limit the attractiveness of bankruptcy is essentially a matter of conjecture, and one can likewise

352. That is, the judgments relative to credit reflect the perceived predictive power of the debtor's earlier failure to pay. See, e.g., Allen, *The Prevention of Default*, 36 J. FIN. 271 (1981); Hassler, Myers & Seldin, *Payment History as a Predictor of Credit Risk*, 47 J. APPLIED PSYCHOLOGY 383 (1963).

353. See, e.g., *Reform Act Hearings*, *supra* note 170, at 19, 21 (stigma regarded as *de minimis*); LoPucki, *supra* note 176, at 373-78 (treating stigma as essentially limited to impaired credit). Even as to postbankruptcy creditworthiness, it is not entirely clear that a bankruptcy filing impairs one's ability to obtain new loans. See D. STANLEY & M. GIRTH, *supra* note 2, at 62-65.

354. For an interesting, but hardly adequate, effort at measurement, see *Reform Act Hearings*, *supra* note 170, at 19, 20 (survey of bankrupt debtors' opinions on "major social impacts" of bankruptcy).

355. See *supra* notes 303-06 and accompanying text.

only guess at whether the costs they impose are useful or counterproductive.

These uncertainties suggest the basis for the Code's somewhat ambivalent response to the role of moral norms. In general, where the externalization of employment costs is reasonably direct and predictable, the Code limits both the imposition of external moral standards (as in the prohibition of discrimination by employers and government agencies)³⁵⁶ and the debtor's capacity to honor his own moral judgments (as in the limited power to reaffirm dischargeable debts).³⁵⁷ In other circumstances, however, the Code refrains from interfering in or adding to the imposition of costs by the enforcement of moral norms, whether the imposition is accomplished by others or by the debtor himself. The policy judgment underlying that approach is in many respects similar to the judgment at the base of the failure to establish specific criteria of need for the discharge. Given the difficulties in ascertaining and predicting the relevant incentives, and in the absence of identifiable externalities or incompetence, the unregulated choice of the participants is as likely as any other device to produce the socially appropriate result.

4. The Collections Function and Payments to Creditors

A final concern sometimes advanced as influencing the contours of the consumer "fresh start" is the historical role of the bankruptcy system as a collections device used to secure payments to

356. 11 U.S.C. § 525 (1982 & Supp. III 1985).

357. *Id.* § 524(c), (d). The shifting legislative treatment of reaffirmations is a particularly useful illustration of the problem of accounting for moral costs. As originally enacted, the Code provided that most reaffirmations were unenforceable unless approved by the court prior to discharge as "not imposing an undue hardship" and "in the best interest of the debtor." See *supra* note 168. Almost without exception, the bankruptcy courts construed "best interest" as meaning "financial or economic best interest" and thus refused to approve reaffirmations motivated by the debtors' sense of moral obligation, whether to creditors or to family members who had given guarantees. See, e.g., *In re Leonard*, 12 Bankr. 91 (Bankr. D. Md. 1981); *In re Berkich*, 7 Bankr. 483 (Bankr. E.D. Pa. 1980); *In re Avis*, 3 Bankr. 205 (Bankr. S.D. Ohio 1980). In 1984, the requirement of court approval was deleted for debtors represented by counsel, and in its place was substituted a requirement that *counsel* certify the agreement as "fully informed and voluntary" and "not an undue hardship." 11 U.S.C. § 524(c)(3) (1982 & Supp. III 1985). Apart from questions as to the wisdom of shifting the decisional responsibility to lawyers, see *Morris*, *supra* note 196, at 106-07, the shift away from judges and the deletion of the "best interest" standard can reasonably be taken as an indication that the judicial treatment of reaffirmations was viewed as unduly constraining, and that greater room was needed for debtors to make their own judgments as to the value of nonmonetary gains and losses.

creditors.³⁵⁸ In the context of consumer bankruptcies, that distinct function is occasionally described as embodying an independent policy concern for creditor payment that must be "balanced" against the "fresh start" policy to determine the extent of particular discharge rights.³⁵⁹ As a framework for interpretation, of course, that approach has the advantage of the flexible vagueness which tends to characterize the use of "balancing" standards in legal discourse generally. Nonetheless, the approach is flawed as a description of bankruptcy policy. To the extent that it rests on an inference from the institutional arrangements for administering the discharge, it appears to misconceive the relationship between the collections and discharge functions of the bankruptcy system. To the extent that it rests on a more general social policy favoring the collection of debts, it adds nothing coherent to the existing Code accommodation of that policy with the concerns underlying discharge rights.

As described in Part II, the combination of the bankruptcy systems collections and discharge functions in a single institutional framework is largely an accident of constitutional history, rather than the product of deliberate choice.³⁶⁰ But the two functions are not wholly unrelated. In the administration of the discharge, a requirement that the debtor surrender some assets to creditors is an important means of controlling moral hazard. To the extent that the imposition of that cost does produce payments for creditors, there are obvious advantages in distributing the dividends by means of an existing, nonduplicative collections system.³⁶¹ From the perspective of discharge policy, however, the relevant point is the imposition of costs on the debtor, not the production of a payment to creditors.³⁶² Likewise, the focus of the distribution is not the relationship between debtor and creditors, but rather the relationship among creditors themselves.³⁶³ Indeed, that policy of equity in distribution is the central point of the collections function of bankruptcy, distinguishing it from the wide variety of individual

358. See *supra* notes 13-15 and accompanying text.

359. See, e.g., *Kokoszka v. Belford*, 417 U.S. 642, 645-46 (1974).

360. See *supra* notes 25-34 and accompanying text.

361. See *Jackson, supra* note 5, at 1396.

362. Thus, as a device for the control of moral hazard, a requirement that a Chapter 13 debtor be divested of three-years worth of disposable income has essentially the same utility whether the income is turned over to plan payments or to Planned Parenthood.

