New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of "Substantial Abuse"*

by

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FIRST INSTALLMENT

I. INTRODUCTION

Bankruptcy is a booming business. Indeed, many have felt that business is too good—that the provisions of the Bankruptcy Reform Act[1] make it too easy for debtors to escape the burden of often improvidently-incurred debt with virtually no adverse consequences other than a $200–$300 attorneys' fee and $60 for court costs.[2] In 1983 alone, over 500,000 persons filed for relief under title 11, the vast majority of whom were consumers having few or no assets available for distribution to creditors.[3] Thus, while historically bankruptcy originated as a means to insure the equitable distribution of a debtor's assets where those assets were insufficient to pay such debtor's debts in full,[4] it has presently evolved into a method of escaping those debts

 A somewhat longer and different version of this article appeared in JOURNAL OF LAW AND COMMERCE 1 (1985).

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[1]Bankruptcy Reform Act of 1978 ["Code"], Pub. L. No. 95–598, 92 Stat. 2549, principally codified at 11 U.S.C. §§ 101–151326 with scattered sections in 28 U.S.C. For a brief history of the Code, see Klee, *History of the New Bankruptcy Code*, 54 AM. BANKR. L.J. 275 (1980). Mr. Klee was one of the principal draftsmen of the Code.

[2]The basic filing fee for both chapter 7 and chapter 13 is $60. See 28 U.S.C. § 1930(a). In addition, the amount charged by an attorney for a typical consumer bankruptcy may range from $200–$400. In some complicated chapter 13 cases, basic fees in some districts have been as high as $1,000. *See* H. SOMMER, CONSUMER BANKRUPTCY LAW AND PRACTICE § 15.2.2 at 134 (1982). Note, however, that under 11 U.S.C. § 329(a), attorneys for the debtor must disclose any compensation received in the year preceding commencement of the case (whether from the debtor or third persons) and under § 329(b), the court may order the return of such payment to the extent it exceeds the reasonable value of services rendered.

[3]*See* ANNUAL REPORT OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS (1983) at 14.

[4]*See generally* J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY § 100 (1956); Rendleman, *The Bankruptcy Discharge: Toward A Fresher Start*, 58 N.C.L. REV. 723, 724–725 (1980) (discharge originally introduced as an incentive to debtors to deliver up all their assets to creditors). Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 W. VA. L. REV. 427 (1974).

at little or no sacrifice.[5]

Why bankruptcies have so proliferated in recent years is somewhat of an open question. What is certain, however, is the existence of a widespread perception on the part of the consumer credit industry that the enactment of the Code is to blame.[6] Citing the expansive automatic stay,[7] the overly generous exemption standards,[8] the broadened scope of discharge protection,[9] the debtor's unfettered choice to elect a no-asset chapter 7 liquidation,[10] and the lack of any meaningful payment requirement as a condition to confirmation of chapter 13 plans,[11] creditors strenuously argued that only extensive reforms of the Code could stop the abuses in the system. And, as one commentator astutely pointed out, the creditors have struck back.[12]

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[5]The fact that the vast majority of bankruptcies produce no assets at all has been documented repeatedly. *See, e.g.*, REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93rd Cong., 1st Sess. pt. 1 at 65 (1973) [hereinafter cited as COMMISSION REPORT] which was the primary impetus for the Code and D. STANLEY and M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM at 20 (1971). If anything, the enactment of the Code has exacerbated this phenomenon. *See infra* text at notes 64–85.

[6]*See, e.g.*, the various statements reproduced in *Future Earnings: Hearings on Bankruptcy Reform Act of 1978 Before the Subcommittee on Courts of the Senate Committee on the Judiciary*, 97th Cong., 1st Sess. Ser. J–97–11 (pt. 2) (1981) and *Hearings Before the Subcommittee on Courts of the Senate Committee on the Judiciary*, 98th Cong., 1st Sess. Ser. J–98–1 (1983). This perception has spread to the public at large. *See* Rork, *Debtors Escaping Though They Can Pay*, USA Today, Dec. 27, 1982 at 10A. *See also infra* test at notes 91–95 for a discussion of the influential Purdue Study.

[7]*See* 11 U.S.C. § 365 which provides that upon the commencement of the case until a discharge is granted or denied, all attempts to collect debts, whether through judicial or nonjudicial means, *e.g.*, dunning letters, are proscribed subject to limited exceptions.

[8]*See* 11 U.S.C. § 522. The debtor is given a choice between a uniform system of federal exemptions and the exemptions provided by the law of the state of his residence unless that state has specifically opted out the federal exemption scheme, in which case, the use of state exemptions becomes mandatory. To date, more than two-thirds of the states have opted out though a number have modernized their own exemption schemes to track the federal exemptions.

[9]*See generally*, 11 U.S.C. § 523 (limited categories of debts that are nondischargeable) and § 1328 (scope of discharge in chapter 13 cases even broader). *See also* § 727 (grounds for denial of discharge of all debts) which, by virtue of its being in chapter 7, does *not* apply in chapter 13 cases. The injunction against all postdischarge collection efforts is found in 11 U.S.C. § 524. The termination of the automatic stay under § 365 is immediately followed by the § 524 discharge injunction which provides essentially identical protection except for the fact that the latter may be inapplicable to § 523 debts.

[10]Under 11 U.S.C. § 109, any person may seek relief under chapter 7 except railroads, insurance companies, and banks. Under § 301, no grounds need be established for a voluntary petition. Under § 303, a chapter 13 case may only be voluntary. Thus, under the Code, creditors had no way of forcing a debtor to utilize his future earning capacity if the debtor desired a chapter 7 liquidation. The 1984 Amendments as originally proposed were an attempt to change this result. *See infra* text at notes 96–104.

[11]*See infra* text at notes 59.

[12]*See* R. Ginsberg, *The Proposed Bankruptcy Improvement Act: The Creditors Strike Back*, 1982 N. ILL. U.L. REV. 1 ("Ginsberg I"). This article is an excellent critique of S. 2000, a predecessor of the 1984 Amendments. Ginsberg also wrote a sequel analyzing S. 445. *The Bankruptcy Improvements Act–An Update*, 1983 N. ILL. U.L. REV. 235 ("Ginsberg II").

Armed with an arsenal of empirical studies[13] and supported by the prestige of the American Bar Association's Section on Corporation, Banking, and Business Law[14]—more of whose members represent creditor interests than debtors—the credit industry spearheaded the introduction of bankruptcy legislation designed to severely curtail the attractiveness of bankruptcy as a debtors' remedy. The gist of these proposals has resurfaced in various forms in virtually every session of Congress since the enactment of the Code but, for a variety of reasons,[15] these bills either died in committee or occasionally would pass one house of Congress but not the other.[16]

After almost a year of inaction by the House, the impasse was finally broken. On July 10, 1984, President Reagan signed into law Public Law No. 98-353, the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("1984 Amendments"),[17] a law which embodies the substance of a number of earlier creditor proposals. While the bill as finally enacted is less solicitous of creditor interests than some of its earlier versions, particularly S. 2000, the so-called Bankruptcy Improvements Act of 1982, it does represent a significant victory for the consumer credit industry and may well serve to make bankruptcy a far less attractive option for the consumer debtor than it has been in the recent past.[18]

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[13]Notably the Purdue Study conducted under the supervision of Dr. Robert Johnson in conjunction with the consulting firm of Arthur D. Little. CREDIT RESEARCH CENTER, KRANNERT SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, MONOGRAPHS No. 23-24, CONSUMER BANKRUPTCY STUDY (1982) ("Purdue Study"). *See infra* text at notes 91-95 for a description of this study. Another influential study was a 1980 survey of 1945 debtors conducted by Andrew Brimmer & Co.

[14]See the *Report and Recommendations of the Consumer Bankruptcy Subcommittee of the Committee on Consumer Financial Services of the American Bar Association Section on Corporation, Banking and Business Law*, most of whose recommendations were incorporated into the 1984 Amendments. The report, drafted by Professor Jonathan M. Landers, is reprinted in 1982 N. ILL. L. REV. 239-283. In evaluating the objectivity of these recommendations one should take into account the fact that the law firm of the chairman of the Committee on Consumer Financial Services and with which Landers is associated was employed by the consumer credit industry to effect these changes.

[15]Primarily indecision as to the restructuring of the Bankruptcy Court system and disagreement with respect to the treatment of collective bargaining contracts, two areas having little bearing on the problems of consumer bankruptcies.

[16]*See infra* text at notes 105-120.

[17]Pub. L. No. 98-353, 98 Stat. 333 (July 10, 1984).

