

NOTES

THE PROPOSED NEW BANKRUPTCY ACT

I. INTRODUCTION

On July 30, 1973, after more than two years of study, the Commission on the Bankruptcy Laws of the United States¹ transmitted to the President, the Congress, and the Chief Justice of the United States its report² evaluating the present system of bankruptcy administration in the United States and recommending the first comprehensive revision of the present national bankruptcy statute since the Chandler Act amendments of 1938.³ Accompany-

¹The Commission on the Bankruptcy Laws of the United States [hereinafter referred to as the Commission] was created by joint resolution of Congress, effective June 24, 1970, to "study, analyze, evaluate, and recommend changes" in the Bankruptcy Act which would "reflect and adequately meet the demands of present technical, financial and commercial activities." Act of June 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. The Commission was specifically directed to consider:

the basic philosophy of bankruptcy, the causes of bankruptcy, the possible alternatives to the present system of administering the Act, the applicability of advanced management techniques to achieve economies in the administration of the Act, and all other matters which the Commission shall deem relevant.

Id. The legislation establishing the Commission enumerated the circumstances which led to its creation: the increase in the number of bankruptcies in the United States by more than 1,000 percent annually in the last twenty years, the widespread feeling among referees in bankruptcy that administrative difficulties in the Act required substantial improvement, the impact of the vast expansion of credit on the operation of the Act, and the limited experience and understanding in the federal government and the commercial community in assessing the operation of the Act. *Id.*

²REP. OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES (1973) [hereinafter cited as COMM'N REP.].

³The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, and its various additions and amendments were comprehensively revised by the Chandler Act of 1938, ch. 575, 52 Stat. 840. The Chandler Act has subsequently been revised and amended by more than sixty different congressional enactments and this conglomerate comprises the Bankruptcy Act as it exists today. 11 U.S.C. § 1 *et seq.* (1970). The Commission found that changes necessary to carry out its recommendations would involve a multitude of additional amendments to the Bankruptcy Act. Since further piecemeal revision by the Commission would not accomplish a much-needed streamlining and

ing the report was a formulation of the recommendations of the Commission in precise statutory language, in the form of a proposed "Bankruptcy Act of 1973," which has been submitted to Congress for enactment, and which, at this writing, is being considered by the Judiciary Committees of the House and Senate.⁴ The Commission's recommendations for change may be classified into two general categories: "procedural" changes in the structure of, and the distribution of functions within, the bankruptcy system, and "substantive" changes in the law to be applied during the administration of a bankrupt estate.

The purpose of this Note is to review some of the substantive features of the proposed Bankruptcy Act which relate to consumer debtors.⁵ Such a review necessarily involves a discussion of the present Bankruptcy Act and the difficulties with it which prompted the recommendations for change. It is hoped that such a review will be of value by increasing both the reader's understanding of the present Bankruptcy Act and his awareness of the revisions which Congress is considering at the present time.

II. FUNCTIONS AND GOALS OF THE BANKRUPTCY PROCESS

A consideration of the functions and goals of the federal bankruptcy process provides an insight into the theory behind the specific recommendations of the Commission for changes in the substantive law of consumer bankruptcy. The existence of a pro-

clarifying of the internal arrangement of the Act and would not account for the impact of the new Rules of Bankruptcy Procedure, effective October 1, 1973, the Commission determined to formulate an entirely new Bankruptcy Act. Press Release by Commission on the Bankruptcy Laws of the United States, July 30, 1973, in COMM'N REP.

In this Note, the specific language of the proposed new Bankruptcy Act will not be considered. The Commission recognized that it was "impossible within the time and budgetary limitations to which [it was] subject to produce a proposed statute which may not need some refinement and clarification." *Id.* Thus, it seems unproductive to criticize specific statutory language which is not yet and may never be law; it seems more productive to approach the theory of the proposed new Bankruptcy Act and to discuss the recommendations in general terms.

⁴S. 2565, 93d Cong., 1st Sess. (1973); H.R. 10792, 93d Cong. 1st Sess. (1973).

⁵For the purposes of this Note, the term "consumer debtor" encompasses nonbusiness individual debtors who do not have the option of liquidation and termination of their activity in the economic community, but instead must continue to live and consume to provide food, clothing, shelter, and health care for themselves and their families after obtaining relief under the Bankruptcy Act.

cedure which permits the nonperformance of contractual obligations seems dangerous in an economy which thrives on credit transactions and anomalous in a society which places primary importance, both morally and legally, upon the performance of contractual commitments. Nonetheless, the bankruptcy process is supportive of and essential to the success of a credit-based economy.⁶

The Commission Report identifies the two primary functions of the bankruptcy system. First, the bankruptcy process serves to "continue the law-based orderliness of the open credit economy in the event of a debtor's inability or unwillingness generally to pay his debts."⁷ Both debtors and creditors need rules and procedures which define the legal consequences of their future conduct to guide them in their day-to-day activities within the credit community.⁸ It is important that there be uniform national standards which determine creditors' rights in the wealth of debtors, wherever and in whatever form this wealth exists, and procedures which give effect to these standards and make it possible for creditors to realize on their claims.⁹ It is important that debtors have "a sanctuary from the jungle of creditors' pursuit of their individualistic collection efforts,"¹⁰ either by way of a stay of these collection efforts or by way of an authoritative discharge.

The bankruptcy process further serves the credit economy by providing a meaningful "fresh start" to debtors too burdened to enter new credit transactions, thereby rehabilitating them for continued and more productive future participation in the credit community.¹¹ It is this latter function which is of special significance to consumer debtors because, while a "fresh start" policy has become independently established in the commercial world by the

⁶COMM'N REP. 84. The Commission uses the term "open credit economy" to refer to the role of private credit generally in the economy of the United States. The open credit economy is a "complex of highly organized processes," *id.* at 81, and although it is not entirely "open", it is characterized as such by the Commission in contrast with the command credit economies of communistic and socialistic countries. *Id.* at 82. The bankruptcy process has its principal impact on the open credit economy since most of the debts scheduled in bankruptcy arise from transactions between debtor and creditor participants; other debts, such as family support obligations, tort liabilities, taxes, and fines, are minimally affected because often they are nondischargeable. *Id.* at 83.

⁷*Id.* at 84.

⁸*Id.*

⁹*Id.*

¹⁰*Id.*

¹¹*Id.*

availability of limited liability and easy dissolution of corporate entities, a meaningful "fresh start" is only available to consumers through bankruptcy legislation.¹²

While serving and supporting the credit economy is both a function and a goal of the bankruptcy process, other specific goals greatly influence the establishment of the policies of the bankruptcy process. The Commission Report enumerates the significant internal specialized goals. First, the bankruptcy process should be easily accessible to both debtors and creditors.¹³ The bankruptcy process should encourage debtors and creditors to participate in informal plans based on private agreement since, when debtors and creditors can agree, a process "less formal, less expensive, and less stigmatized than a case under the Bankruptcy Act is more appropriate."¹⁴ However, when a bankruptcy proceeding is in order, the bankruptcy process should encourage timely resort to relief so as to cut short the dissipation of the debtor's assets and the accumulation of more debts.¹⁵ The process should be "intellectually accessible" by simplification and clarification of the substantive law, procedural rules, and administrative practices, the process should be "physically accessible" by the establishment of local offices and contact points, and the process should be "economically accessible" by eliminating the need for expensive legal representation to fill out forms for simple cases.¹⁶ Second, the bankruptcy process should provide fair and equitable treatment of creditors' claims.¹⁷ Since creditors' rights laws outside bankruptcy are neither consistent nor comprehensive,¹⁸ internal standards of two types are needed:

¹²*Id.* The consumer may attempt to move to a new state to avoid his creditors, but obviously the relief afforded by such self-help methods cannot be deemed meaningful.

¹³The premise of the Commission is that the honest debtor should be benefited by meaningful relief and that the dishonest debtor should not be aided. Thus, easy accessibility should not be taken to mean that relief via the bankruptcy process should be so permissive as to become a popular means of avoiding obligations. Bankruptcy relief should remain a serious alternative, not to be taken lightly and not to be planned for or used as a means of defrauding creditors.

¹⁴COMM'N REP. 57.

¹⁵*Id.* at 87-88.

¹⁶*Id.* at 88.