363. See *Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 *YALE L.J.* 857 (1982); *Radin, supra* note 15, at 3; cf. *In re Phillips*, 298 F. 135 (S.D. Ohio 1924) (discharge denied where debtor scheduled only one nondischargeable debt).

creditor's remedies available under state law. In the existing insitutional arrangement, that function complements devices for the reduction of moral hazard. It does not, however, suggest that increasing the size of the bankruptcy estate is, independent of moral hazard considerations, a relevant factor in determining the availability or scope of discharge rights.

To suggest that the collections function of bankruptcy affords no reason for limiting the "fresh start" is not, of course, to deny the existence of a general social policy favoring the payment and collection of debts. Nor is it to deny that the availability of a means for release from payment is in some respects at odds with that policy. But recognition that there is such a policy does not add to the analysis of the scope of existing discharge rights. There are likewise social policies favoring safe driving, control of pets, and the cleanup of toxic waste sites, each of which is arguably impaired to some degree by the availability of discharge.³⁶⁴ In each case, it might well be possible to advance those policies by restricting the dischargeability of debts. In general, however, as described above, the very existence of the discharge reflects a judgment that the social cost of the impairment of those other policies is small in relation to the social value of avoiding opportunities for the externalization of collections costs.³⁶⁵ In the larger context of legal rules and sanctions generally, that is, one can speak coherently of striking a balance between competing policies. In the narrow context of the discharge, however, the balance has already been struck.

So too, a generalized policy favoring collection of debts, standing alone, would justify virtually any limitation of discharge rights.³⁶⁶ To provide a meaningful basis for distinguishing between appropriate and inappropriate limitations, the collections policy must be more precisely defined: for example, that collection is favored in the absence of employment externalities, or only to the extent that a debtor is able to pay. Cast in those terms, however, the description merely restates the policy concerns that warrant the existence of the discharge. The pertinent considerations are the reasons for

364. See *Ohio v. Kovacs*, 469 U.S. 274 (1985) (toxic waste liabilities dischargeable); *Perez v. Campbell*, 402 U.S. 637 (1971) (automobile accident liabilities); *In re Quezada*, 718 F.2d 121 (5th Cir. 1983) (dog bite liabilities).

365. See *supra* notes 263, 295 and accompanying text.

366. See *Rejoinder*, *supra* note 171, at 1097. "At bottom, then, the argument . . . is the same tired truism: the more limited the discharge, the fewer debtors who will go into bankruptcy. This approach to predictability would reach its apogee where the consequences of nonpayment of debt were so draconian that all debt would be repaid . . ." *Id.*

permitting nonpayment, and not the social value of payment. In short, undifferentiated reliance on the policy favoring payment is incoherent as a source of limits on the "fresh start," and a more precise definition of that policy simply duplicates the limits derivable from the nature of the "fresh start" policy itself. In neither case does reference to the social value of payment make a helpful contribution to the analysis.

D. *The Bankruptcy Code's "Fresh Start" and the Judiciary: By Way of Summary, and an Example*

1. The Theory of Discharge Under the Code

At bottom, the "fresh start" policy, at any given time, consists of the empirical assumptions and normative judgments that underlie the existing set of discharge rights. As outlined in the foregoing description, the Bankruptcy Code's vision of the "fresh start" is built on a relatively narrow subset of the possible range of such assumptions and judgments, and the considerations relevant to the scope and limits of that policy are correspondingly limited. In particular, the central premise of the Code's discharge rights is a circumscribed concern with the externalization to the social insurance system of the costs of collections activity. That concern is attributable in turn to the perceived tendency of consumer debtors to rely excessively on self-insurance in credit decisions due to systematic errors in judgment regarding risk-creating activity. Of the variety of possible responses to those problems, the Code's approach is an indirect one, effectively compelling debtors to substitute for self-insurance a minimum level of implicit insurance. This implicit insurance takes the form of the nonbargainable allocation to creditors of a part of the risk of a change in the debtor's circumstances.

The characteristic features of insurance, together with the underlying concerns for externalities and judgment deficiencies, establish the framework within which particular aspects of the Code's "fresh start" are defined. Thus, the degree to which discharge rights interfere with consumer insurance choices is defined primarily by the extent to which self-insurance decisions are expected to result in the externalization of collections costs. Likewise, both the availability and the extent of the compelled insurance are defined by the need to limit the adverse incentives or moral hazard created by the existence of insurance. Those incentives ordinarily take two forms: first, a decreased reliance on risk-

reducing behavior in advance of a loss; and second, an increased tendency at the time a claim is made to exaggerate either the existence of the peril insured against or the extent of the loss.

Under the Code, the first form of moral hazard is treated as relatively insignificant. This reflects the empirical assumption that, relative to credit, the risk-taking behavior and insurance decisions of consumer debtors are not ordinarily affected by the existence of discharge rights. The focus of predefault incentives, at least as to contract debts, is the creditor. Acting as insurer, he is assumed to afford a measure of unbiased risk estimation and hence more accurate risk reduction in the form of limited credit extensions. At the same time, discharge limitations addressed to the debtor's prebankruptcy behavior are confined to circumstances, such as fraud or malicious injury, in which there is stronger reason to believe that incentive effects exist, or in which the debtor's conduct would impair the creditor's efforts at risk evaluation and prevention. Moreover, even as to such liabilities, the effort to control prebankruptcy behavior is limited to imposing the ordinarily greater cost of a Chapter 13 proceeding as the price of relief.