[18]The 1984 bankruptcy amendments appear in three titles of Pub. L. No. 98-353. Title I, §§ 101-122, consists of a series of amendments to 28 U.S.C. (Judicial Code) restructuring the bankruptcy court system in a belated response to the Supreme Court's directive in Northern Pipeline Construction Company v. Marathon Pipeline Co., 458 U.S. 50, 102 S. Ct. 2858 (1982). Title II, §§ 201-211, creates twenty-one vacancies for circuit judges and sixty-one for district judges and has no connection with bankruptcy law. Title III, §§ 301-553, contains the substantive amendments to the Bankruptcy Code. Besides the two amendments discussed in this article, Title III effects major changes in exemptions, dischargeability of certain classes of consumer debts, reaffirmations, and creditor modification of chapter 13 plans. In addition, Title III contains amendments relating to the specialized problems of grain elevator bankruptcies; repurchase agreements involving government securities; nonresidential leases of real property; timesharing arrangements; and collective bargaining agreements. For a brief overview of these major changes, *see* Breitowitz, *supra* note* at Appendix.

One of the major changes the Act makes is that, for the first time, the bankruptcy court acting on its own motion may dismiss a chapter 7 petition filed by an individual debtor whose debts are primarily consumer debts.[19] Under the Code, debtors had unfettered access to voluntary chapter 7 relief.[20] A second major change is that a chapter 13 debt adjustment plan will be confirmed by the court only if it provides that all of the debtor's disposable income (income in excess of support) for a three year period will be distributed to creditors as payment.[21] The minimal payment plans permitted under the Code are no longer acceptable, at least to the extent the debtor could afford more.[22] Limitations on access to chapter 7 coupled with rigorous chapter 13 confirmation requirements may curtail both the availability and attractiveness of bankruptcy as a debtor's remedy, as indeed was intended.

The purpose of this article is to analyze the impact of these two amendments on consumer bankruptcies,[23] explore some of the definitional and procedural problems courts will face in applying their deceptively-simple directives, and suggest a number of reforms designed to improve both the efficiency and fairness of their provisions.

II. THE TYPICAL CONSUMER BANKRUPTCY IN THEORY AND PRACTICE: A PRIMER

To fully appreciate the major changes the Amendments effect in current law as well as the background behind these changes, it is necessary to understand the steps in a typical consumer bankruptcy. Under the Bankruptcy Reform Act, an individual consumer debtor desirous of invoking the protections of title 11 has essentially two options. The debtor may file for relief under chapter 7[24] or under chapter 13.[25] In a chapter 7 proceeding

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[19]11 U.S.C. § 707(b) as amended by Section 312(2), Pub. L. No. 98-353.

[20]*See supra* note 10.

[21]11 U.S.C. § 1325 as amended by Section 317(3), Pub. L. No. 98-353. *See infra* text at notes 101-104.

[22]*See infra* text at notes 59 and 101-104 for a discussion of chapter 13 plans, the standards for confirmation under the Code and the impact of the 1984 Amendments.

[23]While the primary focus of this article is on the "substantial abuse" test, virtually all of the concerns expressed in connection with that test (difficulties of determining future income and expenses) are equally applicable to chapter 13. In both cases, the court must consider essentially identical factors over the same duration of time. *See infra* text at notes 126-150 but *see also infra* text at notes 151-152. ("Substantial abuse" test may afford debtor more flexibility in determining his needs.) Moreover, in large part the purpose of a chapter 7 dismissal is to induce debtors to file under chapter 13. Thus, what creditors would receive in a chapter 13 is a crucial component in determining whether the chapter 7 should be dismissed. It is, therefore, analytically necessary to consider both amendments together. But *cf. infra* text at notes 197-206 (linkage not always perfect).

[24]11 U.S.C. §§ 701-766.

[25]11 U.S.C. §§ 1301-1330. Chapter 11 reorganization is in theory open to any debtor eligible for relief under chapter 7 except a stockbroker or commodities broker, *see* 11 U.S.C. § 109(d), but the cost of

which may be initiated either by the debtor or creditors,[26] a debtor must surrender all nonexempt property[27] to an official known as a trustee[28] who then liquidates the property and distributes it to creditors pursuant to a scheme of priority established in section 507.[29] Creditors not falling within section 507 priorities share in the remaining assets, if any, *pro rata*.[30] In return for the debtor's surrender of assets to the trustee, a debtor who has not waived the right or engaged in a long list of reprehensible activities[31] is discharged from most prepetition liabilities regardless of how little creditors may have received on account of those debts.[32] Assets that the debtor acquires subsequent to the commencement of the case including future earn-

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such a proceeding, the need to get creditor consent, etc., renders this remedy unattractive to individual consumer debtors. Chapter 11 is clearly designed for the reorganization of insolvent business entities.

[26]Under 11 U.S.C. § 301, any debtor except banks, insurance companies, and railroads (the latter of whom can seek relief only under chapter 11) may seek voluntary relief under chapter 7 without alleging or proving any specific grounds, *e.g.*, insolvency or the like. (Note, however, that under new § 707(b), voluntary petitions are now subject to dismissal on the basis of "substantial abuse.") The filing of a voluntary petition constitutes the automatic entry of an order for relief. Under 11 U.S.C. § 303, an involuntary chapter 7 may be commenced against any debtor eligible for chapter 7 except for farmers and not-for-profit corporations by a single creditor having a noncontingent unsecured claim of at least $5,000 if there are less than twelve creditors having such claims and by three creditors having $5,000 of noncontingent, unsecured claims if there are twelve or more.

[27]Subject to limited exceptions, property that the debtor acquires subsequent to the commencement of the case (*e.g.*, future earnings) is generally not property of the estate in a chapter 7 proceeding, and is therefore not distributed to creditors in bankruptcy. *See* 11 U.S.C. § 541.

[28]Under 11 U.S.C. § 701, as soon as an order for relief is entered, the bankruptcy court must appoint an interim trustee to serve until a permanent trustee is elected by creditors. Section 303 also contains special provisions for the appointment of an interim trustee in the "gap" between the filing of an involuntary petition and the entry of an order upon showing of cause and posting bond. The interim trustee (whether appointed under § 303 or § 701) must be on a panel of trustees approved by the Director of the Administrative Office of the U.S. Courts, *see* 28 U.S.C. § 604(f), though the elected trustee need not. Section 702 contains provisions for the election of permanent trustees by creditors but, as noted in the text, due to lack of creditor interest, elections are rarely held and the court-appointed interim trustee usually stays in office until the case is closed.

[29]11 U.S.C. § 507. Generally, just as under § 541, only property owned by the debtor as of the commencement of the case becomes "property of the estate", only creditors having claims against the debtor as of the commencement of the case share in the bankruptcy distribution though there are a number of important exceptions. *See* 11 U.S.C. § 502(f)-(h). Postpetition liabilities, however, are generally nondischargeable. *See* 11 U.S.C. § 727(b).

[30]11 U.S.C. § 726. Actually, § 726 does create categories of subordinated claims that are to be paid only after general unsecured claims are paid in full, *e.g.*, tardily-filed claims, interest at the *legal* rate (contract interest stops running as of the commencement of the case, *see* § 502(b)(2)). There are even provisions for the debtor to get the excess.

[31]11 U.S.C. § 727 specifies ten grounds for the denial of a discharge in chapter 7 cases. None of these grounds (except for waiver) applies to chapter 13. *See* § 1328(a). For a good discussion of § 727, *see* Sommer, *supra* note 2, § 14.2, at 113–116.

[32]*See* § 523(a) (1)–(a) which specifies which *debts* are nondischargeable even where the debtor is granted a discharge. Section 523 is inapplicable to chapter 13 except for § 523(a) (5) debts (alimony and child support). 11 U.S.C. § 1328. *See also* Sommer, *supra* note 2, § 14.4 at 117–126.

ings remain the property of the debtor.[33] Put differently, for purposes of bankruptcy distribution, human capital and future earnings power are not regarded as prepetition assets.

Under chapter 13, which can only be initiated voluntarily by an individual debtor, the debtor may retain possession of such debtor's assets while proposing a plan under which a portion of such debtor's future earnings will be submitted to a trustee for disbursement to creditors on a periodic basis, usually monthly.[35] This plan must be confirmed by the bankruptcy court but does not require creditor approval.[36] The length of the plan generally does not exceed three years but by leave of court may be as long as five years.[37] Upon completion of payments under a plan, the debtor receives a discharge that is considerably broader than that received under chapter 7.[38] All debts provided for in the plan are discharged with the exception of alimony and child support.[39] Thus, while chapter 7 looks to liquidation of a debtor's present assets, chapter 13 utilizes future earnings as a basis for repayment.[40]

It is important to note at the outset that chapter 13 does not require as a condition for confirmation that all debts be paid in full nor does it even provide that any specific percentage of the debtor's income for the three-year period be handed over to the trustee. Moreover, confirmation does not require the consent of creditors. Essentially, prior to the 1984 Amendments,

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[33]11 U.S.C. § 541 and *supra* note 27.

