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Articles

Consumer Bankruptcy: A Proposal to Reform Chapters 7 and 13 of the U.S. Bankruptcy Code

Charles M. Foster* & Stephen L. Poe**

I. Introduction

Although the U.S. economy has enjoyed a period of steady growth for the past seven years, personal bankruptcies continue to rise.[1] In 1998, a record 1.44 million bankruptcy petitions were filed, a near three percent increase over those filed in 1997, a fifteen percent increase over those filed in 1996, and a forty percent increase over those filed in 1995.[2] More than ninety-five percent of these petitions were filed by individuals, with about eighty percent of the filings in Chapter 7 and Chapter 13.[3] The number of personal

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1. Julie Kosterlitz, *Over the Edge*, 29 NAT'L L.J. 870 (1997).

2. *See* Jennifer Corbett Dooren, *Bankruptcy Filings Hit Record, But Business Fail Rate Slows*, S.F. EXAM'R, Mar. 2, 1999, at B-3; *Visa USA Sees Personal Bankruptcies Headed for a Record in '98*, NAT'L MORTGAGE NEWS, July 20, 1998, at 47.

3. *The Increase in Personal Bankruptcy and Consumer Credit Crisis: Hearings Before the Subcomm. On Administrative Oversight and the Courts of the Senate*

bankruptcies forecast for 2001 is more than 2.2 million, which is almost four times the number a decade ago. Accompanying this rise in personal bankruptcies has been a staggering increase in the amount of losses incurred by consumer creditors, particularly credit card issuers. For example, in 1995 losses sustained by issuers increased forty-five percent to 4.7 billion dollars.[4]

As losses to lenders have steadily risen, the consumer credit industry has continued to request that Congress take action to reform the bankruptcy laws to insure that consumer debtors make more of an effort to repay their obligations in the bankruptcy process. Over the past five years, a number of actions have been taken to accommodate these requests. In 1994, Congress established the National Bankruptcy Review Commission (NBRC) to review the existing bankruptcy laws, evaluate the operation of the bankruptcy system, and propose changes to enhance the efficiency and fairness of the system. In 1997, the NBRC issued its report to Congress, joining a variety of reform proposals already circulated by the consumer credit industry and other interested parties. Most recently, in the spring of 1999, the House of Representatives passed a bill[5] designed to address creditor concerns by significantly reforming the consumer bankruptcy process. The purposes of this paper are to provide an overview of the consumer bankruptcy system, explore the legal, social and economic factors that have contributed to the boom in consumer bankruptcy filings, and discuss the various reform proposals advocated by the NBRC. the consumer credit industry, and those currently being considered by Congress. The article concludes with the authors' own reform proposal, which is an attempt to address the concerns and unite the interests of both consumer advocates and creditors.

II. Overview of Chapter 7 and Chapter 13 Proceedings

The framers of the Constitution had English bankruptcy laws in mind when they gave Congress the power to enact "uniform laws

Judiciary Comm., 105th Cong. 138 (1997) [hereinafter *Hearings*] (statement of American Bankruptcy Institute).

4. Kosterlitz, *supra* note 1, at 870. As one commentator has noted, however, these loss figures are most likely overstated. "The bankruptcy process itself should be blamed only for the marginal losses that occur because of the availability of the bankruptcy option. The figures include all the losses resulting from those filings, many of which would occur even without the availability of bankruptcy." Vern McKinley, *Ballooning Bankruptcies: Issuing Blame for the Explosive Growth*, 20 REGULATION 33, 37 (1997).

5. *See* H.R. 833, 106th Cong. (1999)

on the subject of bankruptcies."[6] At that time, the English bankruptcy system was extremely pro-creditor and very harsh on debtors, who were considered virtually as criminals.[7] Only creditors could initiate bankruptcy proceedings, the primary purpose of which was to facilitate collection and repayment of debts.[8] Any attempt by a debtor to prevent creditors from collecting debts was considered an act of bankruptcy,[9] enabling creditors to petition the Chancellor to seize, appraise and sell the debtor's assets, and then distribute the proceeds pro rata to creditors similar to contemporary liquidation proceedings.[10] No debtor discharge provisions existed in the earliest bankruptcy laws, so creditors were able after bankruptcy to initiate further attempts to collect from the debtor.[11]

Today, the U.S. bankruptcy system attempts to balance the needs of creditors and debtors.[12] The system eschews simple punishment in favor of blending two all-American values: personal responsibility and the availability of a second chance.[13] In theory anyway a goal of the system is to encourage debtors to quickly become productive members of society.

Consumer debtors seeking relief from their creditors essentially have a choice between two alternative procedures under Title 11 of the U.S. Bankruptcy Code. Under Chapter 7, the debtor surrenders all non-exempt assets[14] in which he still has equity to a trustee, who then liquidates the property and distributes the proceeds to creditors in accordance with their respective priorities under bankruptcy law.[15] In the event the debtor acts honestly, fully discloses requested information about his assets and financial affairs, and otherwise cooperates with the trustee and the bankruptcy court, the debtor usually will receive a general discharge which will release him from any remaining personal liability for his dischargeable debts, whether fully paid in the

6. Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 6 (1995).

7. *See id.* at 7.

8. *See id.* at 8.

9. *See id.*

10. *See id.*

11. *See* Tabb *supra* note 6, at 8.

12. *See* Kosterlitz, *supra* note 1, at 870.

13. *See id.*

14. "Exempt assets" refers to property of the debtor that the Bankruptcy Code excludes from the bankruptcy estate and the reach of the debtor's creditors. *See* 11 U.S.C. § 522 (1994).

15. *See id.*

bankruptcy proceeding or not. About seventy percent of individual debtors file Chapter 7 bankruptcy.

Alternatively, a debtor who has a regular income with unsecured debts not exceeding $250,000 and secured debts not exceeding $750,000 can initiate a proceeding under Chapter 13 of the Bankruptcy Code. In Chapter 13, the debtor proposes a plan to repay his debts, typically over a three- to five-year period, which then must be confirmed by the court to be effective. Once the plan is confirmed, the debtor must fund the payments required by the plan, which is typically carried out by the debtor surrendering his future monthly disposable income over the period of the plan to a court-appointed trustee, who then makes the payments required by the plan.[16] To encourage the debtor to make this effort to repay his debts, Chapter 13 permits him to keep both his exempt and non-exempt assets.[17] Also, once all of the payments under the plan have been made, the debtor is entitled to receive a discharge that releases him from many debts that would be non-dischargeable under Chapter 7.

The purpose of Chapter 7 is to provide a fresh start to the debtor. The debtor may lose his non-exempt assets, but is entitled to keep as exempt property much of the equity in his homestead, his automobile, household furnishings, and the tools of his trade, as well as all of his future earnings and amounts in a qualified pension or retirement fund.[18] Also, upon discharge he will be released from most of his debts, whether or not they have been paid in full. Although secured creditors may be repaid from their collateral, unsecured creditors are generally paid on a pro-rata basis to the extent proceeds, if any, are realized from the sale of the debtor's non-exempt assets. Since most assets of many debtors will either be collateral claimed by secured creditors or exempt assets claimed by the debtor, often there are very few assets left to be liquidated for the benefit of the unsecured creditors.

The purpose of Chapter 13, on the other hand, is to provide an opportunity for the debtor to restructure his debts over an extended period of time while maintaining possession of most of his assets. Unsecured creditors usually expect to realize more from a Chapter 13 proceeding, since the source of repayment is not a fixed pool of assets but portions of the debtor's future earnings. Also, to be confirmed, the plan must pay the unsecured creditors (at a

16. *See id.* § 1322(a)(1).
17. *See id.* § 1327(b).
18. *See id.* § 522.

minimum) the same percentage recovery that they would have realized under Chapter 7 and represent a good faith effort by the debtor to repay his debts. Chapter 13 typically appeals to debtors with regular income and assets in excess of state law exemptions.

III. Legal, Social & Economic Factors Contributing to the Boom in Consumer Bankruptcy Filings

A. *The Bankruptcy Process*

Creditors claim the bankruptcy process itself has become so outdated and lenient that it cheats lenders and provides little deterrent against reckless borrowing and spending by consumers.[19] A particularly ominous development to creditors has been the "surprise" bankruptcy, debtors who file for bankruptcy without first having a sustained period of delinquency.[20] This development, according to creditors, has arisen due to the ease and simplicity of the bankruptcy filing process.

1. Substantial Abuse of Chapter 7 by Debtor—Claims are made about the supposedly lax bankruptcy laws, but little significant change has occurred in bankruptcy since 1978.[21] Debtors today can receive discharges in Chapter 7 without any examination of their ability to repay, with the result that consumers not seriously delinquent are filing.[22] In the 1994 Bankruptcy Reform Act,[23] Congress increased the debt levels allowed for debtors who wished to file for Chapter 13, in the hope that more debtors would file for Chapter 13. It does not appear, however, that any such increase has occurred, since Chapter 13 filings are still only about 30% of all consumer filings, about what they were prior to the 1994 Act. Nearly three-fourths of debtors will opt for Chapter 7 over Chapter 13,[24] although it is estimated that nearly half of those filing in

19. *See* Kosterlitz, *supra* note 1, at 870.

20. *See Hearings*, *supra* note 3, at 134 (statement of American Bankruptcy Institute).

21. *See* Kosterlitz, *supra* note 1, at 870. In 1997, a Gallup poll asked individual debtors filing for bankruptcy to list their major reasons for filing. According to the poll respondents, major reasons included job loss or a cut in pay, large medical bills, divorce, and credit card debt.

22. *See Hearings*, *supra* note 3, at 76 (statement of Donald B. Banks, Director of Legal Services for Retailers National Bank Dayton Hudson Corporation).

23. Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C., 18 U.S.C., and 28 U.S.C. (1994 & Supp. I. 1995)).