Postdefault incentives, by contrast, are a central part of the Code's discharge structure. In that respect, the purpose for compelling insurance and the subsidiary goal of limiting the second form of moral hazard are intertwined, since claims can be characterized as exaggerated or unnecessary only with reference to the objective of limiting the externalization of collections costs. Ideally, these postdefault concerns could be addressed by a precise definition of the insured peril in terms of the possibilities for externalization (which is to say, by eligibility standards), and by postbankruptcy monitoring to reduce the opportunities for exaggerated claims. That course is not available, however, due to the impossibility of identifying with any precision the circumstances in which collections costs are likely to be externalized. Instead, the Code relies on the nature and extent of the available relief as a proxy for express standards. Thus, the most important impact of the freedom from personal liability effected by the discharge is the prevention of collection efforts against future income or the fruits of future income, which efforts would otherwise be a chief source of externalizable employment costs. Likewise, the relief extends to other postbankruptcy conduct—employment discrimination, informal collections, reaffirmations, and governmental discrimination—that, as a matter of logic or experience, could be expected to

result in postbankruptcy employment costs if left uncontrolled. By contrast, the debtor's existing assets are protected only to the minimum extent of the basic property covered by exemption rights. Affording some degree of protection in that regard is essential to making the discharge more attractive than unemployment. At the same time, the requirement that the debtor surrender his existing property beyond that level, coupled with other, nonmonetary costs of bankruptcy, tends to render discharge attractive only to those for whom the financial or other burdens of payment are particularly severe. Finally, the Code excludes entirely from the scope of relief a limited class of debts, family obligations and tax liabilities, the discharge of which would externalize costs to the government and neutralize the value of the discharge in reducing costs to the social insurance system. Taken together, those costs and benefits of resort to bankruptcy both define the effective coverage of the compelled insurance and operate as a check on moral hazard in the form of unnecessary or exaggerated claims (that is, bankruptcy petitions by debtors for whom the possibilities of externalized collections costs are minimal).

2. An Illustration: "Substantial Abuse" Dismissal in Chapter 7

As the foregoing summary suggests, both the existence of the discharge and its particular contours under the Code can be understood as reflecting a coherent set of legislative assumptions and judgments regarding consumers and their participation in credit markets. An understanding of the substance of the Code "fresh start" policy is of obvious value in understanding the purposes of and relationships among the various rules regarding the availability, scope, and effect of discharge rights under the Code. In addition, and more importantly from a practical standpoint, a sound grasp of the detailed content of the "fresh start" policy is an essential tool in judicial administration of the discharge. Relative to the Code or any other statute, of course, the judicial function ordinarily involves a task both more narrow and more complex than the direct identification and enforcement of legislative policy. What Congress enacted was the Bankruptcy Code, not a "Fresh Start Policy Act" or a set of empirical assumptions and normative judgments, and the usual means by which courts carry out bankruptcy policy is the application of the statute according to its terms, em-

playing the conventional tools of statutory analysis.³⁶⁷

Within that conventional framework, the underlying theory of discharge may be of distinctly subordinate consequence in the interpretation of a large number of Code provisions. There remain, however, a variety of contexts in which the general policy of the Code provides the only sensible standard for choosing among otherwise plausible but competing constructions of vague or ambiguous statutory language.³⁶⁸ Moreover, there are portions of the Code in which vagueness or ambiguity shades into deliberate legislative invitations to the use of undiluted policy judgments in judicial framing of the contours of the discharge. The most recent addition to this latter class of statutory provisions³⁶⁹—section 707(b)³⁷⁰—affords a valuable illustration not only of the central significance of discharge theory in Code interpretation but also of the means for integrating considerations of policy into the administration of particular Code provisions.

Section 707(b) states that “on its own motion, and not at the request or suggestion of any party in interest,” the bankruptcy court may dismiss a Chapter 7 case filed by an individual debtor “whose debts are primarily consumer debts,” if it finds that relief would be “a substantial abuse of the provisions” of Chapter 7.³⁷¹ The section also establishes notice and hearing requirements and a “presumption in favor of granting the relief requested by the

367. See, e.g., *Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.*, 106 S. Ct. 681, 689 (1986) (“Invocation of the ‘plain purpose’ of legislation at the expense of the terms of the statute itself . . . prevents the effectuation of congressional intent.”); *TVA v. Hill*, 437 U.S. 153, 194 (1978) (“Once the meaning of an enactment is discerned . . . the judicial process comes to an end.”). But see *Balthazor v. Winnebago County*, 36 Bankr. 656, 658 (Bankr. E.D. Wis. 1984) (although not within the literal scope of the then-existing list of nondischargeable claims, see 11 U.S.C. § 523(a)(5) (1982 & Supp. II 1984), liability for support under decree of paternity held nondischargeable as a matter of policy).