¹⁷*Id.*

¹⁸*E.g.*, UNIFORM COMMERCIAL CODE § 2-702 takes into account the insolvency of the debtor, while other rules, such as the priority rules of Part 3 of Article 9 of the Code, do not. Methods of enforcing creditors' rights vary depending upon the class of the lien interest, for example, whether the

“distributive” standards that consider the legal status of the creditors’ claims and “allocative” standards that consider the social and economic consequences of the allocation of the burden of loss.¹⁹ Third, the process must provide fully for the rehabilitation of debtors by providing relief that is “flexible, comprehensive, lasting, and timely.”²⁰ The process should assist the debtor in making an informed choice of the relief best-suited to his domestic and economic circumstances, should preserve the property of debtor which is necessary for the maintenance of his household, and should preclude the denial, encroachment, or termination of discharge benefits.²¹ Fourth, the process should administer cases quickly, impartially, economically, uniformly, and flexibly,²² and should effectively deter and sanction dishonest conduct in its use.²³ The conclusion of the Commission is that the present Bankruptcy Act does not effectively promote the realization of these goals of the bankruptcy process. The recommendations of the Commission for changes in the substantive law of bankruptcy are made with these goals in mind.

III. PROCEDURAL RECOMMENDATIONS

Many of the proposed revisions to the substantive law of consumer bankruptcy are integrally related to the proposed procedural revisions. Although this Note does not pretend to discuss these procedural recommendations in any detail, a brief mention of them at the outset is essential to a full understanding of the proposed substantive changes.

Under the present Bankruptcy Act, the administrative and judicial functions of the bankruptcy system are performed by the federal district courts, their appointees, and assistants.²⁴ A great part of the work of these judicial tribunals is administrative and involves the handling of papers for thousands of cases in which

lien is judicial, consensual, or statutory. COMM’N REP. 89. The order of priority among liens of different classes is not completely resolved because of competing and conflicting interests. *Id.*

¹⁹COMM’N REP. 89.

²⁰*Id.* at 91.

²¹*Id.* at 91-92.

²²*Id.* at 93.

²³*Id.* at 94. Sanctions upon dishonest conduct in the use of the bankruptcy process are found in 18 U.S.C. § 151 *et seq.* (1970).

²⁴Bankruptcy Act, 11 U.S.C. § 2 (1970) [hereinafter referred to as the Act; hereinafter cited as Bankruptcy Act and cited to sections in the

no contest ever arises.²⁵ Not only is a disproportionate amount of judicial time, energy, and money committed to the performance of administrative duties for which a judicial tribunal is not equipped,²⁶ but also, when a judicial resolution is required, the judge's prior participation in the administrative aspects of the bankruptcy proceeding may tend "to impair the litigant's confidence in the impartiality of the tribunal's decision."²⁷

To effect increased efficiency, economy, and impartiality of case handling, the Commission is in favor of a comprehensive restructuring of the bankruptcy system.²⁸ The Commission recommends the division of the administrative and judicial functions within the bankruptcy system by the creation of two independent subsystems. The Commission proposes that the judicial duties be performed by new bankruptcy courts, separate and distinct from, but with powers parallel to those of, the federal district courts.²⁹ The present bankruptcy courts have limited exclusive jurisdiction over controversies which involve an estate undergoing admin-

Bankruptcy Act and not to sections in the United States Code]. Referees in bankruptcy are assigned most of the administrative and judicial functions.

²⁵COMM'N REP. 17.

²⁶*Id.* at 97-98. For example, bankruptcy courts may become involved in the supervision of businesses and wage earner plans.

²⁷*Id.* at 17-18. The litigants may believe that the trustee has a friendly forum in the bankruptcy court. *Id.* at 102. The litigants may also believe that on appeal, the district judge, typically located in the same courthouse as the referee, will be "unlikely to reverse an appointee of the reviewing court." *Id.* at 107. Whether these beliefs are justified or not is not pertinent; if such beliefs do, in fact, tend to undermine confidence in the bankruptcy process by compromising the apparent objectivity of the judicial functionaries, then the process loses some of its effectiveness.

²⁸*See id.* at 97-169 for a discussion of all reasons for the recommended restructuring; *cf. id.* at 321-23 for the comments of a dissenting member of the Commission. *See also* Cyr, *The Abandonment of Judicial Administration of Insolvency Proceedings: A Commitment to Consumer Disservice*, 78 COM. L.J. 37 (1973); Lee, *Possible Alternatives to the Present System of Bankruptcy Administration*, 45 AM. BANKR. L.J. 149 (1971).

²⁹*See* COMM'N REP. 97-108. The judicial districts of the present bankruptcy courts coincide with federal judicial districts. Bankruptcy Act § 37. The Commission proposes local territorial bankruptcy districts, not necessarily coinciding with federal districts, but to be determined by the Judicial Conference. COMM'N REP. 18. Referees in bankruptcy, under the present Bankruptcy Act, do not have the full powers of the federal district judges; they do not have the power to issue restraining orders or the power to conduct jury trials, and until the new Rules of Bankruptcy Procedure became effective in October 1973, they had no power to punish for contempt. *See* Bankruptcy Act § 41; R. BANKR. P. 920. The proposed Act would give the new bankruptcy judges the full powers of federal district judges. COMM'N REP. 19.

istration under the Bankruptcy Act: litigation of some controversies *must* be instituted in a nonbankruptcy court although the decision may seriously affect rights of debtors and creditors in a bankruptcy case;³⁰ litigation of certain other controversies *may* be commenced in a nonbankruptcy court at the option of the plaintiff.³¹ The proposed new bankruptcy courts would have exclusive jurisdiction over *all* controversies arising out of proceedings under the Act³² and would have no administrative functions absent the existence of a litigable controversy.³³

The Commission proposes that the administrative duties be performed by a new federal agency to be created in the executive branch of the government.³⁴ The Administrator of this proposed agency would be authorized to maintain a staff of trained civil servants and, in addition, to employ attorneys, accountants, appraisers, auctioneers, consultants, and business advisors on a temporary basis.³⁵ The Administrator would be authorized to handle

³⁰The bankruptcy court has jurisdiction to determine all disputes affecting property in the custody of the court, to determine all issues arising out of petitions which initiate bankruptcy proceedings, and to determine controversies arising in the course of the administration of an estate in which the adverse parties either waive objections to jurisdiction or fail to assert objections. COMM'N REP. 100. In some other instances, the Bankruptcy Act explicitly confers jurisdiction on the bankruptcy court. *E.g.*, Bankruptcy Act §§ 2a(12), 2a(21), 17c, 50n, 571, 60d, 67a, 69d, 70a(8). Litigation of controversies which do not fall in the above categories *must* be initiated in a nonbankruptcy court. COMM'N REP. 100.

Some provisions seem to give the bankruptcy court and state courts concurrent jurisdiction over plenary proceedings arising out of these sections. *E.g.*, Bankruptcy Act §§ 60b, 67d, 70e. However, the trustee, under these provisions, must bring his action in a federal district court or a state court, unless there are independent grounds for jurisdiction in the bankruptcy court. 2 COLLIER, BANKRUPTCY, ¶ 23.15, at 603 (14th ed. 1973).

³¹Trustees are suable "without leave of the court appointing them." 28 U.S.C. § 959 (1970). *See* 2 COLLIER, BANKRUPTCY, ¶¶ 23.15, 23.16, 23.19, 23.20 (14th ed. 1973).

³²Jurisdiction of railroad reorganizations would, however, remain in the federal district courts. COMM'N REP. 97.

³³Although the proposals of the Commission would result in a decrease in the number of bankruptcy judges, the intent is to increase the stature of those remaining. Broadening the court's jurisdiction would help to eliminate the harmful delay which may occur when procedures and dockets of non-bankruptcy courts are encountered, the extra expense to the bankrupt estate when forced to litigate outside the bankruptcy court, and, most important, the frequent and prolonged litigation of the question of jurisdiction. *Id.* at 101.

³⁴*See id.* at 115-29.

³⁵*Id.* at 129.

almost all matters in proceedings under the Act except those aspects of a case which require a judicial determination.³⁶ Functions presently performed by bankruptcy courts, which supposedly could be more efficiently and economically handled by an agency with modern computer facilities and a well-trained professional staff, include: the receipt and processing of voluntary petitions, schedules, and statements of affairs, the notification of creditors of significant events in cases being administered, the allowance and disallowance of debtors' exemptions and creditors' claims, the granting of discharges when no objections are filed, the determination of priorities in the distribution of proceeds to creditors, and the ordering of payments to creditors.³⁷ The Administrator would also be authorized, and mandated, to perform a function presently undelegated within the bankruptcy system, that is, to provide free counseling to individual debtors with regular income regarding the form of relief most appropriate in their particular circumstances.³⁸ This proposed counseling service is of great significance to the consumer debtor seeking rehabilitation via the federal bankruptcy system.