24. One commentator has offered the following explanation why consumers prefer Chapter 7 over Chapter 13:

> Mirroring the practices of creditors at the time, the bankruptcy code

Chapter 7 could qualify for Chapter 13.[25] Although debtors prefer the stream-lined discharge and the fresh start available under Chapter 7,[26] most unsecured creditors stand a better chance of getting repaid at least in part under Chapter 13, since under Chapter 7 there is typically little left for them after liquidation of the debtor's non-exempt assets and secured creditors are paid off.[27]

Accordingly, credit card issuers and other unsecured creditors maintain that debtors are abusing the Chapter 7 proceeding at creditor expense,[28] and question the effectiveness of Section 707(b) of the Bankruptcy Code. Enacted in 1984, Section 707(b) provides that a bankruptcy court can dismiss a debtor's petition if the court determines that granting relief would constitute "a substantial abuse of the provisions" of Chapter 7.[29] However, "substantial abuse" is not defined by the Bankruptcy Code, the legislative history is not instructive, and the courts are divided about its meaning. For example, at least three U.S. Circuit Courts of Appeal have found that such abuse occurs when the debtor would have been able to pay a substantial portion of his debts through a Chapter 13 plan, while other courts have held that such ability is only one factor to be considered in the "totality of the circumstances"[30] as to whether substantial abuse has occurred, and a

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> treated asset liquidation as the primary source of repayment capacity, an approach that is apparent in the language of Chapter 7. The debtor was allowed to keep certain exempt assets, but the price of the debtor's "fresh start" was the liquidation of remaining, non-exempt assets to repay creditors. Any remaining debts were discharged. Over time, the criteria used to grant consumer credit shifted dramatically toward an evaluation of capacity to repay out of future income. However, the code has not changed with the times, leaving consumers the choice of filing under either the asset liquidation chapter or the repayment chapter. Given the change in the basis for obtaining credit, it is not surprising that at least 95 percent of debtors who filed under Chapter 7 in 1996 had no (non-exempt) assets to liquidate.

Hearings, *supra* note 3, at 10 (statement of Dr. Michael E. Staten, Director, Credit Research Center, Krannert Graduate School of Management, Purdue University).

25. *See* Melynda D. Wilcox, *The Months Ahead*, KIPLINGER'S PERSONAL FINANCE MAGAZINE, May 1997, at 13.

26. As currently structured, Chapter 7 protects most of the assets of most debtors (either through exemption or reaffirmation), while discharging them of most of their debts and preserving their future income from current creditors.

27. *See* Kosterlitz, *supra* note 1, at 870.

28. *See id.*

29. 11 U.S.C. § 707(b) (1994).

30. *See* Brian Wildermuth, Note, In re Lee*: Tithing as Grounds for Dismissal Under Section 707(B) of the Bankruptcy Code*, 26 U. TOL. L. REV. 725, 729-30 (1995), and cases cited therein. The "totality of the circumstances" approach has been found to require an evaluation of the following criteria:

(1) Whether the bankruptcy petition was filed because of sudden illness,

few courts have ruled that such ability constitutes substantial abuse only if it involves some "egregious circumstance," "unfair advantage" or "evidence of bad faith."[31] Regardless of the type of test articulated by the court, however, it appears that "a common thread running through most of the cases dismissed for substantial abuse is the existence of some . . . misconduct, impropriety, or lack of good faith on the part of the debtors," while substantial net disposable incomes, in and of themselves, are insufficient to establish substantial abuse.[32]

2. *Reaffirmation Agreement*—Questions also exist about the appropriateness of reaffirmation agreements. Creditors offer debtors who are in the process of receiving a Chapter 7 discharge an opportunity to "reaffirm" their debts in exchange for allowing them to keep possession of collateral or the extension of credit, including the issuance of a new credit card.[33] Ordinarily in Chapter 7, the debtor surrenders his non-exempt property and any collateral that has been pledged to secured creditors, in exchange for which the debtor is discharged from having to pay the balance of most of his debts. To the extent that the debtor desires to keep possession of collateral - such as the debtor's car or home - the debtor usually may be allowed to do so in exchange for agreeing to reaffirm the debt. Such a reaffirmation agreement obligates the debtor to continue making payments until the balance of the debt affirmed has been paid in full, while the creditor agrees to refrain from repossession and other remedies so long as payments are made. To

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> calamity, disability, or unemployment;
>
> (2) Whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay;
>
> (3) whether the debtor's proposed family budget is excessive or unreasonable;
>
> (4) Whether the petition was filed in good faith.

Id. (citing *In re* Green, 934 F.2d 568, 572 (4th Cir. 1991)).

31. *See id.* at 729-30.

32. *Id.* at 730, n.48 (citing *In re* Wegner, 91 B.R. 854, 857-58 (Bankr. D. Minn. 1988)).

33. As some have noted, however, there may be many valid reasons why a debtor may want to repay some of his debts even though eligible to receive a discharge. For example, reaffirmation may be consented to in order:

> [T]o prevent loss to co-obligors or others with whom the debtor is in a special relationship such as membership in a credit union or co-op; to prevent loss to a related creditor; or to preserve or re-establish a particular line of credit that the debtor values for its utility, whether the debtor is a farmer that needs to buy seed and fertilizer or a homeowner who needs to replace a water heater.

Hearings, *supra* note 3, at 76 (statement of Donald B. Banks, Director of Legal Services for Retailers National Bank Dayton Hudson Corporation).

protect this process from abuse, reaffirmation agreements are not enforceable against consumer debtors unless certain procedural requirements have been fulfilled, including the consent of the bankruptcy court.

Despite these procedural requirements, consumer advocates and other critics charge that the reaffirmation process has been abused by creditors,[34] who have unfairly pressured debtors to pay debts that otherwise would be dischargeable in Chapter 7.[35] Perhaps the best-known example of such abuse involves Sears, Roebuck & Co. In June, 1997, as part of a settlement agreement with the Federal Trade Commission, Sears agreed to pay up to $125 million to more than 200,000 bankrupt consumer debtors from whom it had obtained reaffirmation agreements, and an additional $140 million to settle related class action litigation brought by the nation's state attorneys general. According to allegations in the class-action suits, Sears pressured debtors to enter into these agreements by threatening to repossess items it had previously sold to the debtors, but then failed to obtain court approval of these agreements. Since the reaffirmation agreements were invalid, Sears effectively had been collecting debts that had been discharged in the course of the bankruptcy proceeding. In addition to the civil liability, Sears still may face criminal charges that may result from an investigation by the U.S. Department of Justice.

Although the practice is legal where an attorney or the bankruptcy court approves, critics claim the practice is not consistent with the idea of the opportunity for a new beginning after discharge.[36] Arguing that such agreements result in renewed

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34. *See* Gary Klein, *Suggestion for the National Bankruptcy Review Commission and Congress: Eliminate Reaffirmation Agreements*, 4 AM. BANKR. INST. L. REV. 528, 529 (1996). Several years ago, a Congressional report commented on how such abuse can occur:

> Most often in a consumer case, a secured creditor has a security interest in property that is virtually worthless to anyone but the debtor. The creditor obtains a security interest in . . . the debtor's furniture, clothes, cooking utensils, and other personal effects. These items have little or no resale value. They do, however, have a high replacement cost. The mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than he would receive were he actually to repossess the goods.

H.R. R. NO. 95-595, at 124 (1977).

35. Some consumer advocates charge that some creditors secure reaffirmation agreements by using the threat of questionable nondischargeability proceedings against low income debtors, knowing that such debtors cannot afford to contest such proceedings. *See* Klein, *supra* note 34, at 528-29.

36. *See id.; see also* Steve Miletich, *For Many Debtors, It's All in the Cards; Easy Credit Under Fire as Bankruptcy Soars*, SEATTLE POST-INTELLIGENCER, May

episodes of credit abuse, they claim that some debtors may even believe some sort of obligation exists to reaffirm. They also charge that the reaffirmation process undercuts the policy of equitable treatment for creditors by allowing Chapter 7 debtors to pick and choose which creditors they will repay in full. These critics argue that reaffirmation agreements should be banned from Chapter 7 and instead made part of the Chapter 13 repayment plan process.[37]

Supporters of the reaffirmation process deny that reaffirmations benefit one or a few creditors at the expense of the rest. According to them, "reaffirmations involve post-petition income which is not property of the estate in a Chapter 7 proceeding, any argument to deprive one creditor because the rest are not getting a similar benefit [is asking] that post-petition income should be property of the estate and be shared by all creditors," which is beyond the scope of the existing statute.[38]

3. *Lack of Monitoring of Debtors in the Consumer Bankruptcy System*—Some observers argue that a variety of features in the current consumer bankruptcy system detract from the system's integrity.[39] One example is the lack of independent verification of debtors' ability to pay; specifically, the availability of discharge in Chapter 7 without examination of a debtor's ability to repay. Debtors submit financial information in a sworn statement to the court, but the law does not require auditing or verification of required submissions. Another example is the problem of serial filings by the same debtor. Under current law, individuals can file for bankruptcy every six months, which blocks creditor's debt collection efforts temporarily due to imposition of the automatic stay until the case is dismissed, since a discharge can be obtained only once every six years. Creditors claim that some debtors repeatedly file for bankruptcy even though they are not entitled to a discharge in order to get temporary relief under the automatic stay.

5, 1997 at A. 1.

37. *See* sources cited *supra* note 34.

38. *Hearings, supra* note 3 at (statement of Donald B. Banks, Director of Legal Services for Retailers National Bank Dayton Hudson Corporation). In fact Banks worries that the next step would be to tell debtors how to spend income.

39. *See Hearings, supra* note 3 at (statement of Dr. Michael E. Staten, Director, Credit Research Center, Krannert Graduate School of Management, Purdue University).

B. Social Factors

Many lenders also blame the rise in bankruptcy filings on shifting economic and social attitudes towards consumers who file for bankruptcy. Unlike a generation ago, according to this view, there is no shame in debt any more; the stigma associated with bankruptcy has largely disappeared. As a result, unlike previous decades, today many consumers find it much easier to have credit extended to them after filing.[40] For example, many car dealers advertise the availability of credit to finance cars for bankrupt debtors, and sub-prime loans and secured credit lines make it easier to re-establish credit.[41] Society's view on bankruptcy has also shifted; as financial hardship no longer relegates the debtor to the status of a social outcast.