368. See, e.g., 11 U.S.C. § 523(a)(6) (1982) (nondischargeability of claims for “willful and malicious” injury); 11 U.S.C. § 524(c)(6) (Supp. III 1985) (requirement for approval of reaffirmation by debtor not represented by counsel that agreement be “in the best interest” of the debtor). The vagueness or ambiguity may not be apparent at first glance. See, e.g., *Mid-Atlantic Nat’l Bank v. New Jersey Dept. of Env’tl. Protection*, 106 S. Ct. 755 (1986) (trustee’s duties regarding toxic waste sites); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984) (special standards for rejection of collective bargaining agreements) (modified in part by 11 U.S.C. § 1113 (Supp. III 1985)).

369. Another open invitation of the same class may be embodied in the “penumbra” of the protection against discrimination, 11 U.S.C. § 525 (1982 & Supp. III 1985), as discussed *supra* note 285.

370. Bankruptcy Amendments Act of 1984, *supra* note 7, enacting 11 U.S.C. § 707(b) (Supp. III 1985).

371. *Id.*

debtor."³⁷² As even a quick reading of the section suggests, there are any number of interpretive issues that must be addressed in the course of judicial efforts to apply its provisions to particular cases.³⁷³ Chief among these is, of course, the question of when or in what circumstances discharge would constitute a "substantial abuse" of Chapter 7.

A degree of guidance as to the scope of that vague and undefined language can be garnered from the statute itself and from its legislative history. Thus, various comments in the House and Senate at the time of enactment make it fairly obvious that the central legislative concern was to limit Chapter 7 filings by debtors whose projected available income would be sufficient to pay some significant portion of their debts if they filed under Chapter 13 instead.³⁷⁴ A concern with income as a measure of "abuse" is likewise evident in the addition of an income and expense statement to the schedules required to be filed in Chapter 7 cases,³⁷⁵ since that document would appear to have no other use if it were not intended as the basis for a section 707(b) inquiry. The section itself is the lineal descendant of earlier proposals advocated by the consumer credit industry that would have expressly conditioned the availability of relief on the debtor's "need" or on the insufficiency of his future income.³⁷⁶ Indeed, it seems to be generally conceded that a chief impetus for the consumer bankruptcy amendments in the 1984 Act was the claim of the consumer credit industry that discharge was too accessible for debtors who had substantial income available to them.³⁷⁷ As enacted, however, the section significantly differs from its predecessors by omitting the absence of financial need as an express criterion for dismissal and in limiting the dismissal power to Chapter 7 cases.³⁷⁸

372. *Id.*

373. For example, when are a debtor's debts "primarily consumer debts?" See *In re White*, 49 Bankr. 869, 872-73 (Bankr. W.D.N.C. 1985) (debtor with single liability, a tort judgment, not within § 707(b) since liability was not incurred for personal, family, or household purpose); *In re Bryant*, 47 Bankr. 21, 26 (Bankr. W.D.N.C. 1984) (whether debtor with mix of business and personal debts falls within the section is not *per se* to be determined by number or amount of each class).

374. See, e.g., 130 CONG. REC. S8894 (daily ed. June 29, 1984) (remarks of Sen. Hatch); *id.* H7497 (remarks of Rep. Brooks); *id.* H7499 (remarks of Rep. Anderson).

375. 11 U.S.C. § 521(a) (Supp. III 1985).

376. See, e.g., *supra* note 198. On the derivation from earlier proposals, see 130 CONG. REC. H7491 (daily ed. June 29, 1984) (remarks of Rep. Moorhead).

377. See, e.g., Morris, *supra* note 196, at 94-95; *New Jersey Study*, *supra* note 233, at 590-91; *Rejoinder*, *supra* note 171, at 1103; see also notes 170-71 and accompanying text.

378. Cf. *Rejoinder*, *supra* note 171, at 1103 ("the provisions adopted are pale and ambig-

That background provides, if only tentatively, somewhat more content to the "substantial abuse" question than the bare statutory language imports. Congress, one can reasonably conclude, has determined that, when a Chapter 7 petitioner's income reaches a certain level, it may be appropriate to depart from the general principle that the debtor's own decision to seek relief is the best evidence of the necessity of discharge. When that is the case, the debtor is to be denied the ability to choose Chapter 7, and is to be left to obtain a discharge either under Chapter 13 or not at all. Obviously, however, a focus on income as a primary test of "substantial abuse" serves only to begin the inquiry. In particular cases, a number of questions still remain. What level of income, for example, calls for a finding that the debtor's choice of a Chapter 7 discharge would be a "substantial abuse?"³⁷⁹ Is some level of income alone a sufficient basis for such a finding, or must income be examined with other factors?³⁸⁰ Is excess income even a necessary element of "substantial abuse," or would a section 707(b) dismissal be appropriate on other grounds, apart from income considerations?³⁸¹ An answer to these and similar questions can hardly be derived from the statute alone or from its legislative history. Rather, whether and in what way the debtor's income or other circumstances should operate to veto his choice of discharge generally, or of a Chapter 7 discharge in particular, can be determined only by reference to the reasons for the existence of that choice in the first place.

As suggested by the analysis summarized above, the deference ordinarily accorded the debtor's decision to seek relief is a function

uous reflections of the original . . . proposal").

379. *In re Grant*, 51 Bankr. 385 (Bankr. N.D. Ohio 1985) (abuse found in part on ground that surplus income sufficient to pay 68% of unsecured claims over five years); *In re Edwards*, 50 Bankr. 933 (Bankr. S.D.N.Y. 1985) (threshold income level for instituting inquiry is ordinarily surplus income sufficient to pay 100% of total indebtedness within three years); see *In re Bryant*, 47 Bankr. 21 (abuse found in part on ground that debtor's surplus income was sufficient to pay 67% of unsecured loans over three years).