[34]11 U.S.C. § 303(a): "An involuntary case may be commenced only under chapter 7 or 11 of this title . . . ."

[35]11 U.S.C. § 1322(a): "The plan shall—(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan. . . ." Under § 1302, chapter 13 trustees are appointed by the court and if the number of cases in the district warrant, the court may appoint a standing chapter 13 trustee. In either case, this trustee does not take possession of the debtor's assets but functions in a general supervisory role and as a disbursing agent.

[36]*See* 11 U.S.C. §§ 1324–1325. This is to be contrasted with chapter 11 which requires the approval of at least *some* creditors. 11 U.S.C. § 1129.

[37]11 U.S.C. § 1322(c): "The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years."

[38]11 U.S.C. § 1328.

[39]§ 1328 also excludes from discharge certain long-term liabilities for which the last payment is due after the final payment under the plan.

[40]Chapter 13, from the standpoint of debtors, has a number of advantages over chapter 7: (1) the debtor retains his nonexempt property; (2) upon completion of the plan, he receives a broader discharge; (3) the automatic stay for the duration of the plan protects the debtor not only from collection activities directed against himself but also prohibits such activities against cosigners, at least to the extent the plan proposes to pay such debt, 11 U.S.C. § 1301; (4) there is no 6 year bar to reinstituting a second chapter 7 or chapter 13 case as there is in a chapter 7. *See* § 727. At least under the Code, total payments under a chapter 13 plan need not exceed what would be payable under chapter 7. *But see* revised § 1325 and *infra* text at 101–102. The disadvantage is the long-term nature of the plan as opposed to chapter 7 where the debtor can get in and out of bankruptcy relatively quickly.

the requisites for confirmation were: (1) that the plan be proposed in good faith; (2) that it not unfairly discriminate among creditors; and (3) that each creditor receive as much under the plan as such creditor would have received in a liquidation under chapter 7.[41] This last element—mandating an odd linkage between an assets-based liquidation and a future earnings installment repayment plan—is colloquially termed the "best interests of the creditors" test, though that term is nowhere used in the Code itself.[42]

Under the Code and Bankruptcy Rules,[43] between 20–40 days after the entry of an order for relief, a creditors' meeting is held at which the debtor must attend and be prepared to testify under oath.[44] The purpose of the meeting is to permit creditors and the trustee to examine the debtor concerning scheduled assets and liabilities to ascertain the whereabouts of assets and grounds for objection to exemptions, to the granting of a discharge or to confirmation of a plan.[45] In a chapter 7 case, the meeting serves an additional function. The requisite number of creditors may elect a permanent trustee of their choice to replace the interim trustee appointed immediately after the entry of the order of relief.[46]

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[41]11 U.S.C. § 1322(b) ("may not unfairly discriminate") and 11 U.S.C. § 1325(3) ("good faith") and (4) (property to be distributed not less than amount received in chapter 7). The exception to the "best interests of the creditors" test concerns § 507 priority claims. These claims must be paid in full even if there would have been insufficient assets to do so if the debtor had filed under chapter 7. § 1322(a)(2). *See infra* text at note 59 for definition of "good faith."

Note that while the 1984 Amendments generally retain the requirement that the plan not unfairly discriminate among creditors who are similarly situated, they do permit preferential classifications of debts for which there is a cosigner. § 1322(b)(1) as amended by Section 316, Pub. L. No. 98–353. One reason for permitting such preferential classification is to insure that the codebtor stay remain in effect under § 1301. (The stay remains in effect only to the extent the debt is to be paid under the plan.) *See infra* note 51.

[42]*See* 5 Collier on Bankruptcy ¶1325.01[2][D] at 1329-9 to 1329-14 (15th ed.).

[43]Bankruptcy Rule 2003. 28 U.S.C. § 2075 authorizes the Supreme Court to promulgate rules of bankruptcy procedure. The Court did so under the Bankruptcy Act and recently promulgated rules and official forms under the Bankruptcy Code.

[44]U.S.C. § 341(a): "Within a reasonable time after the order for relief in a case under this title, there shall be a meeting of creditors."

Id., § 343: "The debtor shall appear and submit to examination under oath at the meeting of creditors under section 341(a) of this title. Creditors, any indenture trustee, or any trustee or examiner in the case may examine the debtor."

Failure to attend the meeting or to testify is a ground for a denial of discharge under § 727 (a) (6).

[45]Under 11 U.S.C. § 521, the debtor must file a schedule of assets and liabilities and a statement of the debtor's financial affairs. Under Bankruptcy Rule 1007, these schedules must be filed within 15 days of the entry of the order of relief. Exemptions are claimed on the schedules. Under Rule 4003, objections to exemptions must be filed by creditors or the trustee within thirty days after the conclusion of the § 341 meeting. Concerning objections to discharge, *see infra* text at note 49.

[46]Under 11 U.S.C. § 702, creditors may elect a trustee at the § 341 meeting provided that such an election is requested by creditors holding at least 20% in amount of allowable, undisputed, nonpriority, liquidated claims. A candidate for trustee will be elected if creditors holding at least 20% in amount of the foregoing claims vote and such candidate receives the votes of creditors holding a majority in amount of those claims voting. Thus, a trustee may be elected by creditors holding as little as 10% & $1 of the debtor's liabilities. As noted *infra*, notwithstanding the minimal degree of participation that is required, elections are rarely held.

In both chapter 7 and chapter 13, once a case is commenced, the debtor is protected against virtually all types of debt collection activity—whether judicial or nonjudicial—and this automatic stay remains in effect until the discharge is granted or denied.[47] If the discharge is granted, the automatic stay will be immediately replaced by a functionally equivalent discharge injunction.[48] In a chapter 7 proceeding, in the absence of a timely complaint by the trustee or creditors alleging grounds for a denial of discharge, the discharge will be granted as a matter of course sixty days following the creditors' meeting required under section 341.[49] In a chapter 13 case the discharge will be granted following successful completion of the plan at the end of the 3–5 year period.[50] This means in effect that a debtor is successfully immunized from creditor pressure for the entire duration of the plan.[51] Moreover, if a debtor finds it difficult to maintain payments on the plan, he may apply to the court for a plan modification[52] or, in the alternative, for a more limited discharge which, in any case, is the same he would have received under chapter 7.[53] Finally, the last stage of the process both under

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[47]11 U.S.C. § 362(c).

[48]11 U.S.C. § 524.

[49]11 U.S.C. § 727 (c) provides: "The trustee or creditor may object to discharge under (a) of this section." Although § 727 does not explicitly rule out the possibility of the court's acting on its own motion, the quoted language has generally been taken to mean that a timely complaint must be filed. Sommer, *supra* note 2, § 14.2 at 113. Under Rule 4004, a § 727 complaint must be filed within 60 days of the creditors' meeting.

Note, however, that with respect to contesting the dischargeability of particular debts under § 523, there is generally no specific time limit within which creditors must act nor must a complaint even be filed with the bankruptcy court, *i.e.*, creditors could simply sue in state court, the debtor would interpose the discharge as a defense, and the application of § 523 to the particular debt would be adjudicated by a nonbankruptcy forum. The exception is for debts nondischargeable under § 523(a)(2),(4),(6), (fraud, false financial statements, willful and malicious injury to person or property) where timely objections must be filed with the bankruptcy court, [§ 523(c)] and the time limits for such objections are the same as under § 727. Rule 4007.

[50]11 U.S.C. § 1328(a).

[51]11 U.S.C. § 362 (c) (2) (c). Indeed, chapter 13 goes further and not only bars action against the debtor but in the case of a consumer debt cosigned by an individual, against the cosigner as well, thereby preventing indirect pressure on the debtor arising from the threat of litigation against a codebtor who may be a friend or relative. The codebtor stay may be terminated upon motion if the plan does not propose to pay such cosigner in full. See also *new* § 1301 (automatic termination after twenty days from request unless debtor or codebtor files written objection) and *new* § 1322(b)(1) (permissive classification of cosigned obligations affording them preferential treatment over other classes of claims without running afoul of the "no discrimination" rule).

[52]*See* U.S.C. § 1323 (modification of plan before confirmation) and § 1329 (modification of plan after confirmation).