In recent studies, a bankruptcy consultant to the financial services industry concluded that the increase in bankruptcy rates can be tied to four social factors that often lead to financial crisis: divorce, lack of health insurance, lack of car insurance, and casino gambling. He suggests that one way to reduce the number of bankruptcies is to address these social issues, such as by implementing universal health coverage and enforcing state laws that mandate drivers to carry automobile insurance.[42]

C. Economic Factors

As noted above, many critics seem to believe that the bankruptcy process is the primary culprit behind the recent growth in bankruptcy filings, and thus argue that fixing the process is the only real solution to halting this growth. Some commentators have concluded, however, that the available evidence indicates that such growth may be attributable merely to increases in the general population and in the amount of consumer debt in the economy. In 1989, Sullivan, Warren, and Westbrook released their study of consumer bankruptcies filed during 1981.[43] In their report, the

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40. *See Industry Seeks Resolution to Bankruptcy Dilemma*, CREDIT RISK MGMT. REP., May 19, 1997, at 1.

41. *See Hearings, supra* note 3 (statement of American Bankruptcy Institute).

42. *See* Helen Huntley, *Bankruptcy Surge Defies Easy Solutions*, ST. PETERSBURG TIMES, Apr. 7, 1997, at 8 (quoting Stuart Feldstein, SMR Research Corporation).

43. *See* TERESA SULLIVAN, ET. AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA (Oxford University Press 1989).

authors found that the overwhelming majority of debtors who filed for bankruptcy in 1981 were significantly in debt, and only a very few had any hope of repaying.[44] Of those who chose Chapter 13, only a third were able to complete their repayment plans, and many of these were only to able to make minimal repayments.[45] The authors also found that debtors did not appear to respond predictably to economic incentives created by state law property exemptions; i.e., their results showed that debtors in states with generous property exemptions filed for bankruptcy and selected chapter 13 in similar proportions and in about the same economic condition as those in other states.[46]

In 1994, the authors updated their study to review consumer bankruptcy filings in 1991.[47] In the decade since their first study, the number of bankruptcy filings had tripled, yet the authors found that the debtors in 1991 were strikingly similar to those in 1981.[48] "In other words, the explosion in bankruptcy filings during the ten year period was not due to more debtors with ability to pay their debts taking advantage of bankruptcy law's protections, but simply that there were three times more people with significant debt problems. They also found that, once again, the generosity of state law exemptions did not appear to have any effect on the number of debtors filing for bankruptcy or on the number of debtors who chose Chapter 7 over Chapter 13.[49] The authors concluded that "as a result, there may be a need for greater access to the bankruptcy system, not less."[50] They also suggested that one reason for the increase in the tripling of bankruptcy filings from 1981 to 1991 may have been due to increasingly aggressive marketing and credit extension practices by credit card companies to low income debtors during this period.[51]

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44. *See id.*

45. *See id.*

46. *See id.* The results of the 1989 study have been criticized. *See* Marjorie L. Girth, *The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals*, 65 IND. L. J. 17 (1989); Note, *A Reformed Economic Model of Consumer Bankruptcy*, 109 HARV. L. REV. 1338 (1996).

47 *See* Teresa A. Sullivan, et. al., *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991*, 68 AM. BANK. L. J. 121 (1994).

48. *Id.* at 124.

49. *Id.*

50. *Id.* at 147.

51. *Id.* at 133 (*citing* Michael E. Staten, What Caused the Growth in Personal Bankruptcies: Consumers, Creditors or the Code?, Unnumbered Table, Bank Card Holdings by income Category (speech to The Visa Bankruptcy Recovery Program, Annual Conference, Sept 8, 1993)). The authors had previously

The authors' findings underscore the dilemma faced by the consumer credit industry as it attempts to persuade Congress to change the bankruptcy laws: public perceptions that credit card issuers and other consumer lenders have fueled the consumer debt crisis by engaging in irresponsible credit underwriting. Some critics charge that bad debt write-offs are taken into account in computing the cost of the original credit offer made to consumers, which are often sent unsolicited. According to these critics, credit card companies in particular are to blame for the high delinquency rates:

> Flooding the market with card offers and placing high interest rates on cards without promoting responsible spending habits has contributed to rising delinquency rates, they say. Creditors first need to reduce their debt exposure. The high interest rates on cards makes it less important for creditors to make careful credit decisions. Despite knowledge garnered from credit bureau reports indicating high [delinquency] rates on multiple credit cards, issuers continue to extend credit to consumers.[52]

IV. Proposals by the National Bankruptcy Review Commission

The NBRC, composed of nine members appointed by the President, the Chief Justice, and Congress, was established by Congress pursuant to the Bankruptcy Reform Act of 1994 to investigate issues relating to bankruptcy, examine the bankruptcy laws and to prepare a report suggesting proposals to reform and improve the operation of the bankruptcy process. In the course of preparing its report, the NBRC undertook a thorough review of the consumer bankruptcy system, reviewing evidence, holding hearings, and considering testimony from parties representing a variety of divergent viewpoints across the bankruptcy spectrum, including consumer credit counselors, legal scholars, creditors, judges, trustees, and credit reporting agency representatives.[53] The NBRC

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suggested that Congress enact legislation that would increase the scope of governmental regulation of credit extensions to consumer debtors. *See* TERESA SULLIVAN, *supra* note 43, at 324-25.

52. Another 1997 survey concluded that the explosion in bankruptcy filings was primarily due to aggressive credit card marketing and sloppy credit underwriting and risk assessment by credit card issuers, who increasingly target low and moderate income households. *See* STEPHEN BROBECK, THE CONSUMER IMPACTS OF EXPANDING CREDIT CARD DEBT (Consumer Federation of America 1997).

53. Noting that the number of bankruptcies filed by individual debtors rose more than 27 percent from 1995 to 1996 and with the expectation that this trend will continue, Bradley C. Williamson, the chairman of the NBRC, has called consumer bankruptcy reform "the most challenging and, perhaps, the most

presented its final report to the President and Chief Justice of the Supreme Court on October 20, 1997.[54] Rather than substantially overhauling the fundamental framework of the bankruptcy system, the NBRC recommendations were designed to fine-tune the current system to make it fairer and more uniform, and to provide incentives for debtors to choose to repay their debts under Chapter 13 while preserving their chance for a meaningful fresh start. A summary of the proposed changes follows:

A. Federal Exemptions

One issue the NBRC faced is that under the current system, debtors and creditors may receive vastly different treatment depending on the state in which the bankruptcy proceeding was begun. Nowhere is this disparate treatment more evident than in the case of assets that the debtor can claim as exempt from creditors. Under the current system, debtors can claim federal law exemptions or "opt out" by choosing state law exemptions instead, although more than thirty states require debtors to use state law exemptions exclusively. The amount of property that debtors can claim as exempt can vary widely from state to state - for example, states like Florida and Texas allow debtors to claim all the equity in their homestead as exempt, while states like Pennsylvania have no homestead exemptions. Accordingly, debtors in the former states are able to keep far more of their property (and unsecured creditors will be receive less recovery on their claims) than in the latter states.

The NBRC proposal, which redefined the set of property that debtors filing for Chapter 7 can claim as exempt, was designed to enhance the fairness and integrity of the bankruptcy system by reducing such disparity, yet permit debtors to keep enough assets to make their fresh start meaningful while providing for fair treatment of creditors. Specifically, this proposal established a federal floor of $20,000 and a ceiling of $100,000 on the amount of equity a debtor may treat as exempt, although states would be allowed to set the amount of the exemption within this specified range.[55] In addition, with respect to property of the estate not otherwise exempted by other provisions, a debtor could retain up to $20,000 in value in any

important subject facing the Commission today." *Hearings, supra* note 3 (statement of Brady C. Williamson, Chairman, NBRC).

54. *See* National Bankruptcy Review Commission, *Final Report*, *available at* http://www.nbrc.gov/report/05acons.html.

55. *See id.* ch. 1, recommendation 1.2.2.

form, and debtors who claim no homestead exemptions could exempt an additional $15,000 of property in any form.[56]

B. Encouraging Debtors to File Chapter 13 Rather Than Chapter 7

To encourage debtors with sufficient disposable income to choose Chapter 13 over Chapter 7, thus making more of an attempt to repay their creditors, the NBRC proposed the following changes:

a. Repayments to unsecured creditors under Chapter 13 would be based on a graduated percentage of the debtor's adjusted gross income rather than on disposable income and the disparate percentage of debt, subject to upward adjustment to meet the Code's requirement that creditors receive at least the present value of whatever they would have received in chapter 7.[57]

b. To encourage debt repayment, debtors who successfully perform their payment plans under Chapter 13 would receive more favorable credit reporting than if they had filed for Chapter 7. Not only would the Chapter 13 bankruptcy be reported for a shorter time period, but the bankruptcy proceeding would be completely removed from the debtor's credit records in the event the debtor repaid all of his debts.[58]

c. The preferential treatment granted by the Code under Section 1322(b) would be changed to apply only to purchase money mortgages rather than all debt secured by the debtor's home. As a result, debtors in Chapter 13 could treat other types of loans secured by their home as any other secured debt, meaning that the payment plan could reduced the amount of such debts to the home's value.[59]

d. The Chapter 13 "superdischarge" provisions would be retained.[60]

C. Monitoring Provisions

To promote the fairness and integrity of the consumer bankruptcy system, the NBRC proposed the following changes:

56. *See id.* ch. 1, recommendation 1.2.3.
57. *See id.* ch. 1, recommendation 1.5.4.
58. *See id.* ch. 1, recommendation 1.5.8.
59. *See* National Bankruptcy Review Commission, *supra* note 54, at ch. 1, recommendation 1.5.1.
60. *See id.* ch. 1, recommendation 1.5.7.

a. Courts would be authorized to impose sanctions, specifically any costs and debtor's attorney's fees incurred in correcting the claims, on creditors who file and fail to correct materially false claims.[61]
b. Trustees in Chapter 7 would be instructed to randomly audit schedules of information filed by the debtor to verify the accuracy of the information provided.[62]
c. To eliminate serial filings by the same debtor, Chapter 13 cases that otherwise meet the criteria for conversion to Chapter 7 will instead be dismissed if a party in interest can show that the debtor had been discharged from a Chapter 7 case filed within six years from the current proceeding.[63] Also, the automatic stay would not apply to creditors of an individual debtor who had filed for Chapter 11 bankruptcy relief two or more times within six years of filing the instant petition for relief, if the most recent such case was still outstanding within 180 days prior to the instant case.[64] To help track and prevent serial filings, the NBRC called for a national bankruptcy filing system to be established that would identify bankruptcy filings using unique identification numbers (like the debtor's Social Security number).[65]