380. See *In re Hudson*, 56 Bankr. 415, 419 (Bankr. N.D. Ohio 1985) (court should take into account available income together with circumstances leading to difficulties, debtor's behavior in the proceeding, and the like).

381. Compare *In re Bell*, 56 Bankr. 637, 641 (Bankr. E.D. Mich. 1986) (ability to pay is "primary, if not exclusive" consideration) with *In re Christian*, 51 Bankr. 118, 121 n.3 (Bankr. D.N.J. 1985) (dictum that some forms of injustice or misconduct "could shock the conscience of the court" and permit dismissal even if they do not "ris[e] to the level of a ruling on dischargeability"); *In re Edwards*, 50 Bankr. 933, 937 n.3 (Bankr. S.D.N.Y. 1985) ("future ability to pay is the proper focus" of § 707(b) and other forms of putative "abuse" are immaterial).

of the purpose of the discharge in limiting his need or incentive to rely on the social insurance system. The debtor's reliance may be an involuntary result of coercive collections activity or a product of the attractions of social insurance relative to the burdens of payment.³⁸² In either event, a debtor's "need" for discharge is measured by the likelihood that continued enforcement of his debts will lead to the externalization of payment or collections costs in the form of social insurance costs. Reliance on the debtor's choice as conclusive of need reflects the uncertainties involved in accurately identifying the circumstances in which externalization is likely to occur, as well as an assumption that the financial and other costs of bankruptcy are usually an adequate proxy for express standards.³⁸³

From that perspective, the appropriate focus under section 707(b) is the accuracy *vel non* of those two assumptions in any given case. Thus, if the costs of collection or payment borne by the debtor are so slight as to create no risk that he would find it necessary or desirable to resort to social insurance benefits if bankruptcy were unavailable, there is no social point to relief. In such an instance, discharge would be an "abuse" not simply of Chapter 7, but of the Code generally. Likewise, even when the debtor's circumstances appear to involve some degree of collections costs, the cost of a Chapter 7 discharge may be insufficient to assure that the debtor's burdens are in fact severe enough to entail a risk of externalization. In such a case, one can speak of relief under Chapter 7 as a "substantial abuse," in the narrower sense that the greater cost of a Chapter 13 proceeding provides a more accurate test of "need."

The relevance of the debtor's income to these considerations is, of course, that the existence and extent of available income will frequently have a direct effect on the extent of collections costs and on the risk of externalization. A debtor whose expected income substantially exceeds his liabilities is unlikely to forego that income in favor of social insurance, even if left without the protections of discharge. Likewise, when a prospective Chapter 7 debtor's expected surplus income is large relative to the value of his nonexempt assets, the disparity gives reason to believe that his willingness to bear the asset surrender cost of a Chapter 7 discharge is

382. See *supra* notes 306-09 and accompanying text.

383. See *supra* notes 307-09, 350-57 and accompanying text.

not necessarily strong evidence of the severity of the collections burdens that he would bear in the absence of discharge. A minimal level of surplus income, on the other hand, suggests the contrary, both as to the likelihood of externalizable collections costs and as to the reliability of the debtor's choice. In that circumstance the absence of an income cushion offers strong evidence that the debtor's burdens are likely to become social insurance costs, either due to the impact of unpayable liabilities on his incentive to continue working or as a collateral consequence of aggressive collections activity.³⁸⁴

In each case, examination of the debtor's income is useful in determining whether the assumptions underlying the availability of the discharge are sound. Of necessity, however, income considerations can play only a part in such decisions. In particular, consideration of income alone does not take into account the nonfinancial costs of collections or of discharge. Thus, the situation of a debtor with a substantial surplus of income over liabilities may nonetheless create, due to the nonfinancial costs of payment or collections, a significant likelihood of externalizable employment costs. One can, of course, imagine the somewhat extreme case of a debtor for whom payment has become morally offensive,³⁸⁵ but that is hardly necessary. Even ordinary debtors with substantial income may be largely incapable of personal financial management. Notwithstanding (or perhaps because of) their surplus income, they will be subject to precisely the sort of repeated collections activity that tends to have an adverse effect on employment.³⁸⁶ Likewise, the costs of a Chapter 7 discharge often include not only asset surrender but also a variety of social, psychological, and moral burdens.³⁸⁷ For any given debtor, the combination of asset surrender and those moral costs may be substantial. Thus, even when asset surrender alone would be a weak check on the debtor's "need" for relief, the total cost of the Chapter 7 discharge might still be sufficient to warrant a conclusion that the debtor's payment or collections burdens are in fact particularly severe and that the risk of externalizable health, psychological, or employment costs is correspondingly great.

384. See *supra* notes 278-79 and accompanying text.

385. Cf. Kronman, *supra* note 176, at 783-84, 785-86.

386. See, e.g., *In re Edwards*, 50 Bankr. 933 (married debtors with stable employment, a combined income of \$60,000 per year, and total debts of approximately \$15,000 had nonetheless been unable to maintain payments scheduled through a credit counseling agency and several creditors had recently resorted to wage garnishment for payment).

387. See *supra* notes 350-57 and accompanying text.

As these considerations suggest, the determination whether to grant a debtor's request for discharge under Chapter 7 must be made not only on the basis of the debtor's income level but also in view of the relative costs to the debtor of Chapter 7, Chapter 13, and outright dismissal. It is, after all, those factors that are relevant to whether the debtor's situation corresponds to the assumptions underlying the availability of discharge rights. At the same time, the analysis described in the preceding sections leads to a conclusion that considerations other than relative costs and the debtor's income should play little if any part in resolving "substantial abuse" questions.