IV. CONSUMER CASES: VOLUNTARY

A. *Selection of the Form of Relief*

The present Bankruptcy Act provides that any individual is entitled to the benefits of the Act as a voluntary bankrupt.³⁹ The "benefits of the Act" insofar as the consumer debtor is concerned consist of two distinct forms of relief. The debtor may seek a discharge of his debts under Chapters I to VII in which case his non-exempt assets are liquidated and the proceeds applied in full satisfaction of the provable and nonexcepted claims of his creditors. Alternatively, the debtor may seek to effect a wage earner plan under Chapter XIII in which case he proposes to pay his debts in full or in part out of his future earnings.

The present bankruptcy system provides no assistance to the debtor to help him decide which of these alternatives is best-suited

³⁶The Administrator would not handle any aspects of railroad reorganization cases. *Id.* at 21.

³⁷*Id.* at 133. The Administrator would handle not only the administrative functions of the referees, but also of trustees in liquidation cases (unless the creditors elect an independent trustee), of trustees in wage earner plans, and of the SEC in reorganization proceedings. *Id.* at 132-33.

³⁸*Id.* at 133. See Lee, *The Counseling of Debtors in Bankruptcy Proceedings*, 45 AM. BANKR. L.J. 387 (1972); COMM'N REP. 91 (functions to be performed by counseling service).

³⁹Bankruptcy Act § 4a.

to his economic predicament. If the debtor does not obtain private counsel, he will have no practical conception of what lies ahead in the bankruptcy process. If he does obtain private counsel, he must be prepared to pay what are often inordinately high attorneys' fees in relation to the quality of counsel provided.⁴⁰

The Commission proposes that every individual petitioner with regular income file with the Administrator an "open-ended" petition.⁴¹ The petition would be referred to a counselor⁴² employed by the Administrator. The selection of the type of relief desired by the petitioner would be postponed until he had received advice as to the advantages, disadvantages, and feasibility of the successful completion of a wage earner plan, and as to his eligibility for, and the probable effects of, a discharge in straight bankruptcy.

The interests of both debtors and creditors would be served by his counseling procedure. A debtor, by having the opportunity to make an informed choice of the particular mode of relief best suited to the "continuation of his household as a social and economic unit,"⁴³ could be assured of a chance for a lasting and meaningful rehabilitation. Creditors, likewise, could be more secure in the knowledge that the relief chosen is probably both fair and feasible; they would also be assured, in most cases, that the assets of the bankrupt in which they might be able to share were not being siphoned "off the top" to the debtor's attorney.

B. Straight Bankruptcy Discharge

A voluntary petition for discharge under Chapters I to VII of the present Bankruptcy Act must be filed with the bankruptcy court.⁴⁴ With the petition, the debtor must file a detailed schedule of his property, showing the amount, kind, location, and money value, a list of all his creditors, including those who assert contingent, unliquidated, or disputed claims, showing their residences, the amount due or claimed by each of them, the consideration received, and the security held by each of them, and a claim for those exemptions to which the debtor considers himself entitled.⁴⁵

⁴⁰COMM'N REP. 58.

⁴¹*Id.* at 133.

⁴²The Commission does not contemplate that the counselors be attorneys, but only that they be trained as professional bankruptcy counselors. *Id.* at 134.

⁴³*Id.* at 91.

⁴⁴Bankruptcy Act § 59.

⁴⁵*Id.* § 7a(8).

The filing of a voluntary petition operates automatically as an adjudication, that is, as a determination that the debtor is a bankrupt.⁴⁶ An adjudication of bankruptcy serves as an application for discharge.⁴⁷ Upon receipt of an application for discharge, the court must notify the creditors of the bankrupt that the application is pending,⁴⁸ set a time for filing objections to discharge and for filing applications for a judicial determination that certain debts are not dischargeable,⁴⁹ and set a time for the first meeting of creditors.⁵⁰

Upon the expiration of the time set for the filing of objections, if no objections have been filed and if the filing fees required by the Act have been paid in full, a discharge will be granted.⁵¹ If objections have been filed, the court must hear evidence in opposition to the discharge⁵² and will grant the discharge only if satisfied that the bankrupt has not committed any one of certain specified acts which bar such relief.⁵³

With three exceptions, the Commission recommends substantial retention of the provisions of the present Act which enumerate the acts which bar a bankrupt's discharge. The present Bankruptcy Act limits the availability of successive discharges by providing that the bankrupt's discharge is barred by his having obtained relief by way of a discharge or by way of the confirmation of a wage earner plan for a composition⁵⁴ within six years of

⁴⁶*Id.* § 18f.

⁴⁷*Id.* § 14.

⁴⁸*Id.*

⁴⁹*Id.* For a discussion of the judicial determination of dischargeability, see text accompanying notes 78-86 *infra*.

⁵⁰Bankruptcy Act § 57.

⁵¹*Id.* § 14b(2).

⁵²The evidence must be such that will give the bankrupt and the objecting parties a "reasonable opportunity to be heard." *Id.*

⁵³*Id.* § 14c. Acts which bar discharge include: committing an offense punishable by imprisonment under 18 U.S.C. § 152 (1970), destroying or mutilating records from which the debtor's financial condition and business transactions might be ascertained, making a false written financial statement to obtain credit while engaged in a business as a sole proprietor, partnership, or corporate executive, concealing property with intent to defraud creditors, obtaining relief under the Bankruptcy Act within the preceding six years, refusing to obey a lawful order of the bankruptcy court, failing to explain satisfactorily any deficiencies of assets, or failing to pay the filing fee required by the Act.

⁵⁴A "composition" is a plan in which the debtor proposes to pay only a portion of the total amount of all the debts with which he deals in his wage

the filing of the pending petition.⁵⁵ The Commission contends that, while a time bar is essential to prevent abuse of the bankruptcy system by habitual bankrupts, the bar should not be so absolute as to frustrate the rehabilitative goals of the Bankruptcy Act.⁵⁶ The Commission recommends that the confirmation of a wage earner plan for a composition should not bar subsequent discharge,⁵⁷ that the arbitrary six-year period be reduced to a five-year period,⁵⁸ and that, even within this five-year period, a discharge might be granted if the court is satisfied that "the inability of the debtor to pay his debts is substantially the result of causes not reasonably within his control and if payment of them . . . will impose an undue hardship on the debtor and his dependents."⁵⁹

Perhaps the greatest inconsistency of the present Bankruptcy Act is that a bankrupt may not obtain a discharge until he has paid in full the filing fees required by the Act.⁶⁰ In *United States v. Kras*,⁶¹ the Supreme Court upheld the constitutionality of the Act's preclusion of the filing of an in forma pauperis petition in bankruptcy.⁶² The Commission recommends that failure to pay the filing fee be eliminated as a bar to discharge and that indigent debtors be authorized to file in forma pauperis petitions.⁶³ Although, as the Commission points out, one who is unable to pay a rather minimal filing fee typically "should not be concerned by threats of enforced collection by creditors, it is anomalous that the benefits of the Act should be denied to one because he is so bankrupt that he lacks even the fee."⁶⁴

earner plan; an "extension" is a plan in which the debtor proposes to pay all the debts enumerated in the plan over a specified and extended period of time; a combination "composition and extension" is a plan in which the debtor proposes to pay a portion of his debts over an extended period of time. The confirmation of any plan involving a composition of the debtor's obligations is a bar to subsequent relief under the present Act. Only the confirmation of a plan of extension alone does not bar subsequent relief.

⁵⁵Bankruptcy Act § 14c(5).

⁵⁶COMM'N REP. 186.

⁵⁷*Id.* at 24.

⁵⁸*Id.*

⁵⁹*Id.* at 186. (This is the language of § 4-505(a) of the proposed Act.)

⁶⁰Bankruptcy Act §§ 14b(2), 14c(8).

⁶¹409 U.S. 434 (1973).

⁶²*Id.* at 446-48.

⁶³COMM'N REP. 23.

⁶⁴*Id.* at 21.