D. *Voluntary Financial Education for Debtors*

The NBRC proposed that debtors in all Chapter 7 and Chapter 13 cases be given the opportunity to obtain counseling and participate in financial education programs, and that debtors who complete such programs have that fact noted on their credit reports.[66] The NBRC received a consensus of opinion that consumer financial education, such as basic information on credit, budgeting, and debtor's and creditor's rights, as well as a review of the bankruptcy process, should be made available to debtors as a means of deterring future financial problems, ensuring more

61. *See id.* ch. 1, recommendation 1.1.3.
62. *See id.* ch. 1, recommendation 1.1.2.
63. *See id.* ch. 1, recommendation 1.5.5.
64. *See id.* Under current law, individuals can file for bankruptcy every six months, which blocks creditor's debt collection efforts temporarily due to imposition of the automatic stay until the case is dismissed, since a discharge can be obtained only once every six years.
65. *See* National Bankruptcy Commission, *supra* note 54, at ch. 1, recommendation 1.1.1.
66. *See id.* ch. 1, recommendations 1.1.5, 1.5.8.

knowledgeable consumers and less misuse of credit, and pilot programs for such education on a voluntary basis are being developed.

E. Reaffirmation Agreements

The NBRC recommended that reaffirmation agreements should only be permitted, with court approval, if certain additional safeguards to protect the debtor were provided.[67] Among the safeguards suggested by the NBRC were to limit the amount of debt that could be reaffirmed to the amount of the creditor's allowed secured claim, and to prohibit attorney fees, costs, and other creditor expenses from being added to the principal amount of the debt to be reaffirmed.[68]

V. Proposals by the Consumer Credit Industry

The consumer credit industry has advocated a series of proposals of its own, most of which incorporate the philosophy that any debtor with the means to do so should be required to file for Chapter 13 and repay as much debt as possible from disposable income, while only debtors without sufficient disposable income to fund a repayment plan being allowed to use Chapter 7.[69] Specifically, many consumer lenders have advocated the adoption of a needs-based bankruptcy system. Under a needs-based system, debtors obtain only the relief they need from creditors and debt payment. Persons with some ability to pay (i.e., some disposable income) would be required to file under Chapter 13, where a three to five year debt-repayment plan would be structured,[70] while those without such ability would be allowed to file under Chapter 7.[71] Advocates argue that adopting a needs-based approach would limit

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67. *See id.* ch. 1, recommendation 1.3.1.

68. *See id.*

69. A few creditors are perfectly content with the status quo of consumers choosing Chapter 7 over Chapter 13. For example, companies that finance consumer purchases of automobiles typically receive entire repayment in Chapter 7, as debtors tend to reaffirm these debts to keep possession of their cars. In a Chapter 13 payment plan, however, the amount that the debtor typically repays is limited to the retail or wholesale value of the automobile. *See* Kevin T. Higgins, *The Bankruptcy Scourge*, CREDIT CARD MGMT., Jan. 1997, at 40.

70. *See* Miletich, *supra* note 36, at A.1.

71. According to some proposals, the debtor's ability to pay would be determined by a gatekeeper, who would examine each debtor's circumstances to determine the existence of income that could be used for debt repayment. *See* *Hearings*, *supra* note 3 (statement of Donald B. Banks, Director of Legal Services for Retailers National Bank Dayton Hudson Corporation).

the current phenomenon of bankruptcy filing by debtors not seriously delinquent on payments - sometimes referred to as a "surprise filing."[72]

Other consumer creditors propose that "means testing" be used to limit debtor access to Chapter 7. Under this proposal, relief would be available to debtors, but those who could repay would be required to make payments. Again, the idea is to lessen the incidence of unnecessary Chapter 7 filings.[73] Issues exist, however, as to how to determine who could pay and how much. Should decisions be based on gross income, or income after expenses? As for expenses, more questions arise as to what should be considered legitimate and necessary expenses.[74]

For the most part, consumer creditors have rejected many of the NBRC proposals on the basis that these recommendations do not represent meaningful reform - that debtors who are financially able to repay at least some of their debt would still be able to use Chapter 7, rather than being required to file under Chapter 13 and prepare a repayment plan. Many creditors view some or all of the following reforms as imperative:[75]

1. Under current law, Chapter 13 plans only have to pay most secured creditors the value of their collateral, in which case the debtor may keep the collateral and the remaining balance of the debt is discharged. Creditors advocate the law should be changed so that under these plans either the secured debt must be paid in full or the collateral promptly surrendered to the creditor.
2. The ability of creditors and debtors to enter into enforceable reaffirmation agreements in Chapter 7 cases should not be impaired. The credit card industry in particular does not favor eliminating reaffirmation agreements since they have been successful at getting debtors to reaffirm what would otherwise be dischargeable unsecured debt, affording a substantial amount of recovery for the industry.

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72. Requiring debtors to file initially for Chapter 13 might not result in as much recovery as some creditors anticipate, as research shows that less than two out of every five Chapter 13 plans are ever completed. *See* Higgins, *supra* note 69.

73. *See* Kosterlitz, *supra* note 1, at 870. For a more complete discussion of means-testing, see *infra* notes 80-93 and accompanying text.

74. The number of debtors that would be affected by needs-based bankruptcy or means testing is subject to debate. Existing surveys reveal different answers, indicating a need for further research. *See infra* note 149 and accompanying text.

75. *See, e.g.*, Gene Tharpe, *Card Issuers Want New Rules for Bankruptcy*, ATLANTA J. & CONST., Nov 1996, at 2E.

3. Contrary to the NBRC's proposal, the debtor in Chapter 13 should not receive a discharge until the repayment plan has been successfully completed, and in the event the debtor cannot complete the plan, the original debt terms and amounts should be reinstated. Creditor advocates charge that discharging debt at the time of filing leaves debtors with no incentive to complete their repayment plan.[76]
4. To ensure that the maximum repayment effort is made, all consumer debtors should be required to initially file for Chapter 13 rather than Chapter 7.
5. To discourage consumer abuse of the bankruptcy system, all debts and cash advances incurred within 90 days prior to filing should be treated as non-dischargeable debt. Although currently the Code treats certain cash advances and purchases of luxury items as non-dischargeable if incurred within 60 days of filing, the committee believes that this protection for credit card issuers should be broadened.

On the other hand, creditors seem to be very much in favor of the NBRC's proposal that financial education be made available to debtors who have filed for bankruptcy, the proposed rules against serial filing, and the new mandatory auditing requirements.

Other than trying to overhaul the consumer bankruptcy system, there are other strategies consumer creditors have used to improve their recoveries when their borrowers file for bankruptcy.[77] One such approach is through more active participation in the process, such as attending and questioning the debtor at debtor examination meetings, investigating and challenging questionable bankruptcy filings, and aggressively negotiating with debtors to obtain the maximum recovery possible. Other approaches include inviting debtors in the early stages of delinquency to financial education seminars, to try to help them get back on their feet financially before bankruptcy becomes a viable option.

Similarly, consumer advocates argue that no significant bankruptcy reform would be necessary if more consumer lenders

76. *See A Bankruptcy-Reform Proposal Could Give the Card Antioch Jitters*, CREDIT CARD NEWS, Apr. 15, 1997, at 1. The chairman of the NBRC argues that should the debtor fail to complete the Chapter 13 plan, "the creditor can go after him again (legally reinstate the obligation). [ ]And there will be no re-filing allowed either, . . . so a debtor can't re-file and wipe the debt out." *Id.* (quoting Brady C. Williamson, chairman of the NBRC).

77. *See* Higgins, *supra* note 69.

would engage in responsible credit underwriting. According to this view, credit card issuers in particular have been lax in investigating prospective customers in their push to gain market share, leading to higher default rates and more consumer bankruptcies. Some suggested measures that consumer lenders should take to stem their losses in bankruptcy include requiring proof of income before credit is extended and closing dormant accounts. Some even advocate Congressional intervention if lenders fail to take corrective action on their own, specifically in areas such as marketing to vulnerable groups like students and the elderly.[78]

VI. The Congressional Response

House Bill 3150[79] and its companion bill, Senate Bill 1301,[80] were the first pieces of bankruptcy reform legislation to be seriously considered by Congress following the NBRC report. Rather than advocating the piece-meal reforms recommended by the NBRC, however, these bills proposed more significant reforms, particularly with regard to consumer bankruptcy. Moreover, these bills appeared to have been designed more to satisfy the concerns of consumer creditors rather than debtors, with their overall objectives being to reduce bankruptcy filings and increase payments to creditors in bankruptcy.[81] In order to achieve these objectives, both bills (i) suggested capping homestead exemptions under state law,[82] (ii) instituted a form of means testing to limit debtor access to Chapter 7,[83] (iii) required random auditing of debtors and other

78. *See* Huntley, *supra* note 43, at 8.

79. H. R. 3150, 105th Cong. (1998).

80. S. 1301, 105th Cong. (1998).

81. For an excellent overview of this legislation, *see* Eugene R. Wedoff, *An Analysis of the Consumer Bankruptcy Provisions of H.R. 3150, available at* http://www.abiworld.org/legis/bills/98julhr3150.html; Eugene R. Wedoff, *An Analysis of S. 1301, available at* http://www.abiworld.org/legis/bills/98julnew1301a .html. Eugene R. Wedoff is a judge for the United States Bankruptcy Court, Northern District of Illinois, Chicago, Illinois.

82. Rather than mandating caps on state law homestead exemptions (as did a prior version of this legislation), the final draft of H.R. 3150 merely expressed the sense of Congress that homestead exemptions should be capped under state law at $100,000. *See* H.R. 3150 § 212. Senate Bill 1301 did mandate such a cap. *See* S. 1301, § 320.