[53]11 U.S.C. § 1328(b) provides what is known as a "hardship discharge." Even if a debtor has not completed payments under the plan and hence is not eligible for the comprehensive discharge of § 1328(a), he may be able to receive a more limited discharge under § 1328(b) if failure to complete the plan was due to circumstances "for which the debtor should not justly be held accountable," the minimal "best interests of the creditors" test has been met (creditors have gotten the equivalent of their chapter 7 dividend) and modification under § 1329 "is not practicable." For example, if the debtor has insufficient in-

chapter 7 and chapter 13 requires the debtor to personally appear before the bankruptcy judge—which may be the only time in the entire proceeding that he has even seen the judge—to be informed whether the discharge was granted or denied.[54] This is also the occasion at which the judge may review and approve any proposed reaffirmation agreement submitted by a debtor who was not represented by an attorney in the course of negotiating the agreement.[55]

One who does nothing more than peruse the provisions of the Code, however, would be blissfully unaware of the economic realities of the typical consumer proceeding. As noted, the Code contemplates the possibility of creditors placing a debtor into bankruptcy involuntarily; sets out detailed provisions regarding creditors' meetings and election of trustees; and specifies priorities in the distribution of assets. In point of fact, involuntary petitions against consumers are virtually unknown; few, if any, creditors even bother to show up at a creditors' meeting; indeed, even the interim trustee who generally does attend may do nothing more than look over the schedules and ask the debtor if the information is accurate, a procedure that typically takes less than 15 minutes.[56] Obviously, trustees are seldom elected because of lack of creditor interest notwithstanding the fact that only a minimal indication of such interest is required.[57] Finally, and this explains the rarity of involuntary petitions as well as the dearth of attendance at creditors' meetings, for all practical purposes, the priority and distribution provisions of chapter 7 are virtually a dead letter since, in over 90% of all cases, there are no assets available for distribution after exemptions are claimed.[58] The typical consumer who files for bankruptcy may indeed be employed but he is living off his paycheck—a source of wealth that is excluded from the reach of chapter 7. Note, too, that under the Code, the fact that most debtors do not have any assets that could be distributed to creditors in a chapter 7 proceeding also meant that debtors who invoke chapter 13 can propose a plan calling for only a minimal or no payment, since

come to pay priority claimants in full although he can pay them the dividend they would receive under chapter 7, he cannot seek modification of the plan since the plan as modified fails to comply with § 1322. His only option therefore is to seek relief under § 1328(b). A § 1328(b) discharge is subject to *all* of the § 523(a) exceptions, not just the ones for alimony and child support. *See* § 1328(c).

Note, however, that even a "hardship discharge" is still somewhat broader than the discharge granted under chapter 7 since the former is not subject to § 727.

[54] 11 U.S.C. § 524(d). *See also* Sommer, *supra* note 2, § 3.6, at 13.

[55] Under Bankruptcy Rule 4008 the § 524 discharge hearing must be held within thirty days after the granting or denial of discharge. Under § 524 as amended reaffirmations in cases where debtors are represented by counsel no longer need court approval. 11 U.S.C. § 524(c) and (d).

[56] Sommer, *supra* note 2, § 3.4, at 1.

[57] *Supra* note 46.

[58] *Supra* note 5.

the best interests of the creditors test could be easily satisfied.[59] This was true regardless of the debtor's actual earning capacity, and herein lies the problem.

III. THE CASE FOR REFORM: SUMMARY AND EVALUATION

The legislative history of the bill as finally enacted is sparse. The so-called Conference Report[60] contains nothing more than the text of the corrected bill that ultimately became law. The few remarks in the *Congressional Record*[61] focus almost entirely on the restructuring of the court system, expressing dissatisfaction over the failure to establish an Article III judiciary and vesting the appointment of judges in courts of appeals, rather than in the President. Nevertheless, there are Senate reports on two earlier versions of the law—S. 2000[62] and S. 445[63]—which provide valuable insight into the purpose and interpretation of many provisions which survive in the current version of the law. These reports explain in great detail the arguments in favor of changing the Code and furnish an opportunity for an informed evaluation of the empirical basis and policy judgments that underlie these changes.

The initial impetus for change rested on three propositions: (1) the Code was responsible for a dramatic increase in consumer bankruptcies; (2) this increase was in turn responsible for billions of dollars of losses in discharged debt every year, losses which are ultimately borne by the public at large in the form of higher interest rates, higher prices for goods and services, and denial of access to credit markets and (3) a substantial number of debtors

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[59]Of course, even under the Code the "best interests of the creditors" test was not the only hurdle debtors had to surmount. § 1325 also required (and requires) that the plan be proposed in "good faith." However, a majority of courts that considered the issue concluded that the "good faith" standard did not require that the plan represent the debtor's "best efforts" or that any percentage of debt be paid off. *See, e.g., In re* Kitchens, 702 F.2d 885 (11th Cir. 1983); Deans v. O'Donnell, 692 F.2d 968 (4th Cir. 1982); Barnes v. Whelan, 689 F.2d 193 (D.C. Cir. 1982); *In re* Goeb, 675 F.2d 1386 (9th Cir. 1982); *In re* Rimgale, 669 F.2d 426 (7th Cir. 1982); *In re* Cloutier, 6 BANKR. CT. DEC. (CRR) 196 (D. Colo. 1980); *In re* Armstrong, 6 BANKR. CT. DEC. (CRR) 259 (D. Ore. 1980); *In re* Garcia, 6 BANKR. CT. DEC. (CRR) 1212 (D. Kan. 1980); *In re* Walsey, BANKR. L. REP. (CCH) ¶67,740 (N.D. Ga. 1980); *In re* Harland, 6 BANKR. CT. DEC. (CRR) 235 (D. Neb. 1980); *In re* Thebeau, 3 Bankr. 537 (E.D. Ark. 1980); *In re* Bender, 6 BANKR. CT. DEC. (CRR) 257 (E.D.N.Y. 1980). *Contra: In re* Terry, 630 F.2d 634 (8th Cir. 1980); *In re* Burrell, 6 BANKR. CT. DEC. (CRR) 900 (N.D. Cal. 1980); *In re* Iacovoni, 2 Bankr. 256 (D. Utah 1980); *In re* Beaver, 2 Bankr. 337 (S.D. Cal. 1980) ("substantial" or "meaningful" payment to unsecured creditors required before plan can be confirmed). *See generally,* COLLIER, *supra* note 42, at ¶1325. *See also infra* note 101–102 for the 1984 changes in § 1325.

[60]CONFERENCE REPORT No. 882 on the H.R. 5174, 98th Cong., 2nd. Sess. (June 29, 1984).

[61]*See* Vol. 134, CONG. REC. (March 21, 1984) [House] and (May 22, 1984) [Senate] [daily ed.].

[62]S. REP. No. 446 on S. 2000, 97th Cong., 2nd Session (1982) ["SEN. REP. I"], with dissenting views of Senators Metzenbaum and Kennedy, as reported by the Committee on the Judiciary.

[63]S. REP. No. 65 on S. 445, 98th Cong., 1st Session (1983) ["SEN. REP. II"], with additional views of Senators Metzenbaum and Kennedy, as reported by the Committee on the Judiciary.

resorting to bankruptcy were capable of paying off their debts out of future income and hence did not need or deserve the radical relief that bankruptcy affords.[64]

A. THE RISE IN BANKRUPTCIES SINCE THE CODE

It is undisputed that since the enactment of the Bankruptcy Reform Act there has been a dramatic increase in the number of consumer bankruptcies. According to statistics compiled by the Administrative Office of the U.S. Courts,[65] the number of consumer bankruptcies filed annually is more than double what it was immediately before the enactment of the Code, a rate of increase unparalleled in any other period of American history.[66] The reasons for this dramatic upsurge are less apparent. The proliferation of lawyer advertising in the wake of *Bates*[67] and general economic conditions of recession, unemployment, and inflation obviously have had a great impact. The rapid, indeed explosive growth of consumer credit, particularly through the easy availability of credit cards, is yet another factor. Congress was convinced, however, that the rise was far in excess of what could be attributed to economic factors. Citing a number of studies commissioned by the credit industry,[68] a Senate report noted that most debtors filing for relief under chapter 7 had jobs and expected to keep those jobs in the forseeable future and were thus not "victims" of the unemployment rate.[69] Moreover, while historically there has indeed been a close linkage between the unemployment rate and the number of personal bankruptcies, the increase in bankruptcies since the enactment of the Code substantially outstripped the rise in unemployment.[70]

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[64]*See* SEN. REP. II, *supra* note 63, at 2–7.

[65]*See supra* note 3.