The statutory standard is, to be sure, markedly vague. This is a characteristic that has led some courts to suggest that "substantial abuse" dismissal would be proper for any of a variety of reasons: as a response to the debtor's misbehavior in the proceeding (by the filing of inaccurate income schedules, for example);³⁸⁸ or on the basis of the causes of the debtor's financial difficulties ("unforeseen calamity" versus "a high lifestyle"),³⁸⁹ the offensiveness of his motives or prebankruptcy conduct,³⁹⁰ his putative need for the "curative" discipline of a Chapter 13 proceeding,³⁹¹ or the equities of particular debts.³⁹² Even as a matter of routine statutory construction, however, reliance on at least some of those considerations is unsupportable. The debtor's misbehavior in the proceeding itself, for example, is a matter addressed in detail by the grounds for denial of discharge under section 727³⁹³ as well as by the provision for dismissal on account of "unreasonable delay" under section 707(a),³⁹⁴ each of which establishes specific requirements for denying relief. An application of section 707(b) to punish misconduct that almost but not quite reaches the standards set out in those sections would, of course, render the standards pointless.³⁹⁵ Similarly, to the extent that particular claims are to be accorded special treatment in Chapter 7, they are provided for in the exceptions to

388. See, e.g., *In re Grant*, 51 Bankr. 385; *In re Bryant*, 47 Bankr. 21.

389. See, e.g., *In re Grant*, 51 Bankr. 385.

390. See, e.g., *In re Bryant*, 47 Bankr. 21.

391. See *In re Grant*, 51 Bankr. 385.

392. See, e.g., *In re Christian*, 51 Bankr. at 121 n.3 (dictum); *In re Reynolds*, 49 Bankr. 51 (Bankr. D.N.H. 1985) (dictum).

393. 11 U.S.C. § 727(a) (1982 & Supp. III 1985).

394. *Id.* § 707(a).

395. See *In re Edwards*, 50 Bankr. at 937 n.3 (Abram, J., dictum).

discharge under section 523.³⁹⁶ Since the very point of the Chapter 7 discharge is relief from debts not listed in section 523, one can hardly characterize such relief as a "substantial abuse" of Chapter 7.³⁹⁷ Indeed, a use of section 707(b) to protect the holders of particular dischargeable claims, however appealing they may be, appears to be incompatible with section 707(b) itself, which provides that dismissal may *not* be ordered "at the request or suggestion of any party in interest."³⁹⁸ That denial of standing strongly suggests that creditors lack any cognizable interest in the outcome of the "substantial abuse" inquiry.

The inconsistency of the remaining considerations with the policy underpinnings of the discharge itself is fairly plain, although the statute is less clear. That is particularly true of dismissals premised on the debtors' prebankruptcy "exorbitant lifestyle"³⁹⁹ or their failure to display "a sincere resolve to tighten their belts."⁴⁰⁰ As described above, the very existence of a nonwaivable discharge is predicated in part on the perception that *ex post* consequences afford little utility as a prebankruptcy incentive for debtor caution in incurring credit obligations.⁴⁰¹ At least relative to contract debt, the focus of the Code is on providing an incentive to *creditors* to undertake preventive activities.⁴⁰² In that context, a denial of relief intended to punish the debtor's lack of care has counterproductive incentive effects, since it does nothing to ameliorate the risk of externalized collections costs and it dilutes creditors' incentives to limit risk-creating credit extensions.

Nor is consideration of prebankruptcy conduct warranted by the differential moral appeal of the "unfortunate victim" as opposed to the "extravagant" wastrel, or by the supposed rehabilitative value of the greater financial discipline involved in a Chapter 13 proceeding.⁴⁰³ As described above, the situation of the "victim" who fails to insure against external events is not fundamentally different from that of the borrower with a taste for highly leveraged consumption. Both situations involve excessive reliance on self-insurance, and both are the product of the same deficiencies in

396. 11 U.S.C. § 523(a) (1982).

397. See *In re White*, 49 Bankr. 869.

398. 11 U.S.C. § 707(b) (Supp. III 1985).

399. *In re Bryant*, 47 Bankr. 21.

400. *In re Grant*, 51 Bankr. 385.

401. See *supra* note 263 and accompanying text.

402. See *supra* note 279.

403. See, e.g., *In re Grant*, 51 Bankr. 385; *In re Bryant*, 47 Bankr. 21.

judgment regarding risk.⁴⁰⁴ Moreover, in neither case can one reasonably expect the structured aspects of a Chapter 13 proceeding or other "rehabilitative" efforts to have much impact on the far side of discharge.⁴⁰⁵ In the absence of a rehabilitative effect, of course, dismissal as a response to the debtor's prebankruptcy lifestyle still retains its counterproductive consequences relative both to externalization and to the creditors' prebankruptcy incentives.