The present Bankruptcy Act bars the discharge of an individual engaged in business if he has obtained money or property on credit for the business by making a materially false written statement of his financial condition or the financial condition of his partnership or corporation.⁶⁵ The Commission recommends that this kind of fraud be dealt with by excepting the particular debt from the effects of the discharge, rather than by giving the defrauded creditor a life or death power over the debtor's discharge.⁶⁶

If it is determined that the discharge of the bankrupt is not barred, the debtor and his creditors must then be concerned with the effects of the discharge. The present Bankruptcy Act provides that a discharge releases the bankrupt from all debts which are "provable"⁶⁷ in bankruptcy, except those debts which are "excepted"⁶⁸ by the Act. Property of the debtor which is not "exempt"⁶⁹ constitutes the "estate"⁷⁰ of the debtor in which those creditors whose claims are "proved and allowed"⁷¹ within six months of the first date set for the first meeting of creditors are entitled to share. Certain claims of creditors are given "priority"⁷² and are paid in full before any of the other creditors may share equally in the estate. The Commission recommends the abolition of the concept of "provable" debts and the consolidation of the two tests of "provability" and "allowability" into the single simplified and clarified concept of "allowability."⁷³ In the proposed Act, all legal obligations of the debtor would be dischargeable, unless specifically excepted, and all claims of creditors, unless specifically

⁶⁵Bankruptcy Act § 14c(3)

⁶⁶COMM'N REP. 185.

⁶⁷Bankruptcy Act § 63 defines the types of debts which are provable. An order of discharge must declare void any previous or subsequent judgment in any other court as a determination of the liability of the bankrupt as to discharged debts and must enjoin creditors whose debts have been discharged from instituting or continuing any action to collect such discharged debts. *Id.* § 14f.

⁶⁸*Id.* § 64.

⁶⁹*Id.* § 6.

⁷⁰*Id.* § 70.

⁷¹*Id.* § 57. Proof of a claim consists of establishing the validity and the amount of the claim.

⁷²*Id.* § 64.

⁷³COMM'N REP. 33. Under the present Act, the creditor must consider various sections and various tests to determine if his claim is provable (§ 63), when it is proved (§ 57a), if proved, when it will be allowed (§ 57d), and if proved and allowed, if it will be excepted (§ 64).

disallowed, would be cognizable for potential participation in the bankrupt's assets.⁷⁴

The proposed test of allowability is most significant because of its simplicity and clarity. However, one specific innovation in the allowability section of the proposed Act is of particular importance to consumer debtors and would be more significant from their point of view than the consolidation of the allowability test. The Commission recommends that "unconscionable consumer claims be subject to disallowance under standards set forth in the Act that are based on ones adopted or proposed for consumer protective legislation."⁷⁵ Thus, creditors guilty of "overreaching sales or credit practices"⁷⁶ would have no right to share in the estate of the bankrupt and would have no standing to object to the bankrupt's discharge.

The present Bankruptcy Act enumerates certain types of obligations which are "excepted" and not released by the granting of a discharge.⁷⁷ The Commission recommends the elimination of certain exceptions which frustrate the debtor's chances of rehabilitation and the addition of certain others, without which abuse of the discharge provisions is possible. The present Bankruptcy Act provides that a debt for which credit was extended in reliance on the false financial statement of the debtor is not dischargeable if the creditor seeks a timely determination of the dischargeability issue before the bankruptcy court.⁷⁸ Prior to 1971, a creditor who had taken a financial statement listing the debts of the bankrupt at the time credit was extended could sue the debtor, even after his discharge, upon the debt arising out of the extension of credit if the debtor had made less than a complete disclosure of his finan-

⁷⁴COMM'N REP. 225.

⁷⁵*Id.*

⁷⁶*Id.*

⁷⁷Debts which are not affected by a discharge in bankruptcy include: taxes legally due and owing within three years preceding bankruptcy or those for which no return or a fraudulent return was filed, liabilities for obtaining credit or false pretenses, debts which were known to the bankrupt but which were not scheduled in time for proof and allowance unless the creditor knew of the pendency of the proceedings, debts created by the fraud of the bankrupt as a fiduciary, liabilities for wages and commissions which are entitled to priority under § 64a, money due an employee retained by an employer to secure the faithful performance by the employee of his employment contract, money due for alimony or maintenance and support of a wife or child, and liabilities for wilful injuries to person or property. Bankruptcy Act § 17a.

⁷⁸*Id.* § 17a(2).

cial position.⁷⁹ Congress was informed that in most cases the false financial statement was not relied on by the creditor, but taken merely to be used to obtain a reaffirmation after bankruptcy⁸⁰ or to obtain a default judgment against a debtor unwilling to affirm.⁸¹ In an attempt to combat this abuse of the bankruptcy system, Congress in 1971 amended the Bankruptcy Act to require that a creditor wishing to rely on the false financial statement exception seek a timely determination in the bankruptcy proceeding.⁸²

The Commission recommends that reliance upon the false financial statement of a debtor be eliminated as an exception to discharge.⁸³ The Commission's study revealed that the 1971 dischargeability amendments have not attained their objective of combatting abuse of the bankruptcy system. Creditors have still been able to make advantageous use of the false financial statement by threatening to litigate the question of dischargeability and by accepting a reaffirmation of the debt in settlement.⁸⁴ The Commission determined that the exception has "generated a substantial amount of litigation and has partially frustrated the 'fresh start' goal of the discharge,"⁸⁵ and that the "abuses and harmful effects far outweigh the benefit to creditors."⁸⁶

The present Bankruptcy Act provides that claims for taxes which became "legally due and owing . . . within three years preceding bankruptcy," and those for any period in which a false return or no return was filed, are excepted from discharge.⁸⁷ In furtherance of the "fresh start" goal, the Commission recommends

⁷⁹COMM'N REP. 22. Such creditors relied upon a provision excepting the debt from discharge.

⁸⁰See text accompanying notes 131-33 *infra*.

⁸¹COMM'N REP. 23.

⁸²*Id.*

⁸³*Id.* at 24.

⁸⁴*Id.* at 23. See Countryman, *The New Dischargeability Law*, 45 AM. BANKR. L.J. 1 (1971); Schuchman, *Impact Analysis of the 1970 Bankruptcy Discharge Amendments*, 51 N.C.L. REV. 233 (1972); 69 MICH. L. REV. 1347 (1971). See also Herzog, *The Case for Jury Trials on the Issue of Dischargeability*, 46 AM. BANKR. L.J. 235 (1973); Countryman, *Jury Trials on Dischargeability: A Reply to Referee Herzog*, 46 AM. BANKR. L.J. 305 (1973).

⁸⁵COMM'N REP. 186.

⁸⁶*Id.*

⁸⁷Bankruptcy Act § 17a(1). Prior to 1966, no tax claims were dischargeable.

that the time period be reduced to one year.⁸⁸ The loss of revenue to the Treasury Department as a result of this reduction of time would be minimal, the return to creditors could be significantly increased, and the burden to the debtor of the nondischarged claim would be substantially alleviated.⁸⁹

In an attempt to curtail recognized abuses by debtors of the bankruptcy discharge, the commission recommends the extension of the range of excepted debts in two respects. To discourage pre-bankruptcy shopping sprees, the Commission proposes that debts incurred within ninety days of the petition, with no intention of repayment, not be dischargeable.⁹⁰ To prevent abuse of educational loan programs by those who make no attempt to repay and instead file bankruptcy the day after graduation, the Commission recommends that, unless the debtor can show hardship, educational loans should not be dischargeable until five years after the due date of the first payment.⁹¹

The present Bankruptcy Act provides that the creditors of the bankrupt, at the first meeting of creditors after the adjudication, shall appoint a trustee of the estate of the bankrupt.⁹² If the creditors do not appoint a trustee, the court may do so.⁹³ The trustee, as of date the petition is filed, is vested with the title of the bankrupt to all types of property enumerated in the Act, unless the property is held to be exempt.⁹⁴ The trustee, under the direction of the court, is bound to "collect and reduce to money" the property of the estate for which he is trustee.⁹⁵

⁸⁸COMM'N REP. 186. A tax claim for which either no return or a fraudulent return was filed would also be nondischargeable.

⁸⁹*Id.* at 186, 228.

⁹⁰*Id.* at 186-87.

⁹¹*Id.* at 187.

⁹²Bankruptcy Act § 44a. If there are no assets to be administered, the requirement of a trustee is dispensed with.

⁹³*Id.*

⁹⁴*Id.* § 70a. Kinds of property which are considered to be property of the estate of the bankrupt include: documents relating to the debtor's property, interests in patents, copyrights and trademarks, and in applications therefor, powers which the bankrupt might have exercised for his own benefit, property transferred by the debtor in fraud of his creditors, property which could have been transferred or levied upon prior to the filing of the petition, rights of action upon contracts or for the unlawful taking of property, contingent remainders, executory interests, etc., and property held by an assignee for the benefit of creditors appointed by an assignment which was preferential to some creditors.