[66]In fiscal year 1979 (July 1, 1978–June 30, 1979), the last full year prior to the effective date of the Code, there were 196,976 individual bankruptcies filed, a relatively modest 12% increase over the previous year and well below the record levels of 1975 (224,354) and 1976 (211,348). By 1980, individual bankruptcy filings had risen to 314,856, an increase of 60%, and by June 30, 1981, to 452,145, an increase of 43% over the 1980 increase. Thus, in less than two years, the rate of personal bankruptcies more than doubled. This trend continued in 1982; a total of 545,045 petitions were filed, over 500,000 of which were voluntary chapter 7 or 13 cases filed by individuals. Less than 2,000 involuntary petitions of any type were filed and even voluntary chapter 11 proceedings were less than 20,000. Thus, the overwhelming majority of filings are individual, voluntary chapter 7 or 13 cases, the bulk of which (approximately 2/3's) are the former.

[67]Bates v. State Bar of Arizona, 433 U.S. 350 (1977) (advertisements for legal services protected by the First Amendment).

[68]Particularly the Purdue and Brimmer studies, *infra* note 91–95, as well as statistics compiled by the Federal Reserve Board and Department of Commerce.

[69]SEN. REP. I, *supra* note 62, at 10. (78% of debtors employed).

[70]*Id.* at 5. According to statistics compiled by the Administrative Office of the United States, during the period of 1974–1978 when unemployment rose sharply there was a slight growth in personal bankruptcies. From 1979–1981, as the unemployment rate slightly declined (though still higher than pre-1974 levels), the bankruptcy rate dramatically increased, thereby suggesting that the enactment of

Secondly, while the availability of consumer credit has exploded in recent years (from $44 billion in 1960 to $328 billion in 1981),[71] the level of personal income has risen as well.[72] The ratio of credit outstanding to liquid assets, *i.e.*, annual disposable income and savings, has remained relatively stable since 1960, peaking in 1979 at approximately 21%. The present range of 18–19% is the same as it was in the Eisenhower years.[73] The average consumer pays less than 15% of his monthly disposable income for installment debt.[74] Thus, one study[75] concluded that, at best, economic conditions could account for no more than an additional 50–55,000 bankruptcies a year.

The evidence, therefore, suggested that more consumers were resorting to bankruptcy because the liberalized provisions of the Bankruptcy Code made bankruptcy a more attractive option than it was prior to the Code's enactment. According to the *Senate Report*,[76] the unfettered right to file under chapter 7,[77] overgenerous exemptions,[78] the broadened scope of discharge,[79] lien avoidance on exempt property,[80] redemption of collateral,[81]

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the Code was more significant than the unemployment rate. Of course the unemployment rate does not take into account the short work week resorted to by manufacturers to retain employees but which often results in employees receiving less in wages than they would receive in unemployment pay.

[71]SEN. REP. I, *supra* note 62, at 11.

[72]*Id.* According to the Department of Commerce, consumers' personal income has grown from $404 billion in 1960 to $2.5 trillion in 1981.

[73]*Id.*

[74]*Id.* The 18–19% figure mentioned in the preceding sentence refers to the ratio of *total indebtedness* to *total liquid assets* (a figure that includes savings as well as income). The latter 15% figure is the ratio for monthly consumer installment indebtedness, *i.e.*, periodic indebtedness *excluding* housing costs, to disposable income (personal income reduced by taxes and social insurance).

[75]Testimony of Andrew J. Brimmer quoted in SEN. REP. I, *supra* note 62, at 11.

[76]SEN. REP. I, *supra* note 62 at 2–3.

[77]*See supra* text at note 10.

[78]11 U.S.C. § 522.

[79]*Supra* text at notes 31 and 52–53.

[80]In addition to the creation of generous federal exemptions, 11 U.S.C. § 522 also provides that the debtor may avoid certain liens on exempt property to the extent the lien impairs an exemption. Under § 522(f), liens may be avoided if they are: (1) judicial liens on *any* exempt property; or (2) nonpossessory and nonpurchase-money liens on household furnishings, household goods, tools of the trade, and professionally prescribed health aids. In all cases, lien avoidance is limited to the extent an exemption right is being impaired.

Courts are divided whether § 522 (f) lien avoidance is applicable in chapter 13 cases. *See* 11 U.S.C. § 103(a) (chapter 5 is generally applicable in chapter 13 cases) and Peeples, *Five Into Thirteen*, 61 N.C.L. REV. 849 (June 1983), and MacLachlan, *Lien Avoidance by Debtors in Chapter 13 of the Bankruptcy Act of 1978*, 58 AM. BANKR. L.J. 45 (Jan. 1984).

[81]11 U.S.C. § 722. Even if a lien cannot be avoided under § 522(f), an individual debtor may nonetheless extinguish a lien on exempt property securing a dischargeable consumer debt by paying the secured party the value of the secured claim. For example, assume debtor owns a dining room table worth $200 subject to a purchase-money interest of $300. Although the lien impairs the debtor's $200 per item exemption right, the lien is not voidable under § 522(f)(2) since it is a purchase money interest. Nevertheless, by paying the $200 value of the table (*i.e.*, the value of the *secured* portion of the claim, see § 506), the debtor may keep the table without paying the $100 deficiency. A debtor will have no need of § 722 where the lien may be avoided totally under § 522(f) nor will § 722 be of any help if the nonexempt

and minimal or zero payments in chapter 13 cases without the need to obtain creditor consent[82] coupled with the expansion of the automatic stay to preclude enforcement of even unavoidable security interests[83] encouraged debtors to file petitions under title 11 who would not have done so under prior law.

The argument advanced by the credit industry that the Code was responsible for the sharp rise in consumer bankruptcies was strongly contested. Senators Kennedy and Metzenbaum noted that "on close analysis the claim that the increase in personal bankruptcy has anything to do with the Bankruptcy Reform Act simply falls apart"[84] and attributed the rise to general economic conditions. Ultimately, however, *why* bankruptcies increased was relatively unimportant. Given the *fact* of such an increase and the resulting magnitude of creditor losses, reform to mitigate those losses was thought desirable irrespective of whether the Code was the cause.[85] This brings us to the second, and more important, part of the argument.

B. THE MAGNITUDE OF BANKRUPTCY LOSSES

The total amount of noncollectible debt resulting from discharges in bankruptcy runs into billions of dollars annually.[86] The cost of this dischargeable debt is initially borne by the extender of credit but is eventually passed on to consumers at large in the form of higher interest rates, demands for cosigners or additional collateral, nonavailability of credit and higher prices for goods and services. Thus, it was argued that the incremental bankruptcy losses arising from the enactment of the Code (both because of increased incentives to file and because of greater likelihood of noncollectibility in the event of a filing) is a significant constraint on consumer credit.

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value of the collateral exceeds the amount of the debt since in that case the secured claim is equivalent to the full debt.

There are many cases, however, where a debtor will first use § 522 to invalidate a lien partially and then extinguish the rest through redemption. For example, if debtor has a $600 piano subject to a $500 nonpurchase-money security interest, § 522(f) will avoid the lien to the extent of $100 reducing the secured claim to only $400. § 722 will then permit the debtor to avoid the $400 secured claim by a $400 cash payment.

The 1984 Amendments make no changes in either § 522(f) or § 722.

[82] *See* cases cited *supra* note 59.

[83] 11 U.S.C. § 362. Although secured creditors are entitled to realize their secured claims in full out of their collateral before any distribution is made even to § 507 priority creditors, *supra* note 29 and 11 U.S.C. § 725, the automatic stay requires secured parties to await the trustee's liquidation unless they obtain relief from the stay by demonstrating a lack of adequate protection for their interests or other cause. 11 U.S.C. § 362(d)(1).

[84] SEN. REP. I, *supra* note 62, at 65.

[85] Thus, while the *Senate Report* to S. 2000 devoted several pages in attempting to demonstrate that the Code was the precipitating cause for the dramatic upsurge in individual bankruptcies, the *Senate Report* to S. 445, a bill that essentially adopted many of the same reforms, simply stated that the amendments relating to consumer petitions were appropriate "regardless of the reason for the rise in bankruptcy filings." *Id.*, at 3.

[86] A number of witnesses testified that bankruptcy losses for 1981 may have exceeded $6 billion. SEN. REP. I, *supra* note 62, at 6.

Is that in itself bad? The *Senate Report*[87] notes that curtailing the availability of credit would be contrary to the public policy articulated in statutes such as the Equal Credit Opportunity Act[88] and Fair Credit Reporting Act.[89] Moreover, making credit more difficult and expensive to obtain may have the effect of driving more debtors to the wall, resulting in more bankruptcies, which has a detrimental effect on the economy as a whole. Liberalization of bankruptcy in the interests of consumer protection may ultimately have the opposite effect.