The foregoing considerations suggest, then, the appropriate line of inquiry under section 707(b). The central question is the debtor's "need" for relief, in the sense that discharge is appropriate to limit the externalization of collections costs to the social insurance system. As an initial matter, "substantial abuse" dismissal is thus appropriate in cases in which the court is convinced that the debtor's liabilities will create neither a disincentive to employment nor any risk of employment loss or of significant psychological or health costs due to collections activity. This determination will most frequently rest in large part on the level of the debtor's surplus income, since a debtor capable of fully paying his debts in the short term is ordinarily not likely to be a voluntary or involuntary candidate for social insurance as a result of those minimal burdens. In that context, the appropriate measure of a high surplus income is a capacity for *full* payment in the relatively short term (a year or less, for example), since an ability to rapidly eliminate debts is what gives assurance that the debtor's situation involves no risk of externalization.⁴⁰⁶ But even a high surplus income is not itself a sufficient basis for a finding of "substantial abuse." Because the risk of externalization is also affected by the non-monetary burdens of payment, a determination that discharge is not needed must also rest on the absence or insignificance of those nonmonetary burdens in the particular case. Thus, even for a high-surplus debtor, the absence of indicia of nonmonetary costs, such

404. See *supra* note 297 and accompanying text.

405. See *supra* notes 316-17 and accompanying text.

406. Likewise, in this context, the amount of income that constitutes "surplus" (i.e., the amount regarded as available for payments to creditors) should be measured by the debtor's actual spending habits and not on the basis of what would be "reasonably necessary" for his support, since the central question is what can be expected to happen if the debtor is left to his own devices outside bankruptcy. If full payment in the short term would require an alteration in lifestyle, then the debtor would in fact bear some degree of payment or collections burden, and dismissal on the ground that no such burden exists would be unwarranted. At the same time, of course, a dismissal to obtain the greater assurance of Chapter 13 costs might nonetheless be appropriate in such a case, as described *infra* notes 408-13 and accompanying text.

as a history of financial mismanagement or recent collections activity directed to earnings, should be a condition precedent to dismissal.⁴⁰⁷

Short of a determination that there is *no* risk of externalization, "substantial abuse" dismissal may also be appropriate where the cost to the debtor of a Chapter 7 proceeding is so low relative to his surplus income that his decision to seek relief cannot be taken as a reliable indicator that his debt burdens are severe enough to involve a risk of externalization. In that context, the point of dismissal is only to deny Chapter 7 relief and not to preclude discharge altogether. Thus, the pertinent considerations are subtly but significantly different. First, because the intended effect is to substitute the greater cost of a Chapter 13 proceeding as a test of "need," dismissal in the absence of the circumstances described in the preceding paragraph would be appropriate only when relief is in fact available to the debtor by way of Chapter 13.⁴⁰⁸ At a minimum, that means that the debtor must be eligible to proceed under Chapter 13, but one must also be able to conclude that a Chapter 13 plan would be confirmed and successfully carried out.⁴⁰⁹ Second, because the focus is on the reliability of Chapter 7

407. Because a dismissal in this context is based on the premise that the debtor will not or cannot avail himself of relief by way of Chapter 13, the possible role of bankruptcy protections in limiting nonmonetary costs (as, for example, the effect of the automatic stay in preventing garnishment) cannot be taken into account, as it might be if the decision were premised on the availability of Chapter 13 relief.

408. See *In re Mastroeni*, 56 Bankr. 456 (Bankr. S.D.N.Y. 1985); *In re Edwards*, 50 Bankr. 933; *In re White*, 49 Bankr. 869. At least one court has held that dismissal ought not to turn on the availability of Chapter 13 relief, since a debtor can respond to the dismissal by filing under Chapter 11. See also *In re White*, 49 Bankr. at 874-75, cf. *In re Moog*, 774 F.2d 1073 (11th Cir. 1985) (individual consumer debtor may file under Chapter 11). As described by the court in *In re Mastroeni*, however, the technical availability of Chapter 11 is meaningless in this context. Because a consumer debtor's chief asset, his income, would not be property of the Chapter 11 estate, "an individual consumer's Chapter 11 plan would not differ much from a Chapter 7 liquidation," and creditors could be expected to seek conversion to Chapter 7 in fairly short order. *In re Mastroeni*, 56 Bankr. at 459. Compare 11 U.S.C. § 541(a) (1982 & Supp. III 1985) with 11 U.S.C. § 1306(a) (1982).

409. See *In re Edwards*, 50 Bankr. 933. In that respect, one must take into account the high failure rate among even fully voluntary Chapter 13 plans at a time prior to the enactment of the present rigorous payment requirements. See *supra* note 2. That experience strongly suggests caution in reaching the conclusion that a debtor who prefers to be in Chapter 7 will have the incentive and ability to carry out a three-year regimen of living within the "reasonably necessary" budget imposed by Chapter 13. Nor is it a particularly sound answer to that difficulty to suggest that the act of rendering Chapter 7 unavailable will add to the debtor's incentive to succeed in Chapter 13. As noted by Judge Abram, it can as easily "encourage debtors in need of bankruptcy relief to delay filing and possibly incur further debts they will ultimately prove unable to pay" under either Chapter. *In re Ed-*

costs as a proxy for "need," there must be reason to believe that the debtor's decision to seek discharge does not actually reflect severe debt burdens. This would be true in cases where the debtor's surplus income, while perhaps not sufficient for full payment of his debts in the short term, nonetheless comes close to meeting that measure.⁴¹⁰ Third, there must be some significant added value of Chapter 13 over Chapter 7 in providing assurance of "need." Of course, the cost to the debtor of a Chapter 13 discharge will ordinarily be greater than his costs under Chapter 7,⁴¹¹ and in that sense Chapter 13 will almost inevitably provide some greater assurance that the debtor's payment or collections burdens are substantial. But that greater assurance may be of comparatively little added value if the debtor's Chapter 7 costs, financial or otherwise, are themselves substantial already.