⁹⁵*Id.* § 47a(1).

The present Bankruptcy Act refers to state law to determine what is property of the bankrupt and whether that property is voluntarily or involuntarily transferable.⁹⁶ This double reference to state law not only produces excessive litigation, in which federal tribunals are called upon to decide questions of state law, but also often works unfairly and in contravention of the goals of the federal bankruptcy process.⁹⁷ The return to creditors in a bankruptcy proceeding may depend upon the debtor's residence and that state's laws with respect to creditors' rights in property held jointly, as tenants of the entireties, as community property, or subject to spendthrift restraints, dower, curtesy, or other statutory interests.⁹⁸ The nonuniformity of state laws of transferability results in nonuniformity in the operation of the Act and frustrates the function of the Act to provide standard rules and procedures upon which debtors and creditors anywhere and at any time may rely.

The Commission proposes that the Bankruptcy Act retain the first reference to state law to determine what is property of the debtor, given that the alternative would be to codify a federal law of property solely for the purpose of the Bankruptcy Act.⁹⁹ The Commission recommends, however, that once it is determined by state law what is property of the debtor, the Bankruptcy Act should abandon the state law transferability test and provide uniform rules to determine the availability of the debtor's property to his creditors.¹⁰⁰ The Commission would provide that the undivided interest of a spouse who is a debtor in a bankruptcy case be made available to creditors by authorizing the trustee of either spouse to sell property held jointly and to reimburse the spouse who is not a bankrupt out of the net proceeds of the sale.¹⁰¹ The

⁹⁶*Id.* § 70a(5). Property of the estate of the bankrupt is defined to include:

property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered

Id.

⁹⁷COMM'N REP. 206. See Countryman, *The Use of State Law in Bankruptcy Cases*, 47 N.Y.U.L. REV. 407, 631 (1972).

⁹⁸See Bienenfeld, *Creditors v. Tenancies by the Entirety*, 1 WAYNE L. REV. 105 (1955); Huber, *Creditors' Rights in Tenancies by the Entireties*, 1 B.C. IND. & COM. REV. 201 (1959).

⁹⁹COMM'N REP. 207.

¹⁰⁰*Id.*

¹⁰¹*Id.* at 207-08.

Commission would include community property of the debtor in his estate only if it is "generally liable for the debtor's postnuptial contractual debts."¹⁰² The Commission would recommend that spendthrift restraints be unenforceable in a bankruptcy proceeding to the extent that the value of the beneficial interest is in excess of the "reasonable support needs of the debtor and his dependents."¹⁰³

The provisions of the proposed Act would bring almost all of the property owned by the debtor into his estate, including future interests such as contingent remainders, executory interests, rights of re-entry, and powers of termination.¹⁰⁴ The Commission recognizes that such interests may have only speculative value and recommends that if the realizable value is "only nominal or disproportionate as compared to the potential value to the debtor, such interests are not to be considered property of the estate."¹⁰⁵ The Commission would also invalidate dower, curtesy, and similar statutory interests insofar as the Bankruptcy Act is concerned.¹⁰⁶

The exemption provisions of bankruptcy legislation are as important as the discharge provisions to the debtor seeking rehabilitation and a meaningful "fresh start." A discharge will be of little value to an individual bankrupt if he is left destitute and without a basis for rehabilitation. The present Bankruptcy Act recognizes the need for exemptions, but relies upon state law and federal law other than the Bankruptcy Act to determine what property of the debtor is exempt.¹⁰⁷ The problems of nonuniformity of state law and the consequent frustration of the goals of federal bankruptcy legislation recur.

The Commission recommends that the Bankruptcy Act prescribe the exemptions available to debtors and supercede other state and federal laws.¹⁰⁸ The Commission would allow as exempt the types of property that have traditionally been allowed as ex-

¹⁰²*Id.* at 208-09. This would preserve the result now reached in most community property states, except Arizona and Washington.

¹⁰³*Id.* at 209.

¹⁰⁴*Id.* The present Act includes such interests if they are alienable under state law. Bankruptcy Act § 70a(7).

¹⁰⁵COMM'N REP. 209.

¹⁰⁶*Id.* at 207. This would be an explicit exception to the proposed all-inclusive rule.

¹⁰⁷Bankruptcy Act § 6.

¹⁰⁸COMM'N REP. 181.

empt under state law.¹⁰⁹ The Commission would include a homestead exemption of up to \$5000 of equity in property which the debtor, his spouse, or his dependents owned and used as a home at the time of the filing of the discharge petition.¹¹⁰ In addition to the homestead, the Commission would exempt, up to specified maximum amounts, such property as livestock, jewelry, clothing, household furnishings, tools of the debtor's trade, motor vehicles, a burial plot, disability benefits, health aids, and rights in certain retirement plans.¹¹¹

The present Bankruptcy Act requires that the debtor file with his voluntary petition a list of those exemptions to which he claims he is entitled.¹¹² The trustee of the bankrupt's estate may "set apart the bankrupt's exemptions allowed by law, [only] if claimed."¹¹³ To prevent the inadvertent loss of exemptions to the debtor who fails to claim them, the Commission proposes that the Administrator be authorized to allow exemptions in the absence of any action on the part of the debtor.¹¹⁴

The deference of the present Bankruptcy Act to state law to determine exemptions may result in the loss of exemptions to the debtor who has waived his rights to them and who resides in a state which enforces such waivers.¹¹⁵ The Commission believes that the federal exemption policy should not be frustrated by such consensual waivers and recommends that creditors be allowed to enforce waivers of exemptions only if they have a security interest in the potentially exempt property.¹¹⁶ Recognizing that creditors may nonetheless indirectly frustrate the federal exemption policy simply by making it a practice to take a security interest in exempt property, the Commission further recommends that nonpurchase money security interests in items of property

¹⁰⁹*Id.* at 182.

¹¹⁰*Id.* The bankrupt would also be allowed an additional \$500 of equity for each dependent; if the debtor has no home, or if the value of his home is less than the maximum allowed exemption, he would be allowed, up to the maximum amount, extra amounts for clothing, jewelry, home furnishings, cash, securities, burial plots, income tax refunds, etc. *Id.*

¹¹¹*Id.*

¹¹²Bankruptcy Act § 7a(8).

¹¹³*Id.* § 47a(6).

¹¹⁴COMM'N REP. 181.

¹¹⁵*Id.* at 180; Bankruptcy Act § 6.

¹¹⁶COMM'N REP. 181.

essential to the well-being of the discharged debtor not be enforceable.¹¹⁷

The present Bankruptcy Act requires that debts which have priority be paid in full before any general creditors may share in the bankrupt's estate.¹¹⁸ Debts which are accorded priority status are administrative expenses,¹¹⁹ wages and commission owed by a bankrupt employer,¹²⁰ costs and expenses of creditors in adducing evidence resulting in the conviction of any person of an offense under Chapter IX of title 18 of the United States Code,¹²¹ taxes which are not released by a discharge in bankruptcy,¹²² other debts owing to persons who are entitled to priority by federal law other than the Bankruptcy Act,¹²³ and rent owing to a landlord who is entitled to priority by applicable state law.¹²⁴

A provision which grants priority status to some creditors and relegates the left-overs to others appears to be in conflict with the goal of federal bankruptcy legislation to provide fair and equitable treatment to all creditors. Although some priorities are necessary if the bankruptcy system is to function,¹²⁵ the Commission asserts

¹¹⁷*Id.*

¹¹⁸Bankruptcy Act § 64a.

¹¹⁹*Id.* § 64a(1). This includes costs of preserving the bankrupt's estate subsequent to the filing of the petition, fees for the referee's salary and expense fund, filing to be paid by the debtor, reasonable costs of recovering property transferred by the debtor in fraud of his creditors, trustee's expenses in opposing the bankrupt's discharge or in connection with the prosecution of an offense under 18 U.S.C. § 151 *et seq.* (1970), witness fees, and one reasonable attorney's fee.

¹²⁰Wages have priority up to \$600 to each claimant if such wages have been earned within three months before the commencement of the proceeding. Bankruptcy Act § 64a(2). A proposed revision would increase the priority to \$3000, H.R. 11960, 93d Cong., 1st Sess. (1973).

¹²¹Also included here are costs to the creditor in securing the refusal, revocation, or setting aside of the bankruptcy discharge. Bankruptcy Act § 64a(3).