83. The bills adopted different means-testing criteria in order to achieve this objective. House bill 3150 set forth certain formulas for income levels to determine debtor eligibility for bankruptcy relief. Under this proposal, an individual debtor was deemed to have income available to pay creditors (and is thus eligible for chapter 13) if he or she had: (1) a current monthly total income of not less than the highest national median household income reported for a family of equal or lesser size, or in a one person household, not less than the national

debtor monitoring provisions,[84] and (iv) mandated financial education for debtors.[85] Subsequently, both bills were amended to include additional measures designed to address criticism that these reform proposals protected consumer creditors at the expense of the debtor's family.[86]

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median household income for one earner; (2) projected monthly net income greater than $50; and (3) projected monthly net income sufficient to repay 20 percent or more of unsecured non-priority claims during a five-year repayment plan. "Monthly net income" was defined as current monthly total income minus: (1) expense allowances under specified "Necessary Expenses;" (2) the average monthly payment on account of secured creditors; and (3) the average monthly payment on account of priority creditors. *See* H.R. 3150, § 101.

Under Senate Bill 1301, Chapter 7 cases would have been subjected to dismissal or conversion if the debtor could pay 20% of his or her general unsecured claims through a Chapter 13 plan. *See* S. 1301 § 102.

84. Under both bills, professional audits in accord with generally accepted auditing standards would have been required in a minimum of 1% of bankruptcy cases. *See* H.R. 3150, § 404; S. 1301, § 307. To discourage serial filings, H.R. 3150 extended the mandatory period between discharges in bankruptcy for chapter 7 debtors from six to ten years, and set five years as the mandatory period between discharges for chapter 13 debt repayment plans, while S. 1301 provided that the automatic stay would terminate after 30 days in cases of repeated bankruptcy filings within one year, unless a party in interest demonstrated that the filing of the later case was in good faith, and (2) that the bankruptcy court have discretion to enter orders granting relief from the stay "in rem." *See* H.R. 3150, § 171; S. 1301, § 303.

Under both bills, a presumption of nondischargeability would have existed for all debts incurred within 90 days of bankruptcy. *See* H.R. 3150 §§ 142-43; S. 1301 §§ 314, 316. Both bills also expanded the debtor's disclosure duties when filing for bankruptcy. For example, the debtor would be required to file with the bankruptcy court: (1) all tax returns; (2) evidence of payments received; (3) monthly net income projections; and (4) anticipated debt or expenditure increases. Chapter 13 debtors would be required to file with the court a statement of income and expenditures in the preceding tax year, and monthly net income, showing how calculated. In the event any mandatory information was not timely furnished by a Chapter 7 debtor, the bills provided for automatic dismissal of the proceeding. *See* H.R. 3150, §§ 406-07; S. 1301, §§ 301, 312.

85. Both bills required individual debtors in both Chapter 7 and Chapter 13 cases to engage in consumer credit counseling as a condition for eligibility to file, and indicated that in certain circumstances bankruptcy courts could require completion of a debtor education program as a condition of discharge. *See* H.R. 3150, §§ 104, 112; S. 1301, § 321.

86. Specifically, both bills took steps to try to ensure that claims against a debtor for alimony or child support would be fully recovered. For example, the definition of nondischargeable debts was expanded to include certain debts to a spouse, former spouse or child of the debtor that are not in the nature of support (including those resulting from a property settlement or a hold harmless agreement). Both bills also predicated court confirmation of a chapter 11, 12, or 13 bankruptcy plan upon the debtor's payment of all amounts payable under a judicial order for child or spousal support that become due following the date the bankruptcy petition is filed, and conditioned court discharge of a chapter 12 or 13 debtor upon certification that such debtor has paid all amounts payable under a judicial order for child or spousal support that are due after the date the

VIII. House Bill 833

Due primarily to strong opposition by the Clinton Administration, H.R. 3150 and S. 1301 were not enacted in the fall of 1998. Instead, the House of Representatives revised its bankruptcy reform proposal and passed House Bill 833 late in the spring of 1999.[87] Like the prior legislation, this bill also appears to have been designed primarily to address the concerns of consumer creditors. The bill's most significant features are summarized as follows:

A. *Uniform Federal Exemptions*

Although prior legislative proposals would cap homestead exemptions under state law at $100,000, H.R. 833 does not go so far. Instead, Section 124 merely requires debtors to reside in a state for two years (730 days) before they can use the exemption law of that state.[88] Although Section 147 prohibits debtors from exempting any interest under state law in a residence or burial plot that exceeds $250,000,[89] this limit does not apply to debtors in a state that has expressly provided by statute that the limit does not apply to debtors in that state. Instead of mitigating differences among state exemption laws by capping exemption amounts or mandating uniform federal exemptions, it appears that H.R. 833 merely aims to discourage debtors from changing states prior to filing in order to take advantage of more generous exemption laws. It would also require states that currently allow unlimited homestead exemptions (such as Texas and Florida) to enact new legislation which provides that the $250,000 limit does not apply to debtors who reside in their respective states.[90]

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bankruptcy petition is filed. Debts for family support obligations was also awarded the first priority in Chapter 7 distribution, ahead of debts for administrative expenses in the bankruptcy case. *See* H.R. 3150, 105th Cong. §§ 145-47 (1998); S. 1301, 105th Cong. §§ 323-26 (1998).

87. *See* H. R. 833, 106th Cong. (1999). House Bill 833 was passed by the House of Representatives on May 5, 1999, by a vote of 313 to 108. The Senate amended portions of Senate Bill 625 into House Bill 833 and passed House Bill 833 by a vote of 83 to 14 on February 2, 2000. As of this writing, there has been no conference. For an excellent overview of this legislation, see Eugene R. Wedoff, *An Updated Analysis of the Consumer Bankruptcy Provisions of H.R. 833 Bankruptcy Reform Act of 1999* (published by the American Bankruptcy Institute, available on-line at http://www.abiworld.org/legis/bills/106anal/wedoff833ana820 .html).

88. *See* H.R. 833, § 124.

89. *See id.* § 147.

90. *Id.* at § 147(3).

B. *Requiring Certain Debtors to File Chapter 13 Rather Than Chapter 7*

In order to establish a "needs-based" bankruptcy system for individual debtors, H.R. 833 precludes individuals from remaining in a Chapter 7 liquidation proceeding if they have current monthly income available to pay creditors. Specifically, Section 102 of the bill provides that Chapter 7 cases could be dismissed or (if the debtor consents) converted to Chapter 13 if the case involves "abuse" of Chapter 7.[91] Such "abuse" would be presumed if the debtor's current monthly income, after deducting certain expenses, and multiplied by 60 months, would total more than $6,000.[92] The expenses to be deducted fall into the following four categories: (i) estimated administrative expenses and reasonable attorneys' fees, (ii) the debtor's monthly expenses, (iii) the debtor's average monthly payments on account of secured debts, and (iv) the debtor's monthly unsecured priority debt payments.[93] The debtor's monthly expenses are those allowed under IRS collections standards for the area in which the debtor resides, but do not include any payments for debts.[94] The debtor's average monthly payment on account of secured debts is to be determined by taking the total of all amounts due to secured creditors over the next sixty months, and dividing by sixty.[95] Finally, the debtor's monthly unsecured priority debt payment is to be determined by taking the total amount of all unsecured priority debts, and dividing by sixty.[96] The debtor may rebut the presumption of abuse and maintain the Chapter 7 proceeding, but to do so the debtor must show that "extraordinary circumstances" exist that require either additional expenses to be included or some other adjustment of current monthly total income.[97] The additional expenses or adjustment must be necessary and reasonable in light of the circumstances, and their inclusion must result in the debtor's current monthly income

91. Under Section 707(b) of the current bankruptcy statute, "*substantial* abuse" is required to dismiss or convert a Chapter 7 case. *See supra* notes 18-27 and accompanying text.

92. *See* H.R. 833, § 102(A).

93. *Id.*

94. *Id.* Other amounts, such as actual educational expenses of dependent children under the age of 18 (not to exceed $10,000 per year), and an additional allowance up to five percent of the food and clothing categories allowed under IRS collection standards (if reasonable and necessary), may also be included as part of the debtor's monthly expenses. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at § 102(a)(2)(B).

falling below the $6,000 figure cited above.[98] In addition, no motion to dismiss may be made if the debtor and the debtor's spouse together have current monthly income equal to or less than the regional median household monthly income calculated on a semiannual basis for a household of equal size.[99]

In order to implement this scheme, the trustee is required to review the debtor's filing schedules and other materials, and file a statement within ten days following the first meeting of creditors as to whether or the proceeding should be presumed to be an abuse of Chapter 7.[100] Copies of the statement are to be provided to all creditors, along with an explanation of how the formula was applied in the instant case.[101] If the trustee finds that the presumption should apply, the trustee must file a motion to dismiss or a statement showing why such a motion should not be filed.[102]

Although using the concept of "means testing" as a way to prevent abuse of the Chapter 7 process has been discussed for a number of years, the approach taken by House Bill 833 appears to be much too broad, especially since total unsecured debt is not a factor in determining the debtor's monthly income. As a result of this omission, a debtor with an extremely large amount of unsecured debt could be denied access to Chapter 7 if his monthly net income is barely in excess of the minimum ($100.00 per month). It is also doubtful that this scheme would thwart debtors who are truly bent on "abusing" the Chapter 7 process. For example, it appears that all a debtor has to do to avoid dismissal or conversion of a Chapter 7 case is delay filing until the total amount of his or her secured or priority debts have grown to the point that monthly payments of such debt result in the debtor's current monthly income (as calculated above) to fall below the $6,000 figure cited above.