Thus, a finding of "abuse" requires not only a high income-to-debt ratio but also the absence or insignificance of Chapter 7 costs to the debtor in the case at hand. Conversely, in any case where the likelihood of externalizable collections costs is apparent, as where the debtor has been the subject of repeated collections efforts, or in which the Chapter 7 discharge entails significant costs to the debtor,⁴¹² whatever the level of his income, there is no rea-

wards, 50 Bankr. at 941 n.10. For that reason, one must be confident that the debtor will in fact use Chapter 13 if denied relief under Chapter 7.

410. See, e.g., *In re Edwards*, 50 Bankr. 933 (ability to pay 100% of debts within three years, employing Chapter 13 "disposable income" test). As *Edwards* suggests, a hypothetical Chapter 13 plan affords a useful starting point, both in assessing the relevance of Chapter 13 feasibility, see *supra* notes 408-09 and accompanying text, and in estimating the existence of an income cushion that raises doubts as to the likelihood of the debtor's resort to social insurance benefits. When the Chapter 13 "disposable income" standard is used for the latter purpose, however, the appropriate focus is on surplus income as a measure of need, rather than on that income as a source of repayments to creditors. For that reason, it should be immaterial whether a hypothetical Chapter 13 plan would or would not produce "meaningful" or "substantial" payments to creditor. See, e.g., *In re Bell*, 56 Bankr. at 641. Even if "meaningful payments" can be made, the debtor's Chapter 7 costs may still be substantial and thus sufficient to evidence "need." Conversely, and far less likely, even if "meaningful payments" are not an expected outcome of a hypothetical Chapter 13 case, the debtor's surplus may still be large relative to his Chapter 7 costs, and those costs may be sufficiently small as to raise doubts about "need." The point is that the debtor's surplus income is relevant, not because of its attractions to creditors, but because its size (relative to both his Chapter 7 costs and the amount of his debts) is a valuable indicator of whether his indebtedness creates a risk of employment loss or other externalizable collections costs.

411. See *supra* note 295.

412. Thus, for example, a debtor with substantial nonexempt assets, or one whose exempt property is largely subject to nonavoidable security interests, may already be paying a high price for the Chapter 7 discharge, a price that may in itself evidence the existence of significant payment or collections burdens beyond the monetary value of the property.

son to doubt the accuracy of the debtor's choice as reflecting the existence of substantial payment or collections burdens. There is thus no reason to require the further assurance of Chapter 13 costs as a test of "need."

As may be apparent, both lines of "substantial abuse" inquiry involve common elements. Prime among those is the need to identify with precision both the particular assumptions underlying the ordinary rule of deference to the debtor's choice and the considerations that are material to deciding the accuracy of those assumptions in the case at hand. In addition, the inquiry requires a sensitivity to the role of nonmonetary costs and benefits in deciding whether a particular debtor's choice is in fact compatible with those assumptions.⁴¹³ In that regard, there is room for a substantial measure of judicial skepticism, or perhaps humility, regarding the judicial capacity to make accurate individual assessments of the present or predicted effects of indebtedness on any given debtor's "need" for the relief afforded by the discharge. As suggested above, the general accessibility of the discharge is in large measure a product of the uncertainties inherent in the making of such assessments, and reflects a legislative decision to err on the side of relief.⁴¹⁴ The power conferred by section 707(b) does not obviate, but rather enhances, the role of caution in making firm judgments as to the likely health, psychological, or employment costs of indebtedness in individual cases. As is suggested in part by the statutory presumption "in favor of granting the relief requested by the debtor,"⁴¹⁵ the debtor's own choice, whether of discharge generally or of Chapter 7 in particular, remains a valuable indicium of "need." A decision to override that choice should be made only when one, having taken into account the inherent limits of human judgment, can nonetheless remain confident as to the accuracy of that judgment in the case at hand.

IV. CONCLUSION

The approach suggested above is by no means limited in its relevance solely to section 707(b) or to other provisions of the Bank-

413. See, e.g., *In re Edwards*, 50 Bankr. 933.

414. See *supra* note 306-09 and accompanying text. For a recent and quite remarkable example of blithe unconcern for the limits of one's predictive powers, see *In re Bell*, 56 Bankr. at 642-43 (Chapter 11 plan deemed feasible for community college teacher on terminal contract, since in court's view "he likely will not be unemployed for very long").

415. 11 U.S.C. § 707(b) (West Supp. III 1985).

ruptcy Code in which Congress has deliberately legislated with a view to the judicial identification and enforcement of underlying policies. In any context in which policy is a controlling factor in the choice among plausible interpretations, faithful administration of the Code requires a clear and precise idea of what its provisions are designed to accomplish. Such catch phrases as "fresh start" and "honest but unfortunate" (or, for that matter, "externalization" and "social insurance costs") can be useful as shorthand labels summarizing the complex of values and assumptions that shape the discharge. They become dangerous, however, when they constitute not summaries of, but substitutes for analysis. As described in Part II, it is possible to imagine a host of values that might be taken into account in framing discharge policy. The description in Part III suggests the particular vision of the relevant considerations that appears to be embodied in the Code as it exists. The interpretive theory described is not, of course, a universal solvent for all problems of Code interpretation. But to the extent that it emphasizes the importance of asking questions about the assumptions underlying the Code, and to the extent that it offers plausible answers to some of those questions, the description will have served a useful purpose.