It has been well said that a liberalized bankruptcy system allowing debtors to escape the burden of accumulated debt is essentially a form of insurance and redistribution of risk from an individual debtor to the general public at large.[90] In other words, the costs that bankruptcy imposes on all of us in the form of higher interest rates and reduction of access to credit are justified as a means of providing individual debtors the necessary protection in the event they are unable to meet their financial obligations. Accordingly, imposing such a burden on the public at large is justifiable only to the extent a debtor would otherwise be unable to pay his debts; and this brings us to the third and most important stage in the credit industry argument.

C. Ability to Pay

The credit industry argued that a substantial number of debtors paying little or nothing to their creditors in bankruptcy could easily have paid a large portion of their debts out of future income and it was unfair both to their creditors and to the public at large to allow such nonnecessitous debtors to escape their obligations at little or no cost.[91] The primary source for this contention was a two-volume study prepared by the Credit Research Center affiliated with the Krannert School of Management of Purdue University ("Purdue Study").[92]

Based on information obtained from interviews with 1,200 persons filing for relief under chapter 7, the Purdue Study concluded that if one calculated the present and expected income of these debtors over a one year period and deducted necessary expenses for housing and Department of Labor estimates for basic living expenses as well as any extraordinary expenses these individuals had (such as alimony), a substantial number would be able to pay a large portion of their debt out of their excess disposable income without

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[87]*Id.*

[88]15 U.S.C. §§1691–1691(f).

[89]*Id.* §§1681–1681(t).

[90]*See generally* Weistart, *The Costs of Bankruptcy*, 41 Law & Contemp. Probs 107 (1977).

[91]*See supra* note 13.

[92]*Id.*

undue hardship.[93] Indeed, this was the case even if one inflated nonhousing expenditures by 20%, thereby providing an excess equity cushion. Specifically, the Study found that more than 15% of chapter 7 debtors could pay all debts in full over a period of three years out of excess discretionary income; 22.9% could do so within five years. (Without the 20% excess cushion, these figures would increase to 20.5% and 29.2% respectively.) One-fourth of these debtors could pay at least 50% over three years and 30.5% could do so over five years. (Without the excess cushion, 31.3% could pay a 50% dividend over three years and 37.4% could do so over five years.)[94] Nevertheless, all of these debtors filed petitions for relief under chapter 7 and creditors received nothing on their claims. On the basis of this study, the credit industry argued that it was both unfair to creditors and burdensome to the public at large to allow debtors to seek relief under chapter 7 giving little or nothing to creditors where a substantial portion of those debts could be paid out of excess disposable income.

The validity of the Purdue Study has been seriously questioned by scholars on several grounds with many concluding that the study was "deeply flawed" and an "adversarial document"[95] but it is indisputable that it was a major impetus for bankruptcy reform.

IV. THE RESPONSE OF THE ACT: LIMITING ACCESS TO CHAPTER 7, RAISING CONFIRMATION STANDARDS FOR CHAPTER 13

If chapter 7 was in fact being abused by debtors with a substantial repayment capacity, simply limiting access to chapter 7 by making chapter 13 compulsory would have accomplished little or nothing.[96] Under the Code, the basic test for confirmation of a chapter 13 plan was that it provided no less than creditors would receive under chapter 7.[97] If that amount

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[93]The results of the Purdue Study are summarized in SEN. REP. I, *supra* note 62, at 7–10. All figures in this paragraph are taken from tables reproduced in *Id.*, at 9–10.

[94]SEN. REP. I, *supra* note 62, at 9–10.

[95]*See* Sullivan, Warren, Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 WISCONSIN LAW REVIEW 1091, for a detailed and convincing methodological critique of the Purdue Study concluding that the study is "deeply flawed" and is an "adversarial document." *Id.* at 1145. Moreover, a 1979 study by Professor Philip Shuchman came to a conclusion diametrically opposed to that of the Purdue Study concluding that the majority of chapter 7 debtors were already close to or below the poverty level and generally did not have steady employment. It should also be noted that the Purdue Study was financed by the Coalition for Bankruptcy Reform, a "group made up of a broad cross-section of the consumer credit industry and associated organizations." *Purdue Study, supra* note 13, at VI. As the Study itself noted (though attempted to dispel), this raises some serious questions of bias, lack of neutrality, *etc.*

[96]It is also questionable whether such an alternative could pass constitutional muster. See *infra* text at note 183.

[97]11 U.S.C. § 1325.

itself is nominal, chapter 13 is no more protective of the interests of creditors than is chapter 7.[98] Nor would the reduction or elimination of chapter 7 exemptions go very far. In the first place, most consumer debtors have so few assets of any significant monetary value that regardless of what exemption level is adopted, creditors would receive little or nothing.[99] In other words, exemption levels do not have a significant impact on the amount distributed in a chapter 7. Secondly, there is virtually universal agreement that debtors should be entitled to keep *some* property necessary to maintain a basic standard of living and thus, there is very little in the way of tinkering that can be done. Thirdly, since section 522 as presently written permits states to opt out of the federal exemption scheme and about two-thirds of the states have already done so,[100] any effective limitation of exemption rights would have to be binding on the states as well, and the necessary preemption of a state's judgment as to what its resident debtors need for a fresh start would be inconsistent with the policy that such matters in the first instance should be left to the states, a policy that precluded a mandatory uniform federal exemption scheme in the first place.

Thus, it is clear that any creditor's remedy must by necessity embody two elements: (1) limitation of access to chapter 7 by debtors with a substantial debt repayment capacity; and (2) requiring utilization of that capacity as a condition for confirmation under chapter 13.

The Amendments are intended to accomplish this goal. Section 312 of Public Law 98–353 amends section 707 by adding the following language as subsection (b):

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

The legislative history indicates that the "substantial abuse" provision is primarily directed towards debtors with a repayment capacity out of future income.[101]

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[98] Other than whatever additional margin of protection the "good faith" standard would impose. *See supra* note 59.

[99] *See* Shuchman and Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1 (1982); Shuchman, *Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Most States*, 88 COM. L.J. 288 (June-July 1983); and Woodward, Jr. and Woodward, *Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study*, 57 AM. BANKR. L. J. 53 (1983).

[100] *See* 11 U.S.C. § 522(b).

[101] SEN. REP. I, *supra* note 62, at 32–33 (S. 2000); SEN. REPORT II, *supra* note 63, at 53–54 (S. 445). See also *infra* text accompanying notes 106–109.

Section 317 of Public Law 98-353 amends section 1325 by adding a new subsection (b):

> (1) If the trustee or the holder of any allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.
>
> (2) For purposes of this subsection, 'disposable income' means income which is received by the debtor and which is not reasonably necessary to be expended –
>
> (A) for the maintenance or support of the debtor or a dependent of the debtor; or
>
> (B) if the debtor is engaged in business for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

Thus, while the amended version of chapter 13 still does not require that any specified percentage of debt be repaid (retaining only the "best interests of the creditors" test), it does mandate that the debtor utilize *all* of his disposable income to make payments under the plan unless unsecured creditors can be paid *in full* through a smaller distribution. Interestingly enough, to the extent the confirmed plan calls for payments beyond the three year period pursuant to section 1322(c), no specific percentage of income need be submitted (although there is still a requirement that all creditors receive as much as they would have under chapter 7).[102]

[102] *See infra* text accompanying notes 174-181. *See* also amended § 1326(a)—payments on plan must commence within 30 days of submission even prior to confirmation. (Query: What impact will § 1326(a) have on the maximum duration of a chapter 13 plan? The Amendments provide, as does current law, that the plan may not extend for more than five years from the time the first payment is due under the plan. Does this period now commence automatically from the thirtieth day after submission or only from the date after confirmation that creditors are to receive their first payment? The latter was clearly the case under the Code and would permit plans of considerably longer duration than would the first alternative.)

If subsequent to confirmation the debtor's projected income is reduced, *e.g.*, due to loss of employment, or support expenses are increased, under section 1329 the debtor may petition the court for modification of the plan allowing for reduced payments. Under prior law, however, it was uncertain whether creditors could compel debtors to *increase* payments if the debtor's economic situation improved.[103] Section 319 of Public Law 98–353 now amends section 1329(a) to provide that the plan may be modified "at the request of the debtor, the trustee, or *the holder of an allowed unsecured claim.*"[104] (emphasis added)

In essence, then, by denying certain persons access to chapter 7 and at the same time requiring those persons to utilize all of their disposable income in making payments under chapter 13, the Amendments attempt to insure that a bankruptcy discharge will not be granted unless a debtor makes a serious effort, perhaps at significant sacrifice, to have his debts paid in full. The Amendments proceed on the assumption that a discharge in bankruptcy should not be a matter of right but is in the nature of an extraordinary equitable remedy to be granted only in case of demonstrable necessity.