C. Discouraging Consumer Fraud

To discourage debtors from accumulating large amounts of consumer debt immediately prior to filing bankruptcy, Section 133 of the bill provides that all consumer debt owed to a single creditor in excess of $250 that is incurred for cash advances or luxury goods or services within ninety days prior to bankruptcy is presumed to be

98. *Id.*
99. *Id.* at § 102(a)(2)(D).
100. *Id.* at § 102(b)(3).
101. *Id.*
102. *Id.*

nondischargeable.[103] A similar provision exists under current law, but Section 133 is somewhat harsher on debtors, since under current law the amounts are higher ($500 for luxury goods or services, and $1,000 for cash advances) and the time period is shorter (40 days).[104] Also the bill fails to resolve certain problems that exist under current law: although Section 133 provides that "luxury goods or services" excludes those reasonably necessary for the debtor's support or maintenance, no definition of this term is provided. The bill does not provide any way for the debtor to avoid the application of the presumption of nondischargeability.

D. *Protection of Creditors with a Security Interest in Personal Property*

To provide more protection for secured creditors of individual debtors, Section 122 of H.R. 833 provides that in any type of bankruptcy proceeding, the entire amount of unpaid debt secured by personal property purchased by an individual debtor within five years of bankruptcy would be treated as a secured claim (regardless of the value of the collateral at the time of filing).[105] For debt secured by personal property purchased more than five years prior to bankruptcy, Section 123 provides that in Chapter 7 and 13 proceedings, the secured claim would be valued at the retail price of such property, with no deduction for costs of sale or advertising.[106] In addition, Section 135 requires Chapter 13 debtors to make monthly cash payments in the contract amount as adequate protection to secured creditors who have a purchase money security interest in personal property, beginning thirty days after filing and continuing until the debtor's repayment plan has been confirmed.[107] The bankruptcy court may, however, change the amount and timing of these payments after notice and a hearing.[108]

Section 119 of the bill provides that in Chapter 7 cases, individual debtors may not retain possession of personal property in which a creditor has a valid purchase money security interest unless, within forty-five days after the first meeting of creditors, the debtor reaffirms the claim secured by the property, or the debtor redeems the property from the security interest.[109] If no action is

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103. *See id.* § 133.
104. *See* 11 U.S.C. § 523 (a) (2) (C) (1994).
105. *See* H.R. 833, § 122.
106. *See id.* § 123.
107. *See id.* § 135.
108. *Id.*
109. *See id.* § 119.

taken by the debtor within the forty-five day period, the automatic stay will be terminated as to the property in question, and the creditor may then take action against it.[110] The bankruptcy court may keep the stay in effect, however, if the trustee so requests prior to the expiration of the forty-five day period, and the court finds after notice and a hearing that the property is of consequential value or benefit to the estate, orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee.[111] In order to provide prompt relief from the automatic stay to secured creditors, Section 610 also provides that, in bankruptcy proceedings of individual debtors, the stay will terminate sixty days after a motion by a party in interest, unless the bankruptcy case is terminated prior to the end of the sixty days, or the sixty day period is extended by agreement of all parties in interest or by court order for good cause.[112]

The effect of these changes would be to allow secured creditors to recover much more than they do under current law, where their claims are based on the value of the collateral at the time the debtor files for bankruptcy. These changes also make it much more likely that debtors will simply surrender the collateral to the secured party in these situations, since otherwise the debtor would have to pay the entire amount of the debt (if purchased within five years preceding bankruptcy), or the retail price or replacement cost of the property (if purchased more than five years preceding bankruptcy), in order to keep the collateral, regardless of its current value. Since these protections would result in greater recoveries for secured creditors, unsecured creditors accordingly would fare much worse than they do under current law, particularly in Chapter 13 cases. It also appears that H.R. 833 will protect secured creditors by allowing them to exercise their rights much more quickly in an individual bankruptcy proceeding, by providing automatic termination of the automatic stay within thirty to forty-five days, unless specific action is taken to extend the stay.[113]

E. Child Support and Alimony Payments

To address criticism that bankruptcy reform legislation protects consumer creditors at the expense of the debtor's family,

110. *Id.*
111. *Id.*
112. *See id.* § 610.
113. *See id.* §§ 119, 120.

H.R. 833 takes measures to ensure, to the extent possible, that claims against a debtor for alimony or child support will be fully recovered. Such claims, whether due before or after the filing of bankruptcy, are called "domestic support obligations," as provided in Section 138 of the bill.[114] Sections 139 through 144 award first priority debt status to these obligations, exempt such obligations from discharge, require payment of such obligations to be current as a condition for confirmation of a Chapter 11 or 13 plan, and prevent such payment from being recovered by the trustee as a voidable preference.[115] Further, under Sections 141, 152, and 153, the automatic stay would not apply to the collection of such obligations, paternity suits, actions to enforce certain state law penalties for the failure to pay such obligations, actions to withhold income for payment of such obligations, child custody actions, proceedings alleging domestic violence, and divorce actions.[116]

The most significant changes made by H.R. 833 in this area is to extend first priority status to domestic support obligations.[117] Although such a change seems designed to make the bill more palatable politically to certain opponents of bankruptcy reform, it may actually frustrate payment of these obligations. If this change is enacted, these obligations will be required to be paid in full prior to any money being made available to pay administrative expenses, such as the trustee's fees and fees paid to retain professionals to help recover assets for the estate. In Chapter 7 cases where the estate is minimal and unpaid domestic support obligations are substantial, this change would likely result in the refusal of trustees to administer such cases or reduce recovery efforts. As a result, the payment of domestic support obligations in bankruptcy would be stymied.

F. Debtor Monitoring Provisions

Section 602 of House bill 833 would require the U.S. Attorney General to establish procedures for random audits by independent licensed public accountants in accord with generally accepted auditing standards in at least 0.4% of Chapter 7 and 13 cases.[118] Such procedures would also require audits of all filing schedules that show "greater than average variances from the statistical norm

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114. *See id.* § 138.
115. *See id.* §§ 139-44.
116. *See id.* §§ 141, 152-53.
117. *Id.* § 139.
118. *See* H.R. 833, § 602.

of the district in which the schedules were filed," and the public reporting of the aggregate results of these audits.[119] Sections 603 and 604 also require Chapter 7 and 13 debtors to include in their filing schedules copies of all federal tax returns, schedules and attachments filed within three years prior to bankruptcy, unless excused by court order.[120] Such information would be available for inspection and copying by any party in interest, although procedures are to be established to safeguard the confidentiality of tax information.[121] In the event that this information is not furnished within forty-five days after the case commences, the bill provides for automatic dismissal of the proceeding.[122]

G. *Mandatory Credit Counseling and Alternative Dispute Resolution*

Section 302 of the bill provides that any individual debtor seeking bankruptcy relief would be required to engage in consumer credit counseling prior to filing bankruptcy.[123] The purpose of such counseling would be to learn more about credit counseling and to receive assistance in performing an initial budget analysis. If the U.S. Trustee determines that no credit counseling services are available, or if the debtor is unable to obtain such services within five days after making a request to an approved counselor, this requirement will not apply.[124] Section 103 also requires the bankruptcy court clerk to furnish consumer debtors with written information on a variety of topics prior to commencement of the bankruptcy case.[125] Such information is to include an overview of the purposes, benefits and costs of proceeding under the various bankruptcy chapters, the services available from credit counseling agencies, and the penalties that can be imposed on debtors who fraudulently conceal assets or make false statements in connection with a bankruptcy case.

To encourage the use of alternative dispute resolution of debts prior to bankruptcy, Section 109 of H.R. 833 authorizes the bankruptcy court, upon motion by the debtor and after a hearing, to reduce a claim for unsecured consumer debt by up to twenty percent if the debtor can establish that the creditor had unreason-

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119. *Id.*
120. *See id.* § 603-04.
121. *Id.* at § 603.
122. *Id.* at § 604.
123. *See id.* § 302.
124. *Id.*
125. *See id.* § 103.

ably refused to accept an offer to enter into an alternative repayment schedule proposed by an approved credit counseling agency acting on the debtor's behalf.[126] For the reduction to be approved, the offer must have been made within sixty days prior to the filing of bankruptcy, the alternative repayment schedule must have provided for at least sixty percent of the debt to be paid over a reasonable period of time, and no part of the debt may be nondischargeable, entitled to a priority, or would be paid a greater percentage in a Chapter 13 than proposed in the alternative repayment schedule.[127] Section 109 also provides that no transfer by a debtor to a creditor pursuant to an alternative repayment plan created by an approved credit counseling agency may be set aside or avoided by the trustee.[128]

H. Financial Education Programs for Debtors

Section 104 of the bill would require the Director of the Executive Office for United States Trustees to prepare a program and materials to educate debtors to better manage their finances, test and evaluate the program for one year in six judicial districts, evaluate consumer education programs developed by the consumer credit industry and other groups, and to submit a report to Congress on the effectiveness of the curriculum, materials, and programs within three months after the end of the testing period.[129] Section 302 would deny a discharge to Chapter 7 and Chapter 13 debtors who fail to complete such a personal financial management program, unless the debtor resides in a district in which such programs are unavailable.[130]

I. Reaffirmation Agreements

In order to curb abusive reaffirmation practices, Section 108 of H.R. 833 requires that, in addition to other issues to be considered by a court in evaluating the validity of a reaffirmation agreement, the court must also be satisfied that the agreement has not been entered into by the debtor due to improper threats by creditors.[131] Additional disclosures must also be made in agreements to reaffirm

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126. *See id.* § 109.
127. *See* H.R. 833, § 109.
128. *See id.*
129. *See id.* § 104.
130. *See id.* § 302.
131. *See id.* § 108.

unsecured consumer debts.[132] These disclosures would advise the debtor that he is entitled to a court hearing to determine whether the reaffirmation of the debt is an undue hardship or is the result of improper threats by creditors, and that the hearing may be waived in writing signed by a debtor who is represented by counsel.[133] Section 114 also provides that any individual injured by a creditor's intentional breach of a reaffirmation agreement may recover either the amount of the actual damages or $1,000, whichever is greater, as well as costs and attorneys' fees.[134]

J. Addressing Other Debtor Abuses of the Bankruptcy Process

House Bill 833 attempts to discourage bad faith repeat filings by providing, in Section 117, that the automatic stay is limited to thirty days in any bankruptcy proceeding filed by or against an individual debtor within a one-year period following the dismissal of another bankruptcy case of the same debtor.[135] The bankruptcy court may extend the stay as to any or all creditors after notice and a hearing within the thirty day period provided that the party seeking to extend the stay demonstrates that the filing of the latter proceeding was in good faith.[136] In the event that a bankruptcy case is filed by or against an individual debtor when two or more cases of the debtor were pending within the prior year but were dismissed, the automatic stay will not go into effect upon the filing of that case.[137] Upon the request of any party, the bankruptcy court must promptly enter an order confirming that no stay is in effect.[138] However, the bankruptcy court may order the stay to take effect as to any or all creditors after notice and a hearing within thirty days after the case filing provided that the party seeking to establish the stay demonstrates that the filing of the latter proceeding was in good faith.[139] If the court decides to impose the stay, it must become effective on the date the order is entered.[140] Section 137 also extends the permissible period between discharges in Chapter 7 bankruptcy from six years to eight years.[141]

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132. *Id.*
133. *Id.*
134. *See id.* § 114.
135. *See id.* § 117.
136. *Id.*
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.*
141. *See id.* § 137.