¹²²*See* text accompanying notes 87-89 *supra*.

¹²³The federal priority arises under 31 U.S.C. § 191 (1970) (often referred to by its designation in the Revised Statute of 1875, REV. STAT. § 3466 (1875)). *See* Plumb, *The Federal Priority in Insolvency: Proposals for Reform*, 70 MICH. L. REV. 3 (1971).

¹²⁴Rent claims for actual use and occupancy within the three months prior to the petition share equally with the nontax claims of the federal government.

¹²⁵If the trustees and attorneys are to be encouraged to take bankruptcy cases, they must be assured of being paid for their efforts. Further, the judicial machinery must be funded, to some extent, out of contributions by litigants.

that not all of the priority categories of the present Act are valid. The Commission would limit priorities to three types: administrative expenses, wages and commissions owed by bankrupt employers, and taxes not released by a discharge in bankruptcy.¹²⁶ Given the proposal of the Commission to reduce the time period for nondischargeable tax claims from three years preceding bankruptcy to one year, the proposed priority provisions represent a significant attempt to increase the probability of a return to general creditors.

A creditor who has taken security for a debt in the property of the debtor enjoys a priority to the extent of the value of his collateral. The value of the security held by a secured creditor is determined by converting the security into money pursuant to the security agreement, or by the creditor and the trustee by agreement, arbitration, compromise, or litigation.¹²⁷ The value of the security is credited against the claim of the secured creditor and, to the extent that the claim is in excess of the value of the security, the secured creditor is treated as a general creditor.¹²⁸ Thus, in effect, only the unsecured portion of a secured debt is discharged in bankruptcy; the secured portion is satisfied by the security, either because the collateral is abandoned by the trustee in favor of the creditor or because the creditor is permitted to enforce the security agreement outside bankruptcy.¹²⁹

The fact that the creditor may be permitted to enforce the security agreement outside bankruptcy should, in theory, present no real hardship to the consumer debtor if the collateral is not exempt property. Nonexempt property would have been lost to the bankrupt in any event, whether in satisfaction of the secured claim or whether in satisfaction of priority claims and claims of general creditors. However, if the collateral is exempt property, to permit the secured creditor to enforce the security agreement may seriously frustrate both the exemption policy and the discharge policy of the Bankruptcy Act. Exempt property is, for the most part, made up of the personal property of the debtor, which is typically of little economic value to the creditor and of great economic and practical importance to the debtor in the post-discharge

¹²⁶COMM'N REP. 226-30.

¹²⁷Bankruptcy Act § 57h. The security interest must, of course, be valid.

¹²⁸*Id.*

¹²⁹See generally Moo, *Secured Creditor in Bankruptcy*, 47 AM. BANKR. L.J. 23 (1973); Countryman, *A Reply to Moo*, 47 AM. BANKR. L.J. 73 (1973); 50 N.C.L. REV. 90 (1971).

maintenance of his household. The creditor, by threatening to repossess collateral needed by the debtor, may often hold enough leverage to obtain from the debtor a reaffirmation of the entire prebankruptcy debt.

Any creditor may attempt to obtain a reaffirmation of a debt discharged in bankruptcy. The moral obligation to pay one's debts is held to be sufficient consideration for the post-discharge promise to pay.¹³⁰ Although a secured creditor whose collateral is exempt property of the debtor holds perhaps the most persuasive of threats to obtain reaffirmation, any creditor who is permitted to enforce a security agreement outside bankruptcy, whether the security is exempt or not by the terms of the Bankruptcy Act, may use the threat of repossession in an attempt to obtain a reaffirmation. The strength of the threat depends more upon the value of the collateral to the debtor than upon whether the Bankruptcy Act classifies the collateral as exempt or nonexempt. In fact, any creditor with whom the debtor deals during or after discharge may condition some desired future performance upon a promise to pay the entire amount of the discharged debt and thereby totally negate the protective and rehabilitative effects of the discharge.

The present Bankruptcy Act makes no attempt to curtail post-bankruptcy reaffirmations of discharged debts. The Commission, on the other hand, proposes to establish the general rule that reaffirmations are unenforceable.¹³¹ The only exception to this absolute rule would be made in the case of a secured debt; however, even a secured debt could only be affirmed to the extent of the fair market value of the collateral.¹³² The proposed provision would, in effect, give the debtor an opportunity to redeem the collateral which secures a dischargeable debt upon payment of its fair market value or of the amount of the debt, whichever is less.¹³³

The Commission notes that the "fresh start" policy of the Bankruptcy Act has been eroded by provisions of state and federal law which subject an individual who obtains a discharge, and fails to pay a discharged debt, to discriminatory treatment.¹³⁴ The Commission does not propose to establish a law by which the past

¹³⁰See Boshkoff, *The Bankrupt's Moral Obligation to Pay his Discharged Debts: A Conflict between Contract Theory and Bankruptcy Policy*, 47 IND. L.J. 36 (1971).

¹³¹COMM'N REP. 184.

¹³²*Id.*

¹³³*Id.* at 184-85.

¹³⁴See *Perez v. Campbell*, 402 U.S. 637 (1971); COMM'N REP. 187.

or present financial condition of a debtor may never be taken into consideration, but recommends that a nondiscrimination provision in the Bankruptcy Act supercede any discriminatory state or federal laws.¹³⁵

C. Wage Earner Plans

Chapter XIII of the present Bankruptcy Act provides that a debtor whose principal income is derived from wages, salary, or commissions may petition the bankruptcy court to effect a plan for a composition and/or an extension of time for the payment of his debts.¹³⁶ The petition may be filed originally¹³⁷ or in a pending bankruptcy proceeding either before or after the debtor's adjudication.¹³⁸ A plan *must* include provisions dealing with unsecured debts in general upon any terms, it *may* include provisions dealing with secured debts on any terms, it *may* provide for priority payment during the period of extension between secured and unsecured debts affected by it, and it *must* provide for the submission of the future earnings of the debtor to the supervision and control of the bankruptcy court for the purpose of enforcing the plan.¹³⁹

Upon the filing of a Chapter XIII petition, the court must promptly call a meeting of creditors and, at this meeting, determine the creditors' acceptances of the proposed plan.¹⁴⁰ If all creditors affected by the plan accept it in writing at the initial meeting, it will be confirmed when the debtor has made the deposits required by the Act and the court is satisfied that the plan and the acceptances are in good faith and not made or procured by any means forbidden by the Bankruptcy Act.¹⁴¹ This confirmation will be made regardless of whether the creditors have proved their claims.

If the plan is not accepted at the initial meeting of the creditors, it may still be confirmed if accepted at a later date in writing

¹³⁵COMM'N REP. 187.

¹³⁶Bankruptcy Act § 606(8).

¹³⁷*Id.* § 622.

¹³⁸*Id.* § 621.

¹³⁹*Id.* § 646. The plan must also provide that the court may increase or reduce the amount of installment payments or extend or shorten the time for such payments after notice and hearing when the circumstances of the debtor so require. The plan may include provisions for the rejection of executory contracts of the debtor.

¹⁴⁰*Id.* §§ 632, 633.

¹⁴¹*Id.* § 651. At the initial meeting, the court must also appoint a trustee to receive and distribute moneys to be paid pursuant to the plan. *Id.* § 633.

by a majority in number and amount of all unsecured creditors whose claims have been proved and allowed before the conclusion of the initial meeting and by all secured creditors whose claims are dealt with by the plan.¹⁴² Before confirmation, however, the court must be satisfied that the plan is feasible and in the best interests of the creditors, that the debtor has not been guilty of any acts which would be a bar to a discharge of his debts, and that the proposal and its acceptance are in good faith.¹⁴³ If the plan is not accepted, or if it may not be confirmed, or if after confirmation the debtor defaults, the court must dismiss the Chapter XIII proceedings and adjudge the debtor a bankrupt.¹⁴⁴

Upon confirmation, the plan and its provisions are binding on the debtor and his creditors, whether or not they are affected by it, have accepted it, or have filed their claims and whether or not their claims have been scheduled or allowed.¹⁴⁵ Upon completion of the plan, the court must enter an order discharging the debtor from all debts affected by it; however, the unpaid portions of those debts which are excepted from discharge and are held by creditors who have not accepted the plan are not discharged upon completion.¹⁴⁶

Although Chapter XIII received much acclaim when it was added to the Chandler Act in 1938,¹⁴⁷ and although the Commission was informed that the majority of consumer debtors desire such a means of paying their debts rather than incurring the stigma and other consequences of a straight bankruptcy discharge,¹⁴⁸ the

¹⁴²*Id.* § 652a.