Unfortunately, however, the guidelines laid down in the Amendments are defective, both in their substance and in their procedural implementation. The directives to the court are vague and disturbingly intrusive. The procedures contemplated by the Amendments operate in a manner inconsistent with basic Anglo-American notions of judicial propriety and fairness and will impose a tremendous burden on an already overburdened bankruptcy court system, greatly add to the time and cost of a chapter 7 proceeding, and may produce little or no benefit to creditors.

V. THE MEANING OF "SUBSTANTIAL ABUSE"

Taking vagueness first, section 707(b) provides no definition of what constitutes "substantial abuse." Presumably, if a debtor is able to pay his future obligations as they become due and is not presently in default, it would be a substantial abuse to seek chapter 7 relief but one could hardly imagine such a debtor filing for bankruptcy in the first place. Obviously, something less than *full* ability to pay may nonetheless constitute substantial abuse. While there is no legislative history explaining the test as finally enacted,[105] examination of prior bills may shed some light on the applicable standard. Earlier versions of the bill were somewhat more explicit.

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[103] *See* Breitowitz, *supra* note *, at Appendix note 40 for a discussion of this uncertainty.

[104] The holder of a secured claim would have no reason to petition for modification since § 1325 requires that he receive over the life of the plan payments having a present value equivalent to the *full* value of his allowed secured claim. To the extent this is not equivalent to the full value of his claim, *i.e.*, he is undersecured, he has standing as the holder of an unsecured claim.

[105] *See supra* text accompanying notes 60–63.

A. Earlier Versions—S. 2000, S. 445

S. 2000, introduced in the 97th Congress (Dec. 1981), originally provided that an individual may not be a debtor under chapter 7 if he could pay a *reasonable* portion of his prepetition debts out of anticipated future income.[106] Anticipated future income was defined as income from sources which were either providing actual income at the time of the bankruptcy filing or that would provide such income at a date certain within twelve months of the filing, *e.g.*, a vested pension plan or the like.[107] The bankruptcy judge would ascertain the extent and existence of such income through a statement of income and expenses that a debtor would have to file under an amendment to section 521.[108] An exception was made if dismissal would result in "undue hardship" to the debtor or his dependents.[109]

While the language of S. 2000 was far from clear,[110] the *Senate Report*[111] indicates that in determining what constitutes a substantial percentage of nonmortgage debt, the court was to consider what percentage of debt could be retired *over a three to five year period* if the *projected discretionary income* of the debtor were to be applied in a deferred monthly payment plan.[112] The Report[113] further states that while a substantial percentage of debt is not given precise definition and may "vary depending on the . . . totality of the debtor's financial circumstances,"[114] 75% of debt would clearly be regarded as "reasonable," 25% would clearly not be, leaving all cases in the middle to sound judicial discretion with a presumption in favor of the relief the debtor seeks.

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[106] S. 2000 (97th Cong.), § 3 amending 11 U.S.C. § 109(c).

[107] *Id.*, at (c)(1)(B). *See* also Sen. Rep. I, *supra* note 62, at 34–38.

[108] S. 2000, § 7 amending 11 U.S.C. § 521.

[109] S. 2000, § 3 amending U.S.C. § 109.

[110] *See* Breitowitz, *supra* note* at text accompanying notes 119–121 for an explanation of some of the ambiguities inherent in the anticipated future income test, particularly its failure to expressly deduct necessary living expenses from the total in determining the amount available for creditors.

[111] Sen. Rep. I, *supra* note 62, at 36–37.

[112] This period was apparently chosen because in the event of a chapter 7 dismissal, the debtor would presumably attempt to seek relief under chapter 13. A chapter 13 debtor could never be compelled to utilize more than five years of his future income to make plan payments since, under § 1322, a plan may not extend beyond five years.

[113] Sen. Rep. I, *supra* note 62, at 37.

[114] It is not clear why the definition of a "substantial percentage of debt" should ever vary with circumstances. While consideration of individual circumstances is obviously essential in determining what percentage of debt could be paid off, *i.e.*, the greater the debtor's expenses for support, the lesser his disposable income, once that percentage is ascertained, whether that percentage once established is so "substantial" as to preclude access to chapter 7 appears to be an issue independent of the particular debtor involved.

B. PRESENT LAW

No action was taken on S. 2000 in the 97th Congress. The bill was reintroduced as S. 445 in the 98th Congress in February 1983.[115] In response to criticisms by Senators Kennedy (D.-Mass.) and Metzenbaum (D-Ohio) that the "anticipated future income" test was unworkable and would severely overburden the courts,[116] language was substituted authorizing the bankruptcy court on its own motion to dismiss a chapter 7 case on the grounds of "substantial abuse."[117] This was heralded as a significant improvement by both the supporters of the bill[118] and those who were somewhat less enthusiastic.[119] The "substantial abuse" test, with some minor differences in language, was carried over to H.R. 5174, the bill that eventually became Pub. L. No. 98-353.[120]

"Substantial abuse" is given even less definition than "reasonable portion of debts out of anticipated future income." What exactly is the court looking

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[115]SEN. REP. II. *supra* note 63, at 2.

[116]Their criticisms appear as an appendix to SEN. REP. I, *supra* note 62, at 49-68, particularly at 59-62. The influential role of their views in "toning down" S. 445 was acknowledged by the *Senate Report* to S. 445, SEN. REP. II, *supra* note 63, at 2.

[117]S. 445, § 203 amending 11 U.S.C. § 305:

> (d)(1) Subject to the provisions of paragraph (2), the court on its own motion according to procedures established by rule, and not at the request or suggestion of any party in interest, may dismiss a case under chapter 7 of this title filed by an individual debtor if it finds that the granting of relief under this chapter would be a substantial abuse of the provisions of such chapter. In determining the question of substantial abuse, there shall be a presumption in favor of granting relief requested by the debtor.

Paragraph (2) provided, *inter alia*, that no creditor may participate in judicial proceedings relating to substantial abuse "except upon the request of the court."

In addition to mandatory chapter 7 dismissal on the grounds of "substantial abuse," S. 445 sought to encourage additional use of chapter 13 through a cumbersome system of debtor counselling. This feature was dropped in H.R. 5174, the bill which ultimately became law.

[118]SEN. REP. II, *supra* note 63, at 2-3.

[119]*Id.* at 91 (Statement of Senators Kennedy and Metzenbaum: "In our opinion, the bill, as finally reported, still tips the balance unnecessarily in favor of the creditors. . . . If legislation is to be enacted, however, we are satisfied that the bill as reported is a significant improvement over the measure that was originally introduced in the 96th Congress.")

[120]H.R. 5174 did, however, depart from S. 2000's treatment of chapter 13 plans. Under both S. 2000 and S. 445, a chapter 13 plan had to be extended to five years unless a reasonable portion of all allowed unsecured claims could be paid in a shorter time. While the amount of debt considered "reasonable" was not specifically defined, the *Senate Reports* indicate that the test was essentially the same as that for dismissal of a chapter 7 ("substantial percentage"—70%—75%). Under the law as finally enacted, on the other hand, while the debtor must devote all of his disposable income for three years towards plan payments—a standard that is arguably more rigorous than simply making a *bona fide* effort—there is no requirement that a particular percentage of debt be paid off. As long as the minimal "best interests of the creditors" test is met and secured and priority claimants are paid in full over the life of the plan, the debtor need not propose a plan longer than three years. (Of course, five year plans will still be necessary if the "best interest of the creditors" test is otherwise unsatisfied or priority and secured claims are not paid in full.)

for? Notwithstanding Senators Kennedy and Metzenbaum's disclaimer,[121] it is obvious that the primary, if not exclusive, focus of the court would be on the debtor's projected income and expenses as indicated on the schedules and the availability of that future income to pay off prepetition debts.[122] Thus, the *Senate Report* concludes that if, on the basis of these projections, the debtor could meet his debts without difficulty as they become due, use of chapter 7 will represent a substantial abuse.[123] Even this deceptively simple case poses a host of interpretive difficulties involving speculations as to a future income stream and value judgments as to the appropriate level of expenditures. It is equally certain that this obvious but rare circumstance was not intended to be the outer limit of judicial inquiry.