IX. Criticisms of Mandatory Means Testing

The Clinton Administration has stated that it could not support any bankruptcy reform proposal that employed mandatory means testing to control access to the Chapter 7 bankruptcy process, as it believes that means testing is "rigid and arbitrary," and denies bankruptcy courts the discretion to consider the specific circumstances of a debtor in bankruptcy.[142] Many scholars have also questioned whether means testing is necessary to restrict access to bankruptcy.[143] Some, like Jean Braucher, argue that it is folly to think that restricting access to bankruptcy will mean more debts now discharged will be paid.[144] Although such a proposal would result in more Chapter 13 filings, the current non-completion rate in Chapter 13 exceeds sixty percent. By implementing means testing and restricting access further to Chapter 7, an even higher failure rate would result. One other practical problem with means testing involves the cost - who will pay for means testing? If borne by the debtor in the form of increased filing fees and/or attorney fees, the plan would disproportionately affect those who need bankruptcy protection most.[145]

Another problem with implementing means testing as a way to

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142. According to a policy statement released by the OMB:

> The formulaic mechanism in H.R. 3150 will not always distinguish accurately those debtors who have the capacity to repay from those that do not have that capacity. A properly structured system would give bankruptcy courts greater discretion to consider the specific circumstances of a debtor in bankruptcy. The formulaic approach in this bill, as currently written, could result in moving to chapter 13 those debtors who are likely to fail to complete required repayment plans. These debtors would return to chapter 7 with a diminished ability to repay their nondischarged debt—including child support and alimony.

Office of Management & Budget, *Statement of Administrative Policy*, June 10, 1998 (coordinated by OMB with the concerned agencies).

Although the Clinton Administration supports "balanced bankruptcy reform that would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly," it still would not support H.R. 833 for its inclusion of mandatory means testing as a way of limiting access to Chapter 7. *See* Letter from Jacob J. Lew, Director, Executive Office of the President, Office of Management and Budget, to Rep. Jerrold Nader, Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, U.S. House of Representatives (March 23, 1999) (copy on file with author).

143. *See, e.g.*, Jean Braucher, *Increasing Uniformity In Consumer Bankruptcy: Means Testing As A Distraction And The National Bankruptcy Review Commission's Proposals As A Starting Point*, 6 AM. BANK. L. J. 1 (1998); Gary Klein, *Means Tested Bankruptcy: What Would It Mean?* 28 U. MEM. L. REV. 711 (1998); Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L. J. 1079 (1998).

144. *See* Braucher, *supra* note 143, at 8.

145. *See id.* at 10.

restrict bankruptcy access is that it would not address what some see as the true culprit for the boom in bankruptcy filings: a substantial increase in consumer debt that has been fueled by easy access to credit granted by consumer lenders. In fact, some argue that means testing might even lead to even greater growth in credit, as lenders respond to the increased bankruptcy protection by easing underwriting standards further.[146] These critics point out that debt-income ratios have not changed over the last two decades, so the increase in bankruptcy filings cannot be attributed to well-off debtors using bankruptcy as an easy solution. The problem is the rise in the number of overextended consumers.[147] Accordingly, if the credit industry is unhappy with the default and bankruptcy rate, the best solution is to reduce the volume of credit to high-risk debtors.[148]

Although no definitive conclusion has been reached, several recent studies have tested the results of means testing under proposed legislation. Several of these studies have been financed by creditors and other proponents of means testing, and others by organizations that would seem to have no direct financial interest in the results.[149] An example of the former, which was funded by VISA and U.S.A. MasterCard International, both proponents of means testing, was conducted by Ernst & Young.[150] An example of the latter, which was funded by the American Bankruptcy Institute, was conducted by two Creighton University professors, Marianne B. Culhane and Michaela M. White.[151]

Both studies purported to examine current means testing proposals and estimate (i) the percentage of current Chapter 7 debtors that would be required under these proposals to file Chapter 13 instead, and (ii) the amount of debt such debtors could be expected to pay over a five-year period. As the General Accounting Office noted in its review of these studies, both studies

146. *See id.* at 8.

147. *See id.*

148. *See id.* at 6.

149. For a descriptive summary and analysis of four such studies, *see* GENERAL ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: ANALYSIS OF FOUR REPORTS ON CHAPTER 7 DEBTORS' ABILITY TO PAY, GA 1. 13:GGD-99-103 (1999) [hereinafter GAO REPORT].

150. *See* Tom Neubig, et al., ERNST & YOUNG,: CHAPTER 7 BANKRUPTCY PETITIONERS' REPAYMENT ABILITY UNDER H.R. 833: THE NATIONAL PERSPECTIVE 7 AM. BANKR. INST. L. REV. 79 (1999).

151. *See* Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANK. INST. L. REV. 27 (1999).

made three assumptions in order to make these determinations.[152] They assumed that the data listed on the debtors' filing schedules relating to income, expenses, and debts was accurate, that debtors' income and living expenses would not change over five years, and that all debtors required to enter a five-year repayment plan would complete the plan.[153] As the GAO Report observed, these assumptions have not been validated.[154]

The Ernst & Yound Study was based on a stratified ramdom sample of over 2,100 debtors, drawn from Chapter 7 bankruptcy petitions filed in all federal bankruptcy districts.[155] The Culhane and White Study used 150 randomly selected Chapter 7 cases from each of seven federal bankruptcy districts, for a total of 1,050 cases.[156]

The Culhane and White Study found that only 3.6 percent of Chapter 7 debtors could repay their debts over a five year period,[157] while the Ernst & Young Study found that 10 percent could repay within the same period.[158] Estimates of the debt that could be repaid over five years was found to be about $870 million by the Culhane and White Study and almost $3 billion by the Ernst & Young Study.[159] Although the study results are interesting, it is hard to determine which (if either) is more accurate, since the studies used different sampling methods, selected debtors from different calendar periods, examined different means testing proposals, screened debtors using different income levels, and adopted different assumptions to estimate living expenses.

X. A Modest Proposal: Streamlining the Consumer Bankruptcy Process

We believe that some bankruptcy reform is warranted due to the record number of filings since 1978 and the examples of abuse in the current process cited by both consumer advocates and creditors. Both the NBRC recommendations and the consumer creditor-sponsored legislation described above, however, have

152 GAO REPORT, *supra* note 149, at 3.

153. *See also* Ernst & Young Study, *supra* note 150, at 81, 96; Culhane and White, *supra* note 151, at 30.

154. *See* GAO REPORT, *supra* note 149, at 3.

155. Ernst & Young Study, *supra* note 150, at 81.

156. Culhane & White, *supra* note 151, at 73.

157. *See* Culhane & White, *supra* note 151, at 31.

158. *See* Ernst & Young Study, *supra* note 150, at 81.

159. *See* CULHANE & WHITE, *supra* note 151, at 59; Ernst & Young Study, *supra* note 150, at 81.

drawn heavy criticism. We favor an approach that should eliminate the high transaction costs currently associated with the bankruptcy process by greatly reducing the need for and the cost of the process itself.[160] As described more fully below, such an approach might be expected to appeal both to debtors and creditors.

Studies have shown that few bankruptcy cases involve contested matters or sufficient property to warrant the current judicial process.[161] Most consumer bankruptcies are relatively routine, uncontested matters that usually involve small sums.[162]

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160. Ninety-five percent of all bankruptcy filings are by consumers, and the purpose and scope of this article are limited to consumer bankruptcies. Although a similar proposal might be devised for business bankruptcies (particularly liquidation proceedings), it might be very problematic to do so for Chapter 11 cases. In Chapter 11, typically many more parties with a much greater variety of interests are involved (i.e., creditors, creditors' committees, lending institutions, prospective investors), and much more negotiation is typically involved in drawing up a reorganization plan than exists in consumer bankruptcies.

161. According to a 1994 report analyzing Chapter 7 cases from 1990-92, the General Accounting Office (GAO) found that approximately that only five percent of Chapter 7 cases resulted in the collection and distribution of funds by the trustees. Fifty-two percent of these cases generated less than $2,500 in receipts and eighty-eight percent involved less than $25,000 in receipts. Of the total receipts raised, over twenty-eight percent went to pay fees and expenses, but general unsecured creditors were only paid about twenty-two percent. *See* Ed Flynn, *Bankruptcy by the Numbers: General Accounting Office Report on Chapter 7 Cases*, AM. BANKR. INST. J., Sept. 1994.

162. It has been argued that bankruptcy law addresses what are essentially administrative issues that are inherently anti-adversarial in nature. Bankruptcy forces creditors to cooperate by blocking private credit collection efforts and other litigation against the debtor and consolidating the consideration of claims into a single forum. Such cooperation, although resisted by creditors in the short term, is collectively in their long-term best interests. Due to this commonality of interest, "bankruptcy law ought to be 'anti-adversarial' and amenable to replacement reform that suspends the right to pursue individual claims in favor of more cooperative action." Jeb Barnes, *Bankrupt Bargain? Bankruptcy Reform and The Politics of Adversarial Legalism*, 13 J. L. & POL. 893 (1997). Even in Chapter 13 cases, which are often an "an exercise in financial planning, nonattorney providers such as accountants and financial planners, should be allowed to prepare bankruptcy plans, similar to the way tax advice is currently available." *See* McKinley, *supra* note 4, at 33.