¹⁴³*Id.* § 655.

¹⁴⁴*Id.* § 666. The court will adjudge the debtor a bankrupt with the debtor's consent if the petition was an original one and notwithstanding the debtor's consent or lack thereof if the petition under Chapter XIII was filed in a pending bankruptcy proceeding.

¹⁴⁵*Id.* § 657. The bankruptcy court retains jurisdiction of the debtor and his property for all purposes of the plan and may issue any orders required to effectuate the plan's provisions. *Id.* § 658. No creditor may attempt to reach the future earnings of the debtor without the approval of the bankruptcy court. *Id.*

¹⁴⁶*Id.* § 660. Thus, for example, if the plan were one of composition, so that upon completion some debts had not been paid in full, the unpaid portions of all excepted debts held by creditors who did not accept the plan would not be discharged. All other debts affected by the plan would be discharged upon completion.

¹⁴⁷COMM'N REP. 170.

¹⁴⁸*Id.*

use and success of the Chapter XIII option has been sporadic.¹⁴⁹ The Commission discovered several factors contributing to the disparity of use throughout the United States including: the lack of knowledge of the petitioning debtor of the advantages, or even the availability, of Chapter XIII relief; differing attitudes of referees, attorneys, and the credit community toward Chapter XIII petitioners; and varying knowledge and experience of attorneys consulted by debtors with financial problems.¹⁵⁰ The recommendations of the Commission for modification of the structure of the bankruptcy system are directed toward combatting these factors.¹⁵¹ Likewise, the recommendations of the Commission for changes in the substantive law of bankruptcy reflect the Commission's belief that, while a debtor should not be forced to participate in a plan which requires contributions out of future earnings, wage earner plans of the Chapter XIII type should be encouraged.¹⁵²

The Commission recommends that the definition of eligible petitioners be broadened. The present Act limits Chapter XIII relief to those individuals "whose principal income is derived from wages, salary, or commissions."¹⁵³ Although this provision has been liberally construed by the courts,¹⁵⁴ the Commission contends that there should be no such limitation written into the Act and proposes that eligible petitioners be defined to include those individuals whose principal income is derived from any "source with sufficient regularity and stability that periodical payment of a fixed amount to . . . creditors pursuant to a plan . . . is feasible."¹⁵⁵

The Commission's study revealed that, under the present Act, a debtor is often counseled not to elect Chapter XIII relief if it is not feasible for him to pay the full amount of his indebtedness plus the costs of administration within a three year period.¹⁵⁶

¹⁴⁹*Id.* Chapter XIII is extensively used in Alabama, Ohio, California, Georgia, Tennessee, Kansas and Maine; other districts, however, have records which do not disclose any Chapter XIII filings since 1938. *Id.*

¹⁵⁰COMM'N REP. 24-25.

¹⁵¹See text accompanying notes 27-41 *supra*.

¹⁵²COMM'N REP. 172.

¹⁵³Bankruptcy Act § 606(8).

¹⁵⁴*E.g., In re Bradford*, 268 F. Supp. 896 (N.D. Ala. 1967) (sole income derived from social security benefits).

¹⁵⁵COMM'N REP. 176. (This is the language of § 1-102(28) of the proposed Act.)

¹⁵⁶COMM'N REP. 172.

The three year suggestion is apparently an offshoot of a section of the present Act which provides that if a debtor has not completed his payments under a plan at the expiration of three years after confirmation, and if the debtor's failure to complete his payments was due to circumstances not within his control, the debtor may apply for, and the court may grant, a discharge of all remaining debts provided for by the plan.¹⁵⁷ Although this provision in no way requires that the debtor propose in his plan to complete payments within three years, its effect is to make creditors wary of the prospect of any payment after the three year period. Counselors probably rightly assume that creditor consent will be difficult to obtain if the plan is to continue for more than three years; and without creditor consent a plan may not be confirmed. The reason for the suggestion that the debtor propose to pay *all* his debts within the three year period is again not that the Act requires that the debtor propose to pay his indebtedness in full; in fact, the Act specifically authorizes compositions in which the debtor may propose to pay only part of his indebtedness.¹⁵⁸ Rather, payment in full is encouraged, and payment in part by use of the composition feature discouraged, because confirmation of a plan involving a composition absolutely precludes subsequent relief under the Act for six years.¹⁵⁹

The Commission's proposal that confirmation of a plan of composition should not limit future relief under the Act would eliminate a significant deterrent to the use of the composition feature of Chapter XIII.¹⁶⁰ The recommendation of the Commission that the debtor who opts for the extension type of wage earner plan should in no case pay more than the aggregate of all his debts would remove a practical impediment to the viability of the extension option.¹⁶¹ Creditors typically have a chance to receive more money on the dollar if a wage earner plan is successful than if the debtor obtains an immediate discharge and should be willing to give up a portion of their return to insure the feasibility of the successful completion of such a plan. Therefore the Commission reasons that the allocation of the burden of the administrative

¹⁵⁷Bankruptcy Act § 661. Many debtors fail to keep up payments due to unforeseen circumstances. COMM'N REP. 172.

¹⁵⁸Bankruptcy Act § 606(7). *See* note 60 *supra*.

¹⁵⁹Bankruptcy Act § 14c(5). Both a plan for composition and a plan for a combination composition and extension preclude subsequent relief.

¹⁶⁰*See* text accompanying note 57 *supra*.

¹⁶¹COMM'N REP. 173. This is a codification of a procedure used successfully in Seattle, Washington.

costs to creditors would be more reasonable than the allocation of such costs to the debtor.¹⁶²

Chapter XIII of the present Bankruptcy Act requires that a wage earner plan be accepted either at the initial meeting by *all* unsecured creditors or at a later date by a majority in number and amount of all general creditors whose claims have been proved and allowed before the conclusion of the initial meeting.¹⁶³ Unanimous consent, especially at the initial stage of a proceeding, is rarely obtained. Furthermore, few creditors' claims are proved and allowed before the conclusion of the initial meeting and thus few unsecured creditors qualify to vote in the later determination. Finally, of those who do qualify to vote, few object to proposed wage earner plans, since the alternative is a straight bankruptcy discharge in which the general creditors are last in priority.¹⁶⁴ Given these practical considerations, the Commission recommends that the requirement of creditor consent be eliminated.¹⁶⁵ As a safeguard of the creditors' interests, the Commission proposes that an independent determination be made by the Administrator that the provisions of the Chapter have been complied with and that the plan is in the best interests of the creditors, is feasible, and is proposed in good faith.¹⁶⁶ Any creditor could file with the Administrator objections to confirmation. Then, if a plan were confirmed in spite of these objections, the objecting creditor, by filing a timely complaint in the bankruptcy court, could judicially challenge the Administrator's determination.¹⁶⁷

Since most of the litigation that has arisen under Chapter XIII has involved the rights of secured creditors, the Commission proposes a clarification of these rights.¹⁶⁸ Under the present Act, a secured creditor has a veto over any plan which deals in any way with his claim.¹⁶⁹ Also, under the present Act, the court may enjoin any proceeding to enforce a lien upon the property of the debtor.¹⁷⁰ The case law is in conflict as to whether a plan which does not mention a secured debt may be vetoed by the creditor

¹⁶²*Id.*

¹⁶³Bankruptcy Act § 652(1).

¹⁶⁴COMM'N REP. 174.

¹⁶⁵*Id.*

¹⁶⁶*Id.*

¹⁶⁷*Id.* at 175.

¹⁶⁸*Id.* at 176.

¹⁶⁹Bankruptcy Act § 652(1).