Due to the increasing number of bankruptcy filings, the desire to save the time and expenses involved in litigation, and the recognition that bankruptcy matters do not necessarily have to be addressed in an adversarial judicial environment, more and more bankruptcy courts have begun to require the use of alternative dispute resolution methods to resolve issues such as lifting the automatic stay, confirming a plan, fraudulent or preferential transfers, and other disputes. *See* Ralph R. Mabey, et.al., *Expanding the Reach of Alternative Dispute Resolution in Bankruptcy: The Legal and Practical Bases for the Use of Mediation and the Other Forms of ADR*, 46 S.C. L. REV. 1259 (1995).

The NBRC has recognized the efficiency in this plan as well. In its report, the NBRC recommended that Congress authorize the establish-ment of local rules

Presumably, few procedural safeguards are necessary in such cases yet, under the current bankruptcy scheme, such cases not only must follow the formal procedures associated with an adversarial legal process but must also incur the high cost and delays that are associated with such a process. We believe that the concerns of both consumer creditors and debtors would be better addressed by simplifying bankruptcy law and procedure, particularly in routine bankruptcy matters. In fact, the purpose of our proposal is to make the bankruptcy process as simple, inexpensive, and informal as possible, in order to provide prompt payment to creditors and timely relief to debtors. Specifically, our proposal is as follows:[163]

1. Using a judicial system to solve problems that are essentially administrative in nature has led to inefficiency.[164] Accordingly, Congress should abolish the existing bankruptcy process and establish an independent agency for processing consumer bankruptcies. As with many other federal agencies, its decisions would be appealable first to an appeal board within the agency and then to the United States Court of Appeals. This agency should have field offices throughout the United States.
2. An individual seeking debt relief would first meet with a trained agency representative, who would review financial information supplied by the debtor and then advise the debtor of his or her options: whether the debtor should try to reach a non-bankruptcy settlement with his or her creditors, file for liquidation under Chapter 7, or seek a repayment plan under Chapter 13. In the event that the debtor elects to proceed with bankruptcy, the debtor next would be referred to an agency analyst, who would be authorized to determine, according to general guidelines established by Congress based on the debtor's monthly income and debt service requirements, whether the debtor

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that would enable courts to order non-binding, confidential mediation to resolve disptes or determine claims in bankruptcy cases.

163. Our proposal is modeled on recommendations made by the Brookings Institution following its comprehensive study of the bankruptcy process in the late 1960's. *See generally* DAVID T. STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM (Brookings Institution, 1971).

164. *See supra* notes 161, 162 and accompanying text. Such inefficiency was also documented by Stanley and Marjorie, who found that over forty cents of every dollar in the median "asset" case went to administrative costs, which (under bankruptcy law) were paid prior to the creditors' unsecured claims. *See* STANLEY & MARJORIE, *supra* note 163, at 173-95.

must file for Chapter 13 rather than seek liquidation under Chapter 7.

3. Debtors who desire access to more detailed legal advice during this process could consult with ombudsmen furnished by the agency (similar to those used in state workers' compensation proceedings).[165] Alternatively, such debtors could always seek advice from counsel of their choice.
4. In Chapter 7 cases, the analyst would appraise the debtor's property, determine the amount of the debtor's exemptions, and then notify creditors of (1) the filing, (2) the debtor's exempt property, (3) the expected distribution, (4) the automatic stay, (5) the anticipated discharge of the debtor unless written objections are filed with the agency, and (6) a thirty-day deadline for filing proofs of claims (which is currently six months under the Bankruptcy Code). Following the expiration of the thirty-day deadline, unless objections are filed, the analyst would liquidate the debtor's non-exempt assets, gather the proceeds, review, determine and allow claims, resolve discharge questions, if any, and distribute proceeds to creditors.
5. If, within the thirty-day period, the debtor objects to the analyst's decision that the debtor must file for Chapter 13, or if any creditor objects to the appraisal or to the debtor's discharge, notice of such objection and the date and time for a hearing will be sent to each of the parties.

165. From the period 1995 to 1997, approximately sixty percent of workers filing claims with the Texas Workers' Compensation System used ombudsmen in the initial review conference. *See generally Texas Workers' Compensation System Data Report*, TEXAS WORKERS' COMP. COM., Pub. No. EX97-001, Feb 1998, at 16. Ombudsmen are available to meet with employees, to investigate complaints as well as to communicate with employers and insurance carriers to assure that workers' rights are protected. *See id.* Only a third of such workers chose to be represented by an attorney during this process. *See id.* Only about three percent of workers go on to contested case hearings, at which approximately fifty percent of workers utilized ombudsmen, and thirty-five to forty-five percent used attorneys. *See id.* Less than one percent of injured workers and a similar percentage of insurance carriers seek judicial review per year, with only about ten percent actually resulting in trials per year. *See id.* These figures indicate the level of confidence that workers appear to have in ombudsmen as well as the minor role in the determination of claims played by courts in the workers' compensation process.

An agency hearing examiner would then consider and rule on any such objections.[166]

6. To further simplify consumer bankruptcy and expedite the process, as well as provide more equitable treatment for debtors and additional recovery for creditors, we propose replacing the current array of state law exemptions with a uniform federal exemption (along the lines of that proposed by the NBRC). We would also suggest that some thought be given to reducing the number of priority claims; for example, all such claims might be claims for wages earned within ninety days prior to bankruptcy.
7. In Chapter 13 cases, the analyst would propose a plan and notify creditors of its provisions together with the other matters outlined in paragraph 4 above. The plan would be confirmed by the agency unless objected to in writing by a majority of creditors. In the event of objection, the hearings examiner would approve the confirmation unless it was determined that the objecting creditors could not reasonably expect to receive fair value for their claims. Following confirmation, the agency would receive funds from the debtor and distribute them to creditors pursuant to the plan. Once the plan's payment provisions were completed, the agency would grant a discharge to the debtor.

Would such a proposal gain sufficient support in Congress to be enacted?[167] Creditors might be expected to support reform of this type for a variety of reasons: (i) because much of the proceeding's administrative costs would be borne by general federal revenues instead of the debtor's estate, more money remains in the debtor's estate to pay other unsecured claims, (ii) debtors who have

166. Alternatively, the bankruptcy courts could be used for this purpose, but this would result in higher costs and longer delays than would using hearing examiners.

167. The reform legislation arising from the Brookings Study conducted by Stanley and Girth in the 1970s was rejected by Congress, which ultimately chose the minor, less drastic reforms included in the Bankruptcy Reform Act of 1978. *See* Claudia MacLachlan, *Bankruptcy Bill: Trimmed, Safe and a Crowd Pleaser*, NAT'L L. J., Oct. 24, 1994, at B1. No doubt the lobbying efforts of the legal profession and bankruptcy judges, who had vested interests in maintaining the status quo, had a great deal to do with the demise of the Brookings reforms, but at least one commentator has noted that other obstacles existed as well, including "American liberalism and distrust of centralized bureaucracy," and "political uncertainty." *See* Barnes, *supra* note 162, at 893, 934.

sufficient income to support a repayment plan would be required to file under Chapter 13 rather than under Chapter 7, (iii) legal costs creditors incur in the current bankruptcy process would also be reduced, (iv) reducing the number of priority claims would result in more recovery by unsecured creditors, and (v) replacing the current array of state law exemptions with a uniform federal exemption would lead to more uniform, predictable results and perhaps additional recovery in states with extremely generous exemption laws.[168] Consumer advocates might also support this proposal as it provides debtors with financial counseling and debt relief much more quickly and less expensively than under the current process.[169]

XI. Conclusion

The proposals being considered currently by Congress seem to have one element in common: all would increase the cost and complexity of the bankruptcy process. Even if adoption of these proposals results in greater recoveries for consumer creditors, the cost of implementing these reforms, particularly debtor education and some form of means-testing, would likely offset these gains. Establishing an administrative process for the bankruptcy process would more efficiently and effectively utilize economic resources by reducing the incidence of bankruptcy as well as legal costs when bankruptcy proceedings are appropriate. In addition, we believe that the process advocated would adequately address the concerns and facilitate achievement of most of the stated objectives of legislators, creditors, and the NBRC. For example, a debtor's ability to repay his or her debts would be more efficiently and effectively determined in an administrative setting, on a case-by-case basis by an independent analyst, as opposed to courts applying arbitrary means-testing requirements in the adversarial climate of the judicial process. Also, proposals to mandate debtor education, credit counseling, and the use of alternative dispute resolution as an alternative to bankruptcy could not only be easily incorporated into

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168. Although some creditors would no doubt complain that simplifying the bankruptcy process might lead to even more bankruptcy filings, such criticism may be unwarranted under our proposal because debtors with the ability to pay their debts would have far less incentive to file for bankruptcy than they currently possess. In any event, the strong possibility that creditors would recover much more through the bankruptcy process under our proposal should mute such criticism.

169. This type of legislation might also be quite well-received in the current political climate, which has sparked the enactment of much recent reform at both the state and federal levels to simplify and expedite the litigation process, particularly in the area of torts.

an administrative process, but arguably may be more effectively and efficiently performed as part of such a process.

As the tide of personal bankruptcies in the United States continues to rise, consumer creditors continue to urge Congress to enact bankruptcy reform. As this article has attempted to show, there are many factors that contribute to the increase in filings, most of which are quite unrelated to the structure of the current bankruptcy system. Although a comprehensive review of this system led to only minimal reform proposals by the NBRC, Congress is currently considering at least two proposals that would impose significant reforms. While these reforms may result in increased recoveries for consumer creditors, it appears that several of them (particularly H.R. 833's means testing proposal) would result in severe hardship for debtors. While such hardships might be justified if necessary to correct imbalances in the current system, the available empirical evidence, although mixed, does not appear to support the contention that such imbalances exist. Accordingly, Congress (and reform advocates) might look beyond House bill 833, particularly if the objective is to maximize creditor recovery while at the same time being fair to the debtor. Our proposal attempts to achieve this goal: by removing the bankruptcy process from the courts, a more efficient, fairer bankruptcy system would result, thus serving the best interests of consumer creditors and debtors.