¹⁷⁰*Id.* § 614.

if the court enjoins the creditor's right to repossess.¹⁷¹ The Commission would codify the view of the probable weight of authority that, if a creditor is protected to the extent of the value of his collateral, there is no reason to afford him a veto of the plan.¹⁷²

The Commission proposes to remedy certain other provisions of Chapter XIII of the present Bankruptcy Act which tend to frustrate and limit its use. The present Act provides that a wage earner plan may not be confirmed if the debtor has been guilty of any acts which would have been a bar to his discharge if he had opted for straight bankruptcy.¹⁷³ The Commission is of the opinion that this is an "inappropriate limitation of the court's ability to confirm a plan in which the debtor proposes to pay his debts out of his future earnings."¹⁷⁴ The court or the Administrator should not be precluded from confirming a plan that meets the tests of good faith and best interests of creditors.¹⁷⁵

Chapter XIII of the present Act is practically limited by the fact that it contemplates payment of debts *only* out of future earnings.¹⁷⁶ Often a debtor has assets which could be applied immediately to payment of his debts and the fact that these may not be used may result either in an objection by a creditor or in a determination that the plan is not in the best interests of the creditors.¹⁷⁷ In order to encourage wage earner plans and to promote fair treatment of creditors, the Commission recommends that the proposed Act authorize, but not require except as necessary to meet the best interests and good faith tests, the application of nonexempt assets to the immediate payment of the debtor's obligations.¹⁷⁸

The Commission notes that the success of a wage earner plan may be jeopardized by guarantors of the debtor's obligations who have been compelled to pay by the Chapter XIII debtor's creditors who are not willing to await payment pursuant to the plan.¹⁷⁹ Although it is possible for a plan under the present Act

¹⁷¹COMM'N REP. 177. Compare *Cheetham v. Universal C.I.T. Corp.*, 390 F.2d 234 (1st Cir. 1968), with *In re O'Dell*, 198 F. Supp. 389 (D. Kan. 1961).

¹⁷²COMM'N REP. 177.

¹⁷³Bankruptcy Act § 656a(3).

¹⁷⁴COMM'N REP. 175.

¹⁷⁵*Id.*

¹⁷⁶*See* Bankruptcy Act § 658.

¹⁷⁷COMM'N REP. 175-76.

¹⁷⁸*Id.* at 176.

¹⁷⁹*Id.* at 178.

to deal with the creditor's claim against the surety as well as the debtor, it is unlikely that the creditor's consent to such a plan would be forthcoming.¹⁸⁰ Thus, if the debtor's plan is to be accepted and confirmed, he must subject himself to the pressures of the surety with no protection from the Bankruptcy Act. To protect the debtor in the performance of his plan, the Commission recommends that the Act impose a moratorium on collections from the co-debtor of any debt which is being paid under the plan, but only so long as the debtor is performing under the plan.¹⁸¹ The moratorium would terminate when the case was closed or was converted to one of straight bankruptcy.¹⁸²

The recommendations of the Commission for changes in the substantive law affecting wage earner plans evidence an attempt to more realistically balance the interests of debtors and creditors in the hope of fostering such plans.

V. CONSUMER CASES: INVOLUNTARY

The present Bankruptcy Act provides that any "natural person" who owes debts of \$1000 or more, except a wage earner or a farmer, may be adjudged an involuntary bankrupt.¹⁸³ Three or more creditors who have provable claims amounting in the aggregate to \$500 in excess of the value of any securities held by them may file a petition to have a debtor adjudicated.¹⁸⁴ The general rule is that an involuntary petition must be filed within four months after the commission of an "act of bankruptcy."¹⁸⁵ The present Act specifies six "acts of bankruptcy" and provides complex tests to determine exactly when each "act" occurs.¹⁸⁶

¹⁸⁰*Id.*

¹⁸¹*Id.*

¹⁸²*Id.*

¹⁸³Bankruptcy Act §§ 4b, 59b.

¹⁸⁴*Id.* § 59. If the total number of creditors is less than twelve, one or more creditors with claims totalling \$500 may file an involuntary petition.

¹⁸⁵*Id.* § 3b.

¹⁸⁶The specified acts of bankruptcy are: concealing or removing property with intent to hinder or defraud creditors; making a preferential transfer under § 60a of the Act; suffering, while insolvent, a creditor to obtain a lien on his property; making a general assignment for the benefit of his creditors, while insolvent; permitting the appointment of a receiver; or admitting in writing an inability to pay one's debts and a willingness to be adjudged a bankrupt. *Id.* § 3a. Tests to determine when each "act" occurs are found at *id.* § 36.

A debtor against whom an involuntary petition has been filed must respond to the petition much as he would to any lawsuit filed against him. He must plead and appear or else be adjudicated in default.¹⁸⁷ He may controvert the facts in his pleadings and may make a timely demand for a jury trial on the issues of his insolvency and the commission of an act of bankruptcy.¹⁸⁸

Typically, it is not difficult for a creditor to initiate an involuntary proceeding under the present Act.¹⁸⁹ However, it may be difficult and time-consuming to obtain an adjudication of bankruptcy. The requirement of an act of bankruptcy increases the time between the first indication of the debtor's inability to pay his debts and the filing of the petition.¹⁹⁰ Conducting a jury trial may also cause substantial delay.¹⁹¹ The Commission believes that the inability to force a proceeding at an early stage and to obtain a timely determination has "frustrated a prime goal of federal bankruptcy legislation, equitable treatment of creditors."¹⁹² Restrictions which delay relief too long are a substantial factor causing a typically low return to creditors and subsequent creditor dissatisfaction and lack of interest in the bankruptcy system.¹⁹³ The Commission would amend the present Act to encourage and authorize earlier resort to relief.¹⁹⁴

The Commission recommends that all persons eligible for voluntary relief be subject to involuntary relief, with the sole exception of the individual farmer.¹⁹⁵ The present Act excludes "wage earners," but since a wage earner is defined as an individual who works for "wages, salary, or hire at a rate of compensation not exceeding \$1500 per year,"¹⁹⁶ the exclusion has little practical effect. Nonetheless, the Commission would include no

¹⁸⁷*Id.* § 18b.

¹⁸⁸*Id.* § 19.

¹⁸⁹COMM'N REP. 201. The required number of creditors and the required amounts are minimal. Most debtors in financial difficulty can be found to have committed one of the several acts of bankruptcy.

¹⁹⁰*Id.*

¹⁹¹In addition to the typical delay of sequestering the jury, there is further delay because the referee does not have the power to hear jury trials and the case must be fitted into the schedule of a federal district judge.

¹⁹²COMM'N REP. 203.

¹⁹³*Id.* at 199.

¹⁹⁴*Id.* at 200.

¹⁹⁵*Id.* at 198.

¹⁹⁶Bankruptcy Act § 1(32).

such limitation upon eligibility for involuntary relief and would make the source of an individual's earnings in no way determinative.¹⁹⁷

The Commission would abandon the complex, artificial, technical, and litigation-producing concept of an act of bankruptcy in favor of a simple test of inability or failure to pay debts as they become due.¹⁹⁸ Recognizing the possibility that such a simple test might be subject to abuse or misuse in the form of unfounded petitions or might result in the temporary financial embarrassment of a debtor unnecessarily or improperly subjected to an expensive federal proceeding, the Commission directs attention to mitigating features in the proposed Act.¹⁹⁹ The Commission believes that its recommendations for change in the structure of the bankruptcy system make it possible to give substantial discretion to the bankruptcy judge.²⁰⁰ This discretion would provide a "far better safeguard against unwise and malicious petitions than the existing litigation-producing restrictions on the institution of involuntary proceedings."²⁰¹ The Commission further believes that this grant of discretion would eliminate the need for a jury trial as to the appropriateness of relief.²⁰² Perhaps the most important safeguard provision of the proposed Act is that which allows the judge to require that a petitioner file a bond indemnifying the debtor against costs, counsel fees, expenses, and damages.²⁰³ If the involuntary petition were dismissed, all but damages would be awarded the debtor as a matter of course; if the debtor could prove that the petition was filed in bad faith, damages proximately caused by the petition could be recovered.²⁰⁴

VI. CONCLUSION

The recommendations of the Commission for changes in the present Bankruptcy Act evidence a studied effort to balance the interests of debtors and creditors involved in the bankruptcy process. These recommendations are based upon the Commission's comprehensive study of the practical and theoretical problems

¹⁹⁷COMM'N REP. 199, 237.

¹⁹⁸*Id.* at 201.

¹⁹⁹*Id.*

²⁰⁰*Id.* at 202.

²⁰¹*Id.* at 203.

²⁰²*Id.*

²⁰³*Id.*

²⁰⁴*Id.*

which have been encountered under the present Bankruptcy Act. Perhaps the substantive provisions of the proposed Bankruptcy Act, if enacted into law, will not withstand the test of time and will require further comprehensive revision. Perhaps the substantive provisions of the proposed Bankruptcy Act will not accomplish all that the Commission believes can and should be accomplished. Nonetheless, the proposed Act seems to be a progressive step toward attaining the goals of the federal bankruptcy process: easy accessibility of debtors and creditors to the process, fair and equitable treatment of creditors involved in the process, and rehabilitation of honest but unfortunate debtors for more productive future participation within the credit community and society by providing more lasting, more timely, and more meaningful relief.

DEBRA A. FALENDER