Assuming that "substantial abuse" turns on the debtor's ability to repay his debts out of future income—a linkage that was more explicit in S. 2000 but still retained in the present law—in determining the presence or absence of such abuse, the bankruptcy court must decide four distinct issues.[124] First, the court must determine a period of time for which the debtor's earning capacity is to be measured. Second, it must estimate the debtor's income over that period of time taking into account job stability, medical history, and the like. It must then subtract from that income those expenses deemed by the court to be necessary for support. Finally, after calculating disposable income and applying it to the payment of debts over the specified period of time, the court must decide whether the percentage of debt that would thereby be paid, and that would not be paid were the debtor allowed to proceed under chapter 7, is so significant that utilizing chapter 7 constitutes a "substantial abuse."

This formula may, at first blush, appear to be deceptively simple, calling on the judge to do nothing more than add and subtract figures based on factual information presented in the debtor's schedules. In reality only the issue of future income can be regarded as "factual." Even there, the court faces dif-

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[121] SEN. REP. II, *supra* note 63, at 90–91. ("Most importantly, the future income text has been completely deleted.")

[122] *But see infra* text accompanying notes 222–231 whether § 707 also encompasses abuses other than the ability to pay debts out of future income.

[123] SEN. REP. II, *supra* note 63, at 54.

[124] Two of these issues—predictions as to the debtor's future income and judgments as to the appropriate level of expenditures—are identical to those the court must face in defining "disposable income" for purposes of chapter 13 and the author's comments regarding the difficulties of the "substantial abuse" test are equally applicable to the "disposable income" standard. Since, however, the great majority of consumer debtors seek relief under chapter 7, these difficulties impose a considerably greater burden on the court system than would be the case if such inquiries were limited to chapter 13 cases. Also, it is not entirely clear that the amount of "disposable income" for purposes of chapter 13 will be the comparative figure used to determine whether access to chapter 7 represents a "substantial abuse." *See infra* text accompanying notes 150–153.

ficult questions of prediction and verification. By and large, however, the difficulty of determining a future income stream is a *predictive*, rather than *judgmental* one.[125]

The same cannot be said for expenses. While here too there are significant empirical difficulties in attempting to project the debtor's needs over a long period in time, particularly in light of inflation, unanticipated emergencies, and the like, the court must also exercise its judgment as to what expenses are deemed necessary. The court is not merely determining a fact but establishing a standard. Similarly, whether a particular degree of debt payment ability—25%, 50%, or 75%—is significant and over how long a period of time should this ability be measured are not "factual" issues in any sense but call upon the court to balance the competing interests of debtors and creditors and determine that beyond a certain point use of chapter 7 is unfair. Yet the "substantial abuse" standard gives the court no real definitional guidance as to where that point is and it can hardly be gathered from the debtor's schedules.

This portion of the article will attempt to address these issues in greater depth: (1) What is future income and how is it determined? (2) What expense items are taken into account in determining "disposable income" under chapter 13 and "substantial abuse" under chapter 7 and are the standards identical in both cases? (3) What percentages or dollar amount of debt must be payable out of future income before use of chapter 7 constitutes a "substantial abuse"? (4) What period of time should the court choose in determining debt repayment ability? How much debt must be payable over how long a period of time? (5) Is dismissal of a chapter 7 case warranted where the debtor is ineligible for chapter 13 relief? (6) Does the "substantial abuse" test permit dismissal on the basis of factors other than debt repayment ability?

1. *Definition of Income*

Determining the debtor's future income stream is essentially a question of fact—what will the debtor's future income be over a given period of time? The court will presumably base its decision on schedules the debtor files with the court.[126] Reliance on such information, however, poses serious

[125] Also, as will be discussed *infra* text accompanying notes 134–135, with respect to certain future or potential sources of income, the court may have to assess probabilities and make difficult policy judgments as to the legitimacy of certain employment choices.

[126] *See* 11 U.S.C. § 521 as amended by § 305 Pub. L. No. 98-353.

problems of both verification and prediction. On one hand, in a nonadversarial context,[127] how is the judge to ascertain the veracity of those schedules?[128] Since the Amendments, unlike some of its predecessors,[129] continues the Code's approach of the bankruptcy judge *not* attending the creditors' meeting,[130] the judge will not necessarily be aware of any inaccuracies discovered at this meeting and there is no clear mechanism for informing the court.[131] Is the court expected to call its own witnesses or subpoena

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[127]*See* 11 U.S.C. § 707(b) which directs the court to act on its own motion and "not at the request or suggestion of any party in interest." This arguably means that creditors cannot inform the court that the debtor misstated his income unless the court specifically requested such information. *See infra* text accompanying notes 232–252 where this problem is discussed in greater detail.

[128]While the problem of verification is ever present, it was significantly less acute under S. 2000, which gave creditors standing to file a motion to dismiss. S. 2000, § 7 amending 11 U.S.C. § 305. Creditors of course, would have had a greater incentive to ferret out inaccuracies and could have utilized the extensive discovery procedures authorized by the *Federal Rules of Civil Procedure* and incorporated by reference in the *Bankruptcy Rules*, Part VII. S. 445, however, not only precluded creditors from initiating the motion but also provided that no creditor or representative of creditors could participate in proceedings relating to substantial abuse unless the court so requests. S. 445, § 203 amending 11 U.S.C. § 305. Thus, creditors could not bring certain information (such as schedules, inaccuracies) before the court without first obtaining leave of court. (Could they even approach the court to seek leave?) While the wording of the present law is somewhat different, the same result would arguably follow. *See infra* text accompanying notes 232–252.

[129]Under the 1898 Bankruptcy Act, the bankruptcy judge (or referee as he was originally termed) presided over the creditors' meetings. The Code specifically prohibited this practice, in part to enhance the prestige of bankruptcy judges by removing them from administrative matters and in part to insure that the court does not obtain information not subject to the rules of evidence, *e.g.*, hearsay, which may impair "the court's ability to resolve disputes at a later date." *See* 11 U.S.C. § 341(c) and H.R. Rep. No. 595, 95th Cong., 1st Sess. 15–18 (1978).

S. 2000 would have changed this result by providing that the bankruptcy judge was to "convene" the creditors' meeting and "perform such additional judicial duties as may be required." S. 2000, § 5 amending 11 U.S.C. § 341. While the amendment would not have necessitated that the judge actually remain in attendance, neither would such attendance have been prohibited. *See* Sen. Rep. I, *supra* note 62, at 38–39. This proposed change was dropped from present law which reverts back to the Code's approach. Under the Bankruptcy Rules, meetings are convened by the clerk of the bankruptcy court and in "pilot" districts by the U.S. Trustee or his designee. *Compare* Rule 2003 with Rule X-1006.

[130]11 U.S.C. § 341(c).

[131]It is important to note, however, that even if § 707(b) precludes creditors from informing the court that the debtor's schedules are inaccurate for purposes of a "substantial abuse" dismissal, *infra* text accompanying notes , they are not totally without recourse. Bankruptcy statements and schedules are filed under oath. *See* Official Forms. Under 11 U.S.C. § 727(a)(4) a discharge will be denied if the debtor "knowingly or fraudulently made a false oath or account." This would apparently include statements made in the schedules to the extent the misrepresentations were both material and intentional. *See* Sommer, *supra* note 2, § 14.2, at 114 and Collier, *supra* note 42, at ¶727.04. Thus, any falsification in the debtor's statements could be brought to the attention of the court in the context of a *creditors'* motion for a denial of discharge. Moreover, even after a discharge is granted, creditors could petition the court for a revocation of discharge on the grounds of fraud under § 727(d) if they could demonstrate that had the debtor accurately stated his income, he would not have been entitled to the relief he received, *i.e.*, the case would have been dismissed under § 707(b).

From a creditors' standpoint, petitioning for a denial or revocation of a discharge is less advantageous documents?

On the other hand, even assuming the judge is in possession of complete and accurate information as to the debtor's present income, on what basis does he determine to the detriment of the debtor that such income will continue? In a depressed economy, job security has been virtually eliminated.[132] Thus, problems in the obtaining and verification of *present* information, particularly if creditors or the trustee cannot play a role in the process, coupled with the near impossibility of extrapolating from the present to the future make even the initial income determination quite difficult.[133]

These computational problems are magnified if the court is also to consider sources of income other than those actually providing income as of the commencement of the case. For example, assume a debtor's present earning capacity as of the date of the petition is insufficient to pay a substantial percentage of debt but an income opportunity materializes at a later date, *e.g.*, an unemployed debtor gets a job. May the court dismiss the petition on the basis of this subsequent development or is it limited to a consideration of the circumstances as they existed on the date of the petition?[134] Should there be a distinction between an anticipated income opportunity and an unanticipated one with only the former being a basis for dismissal on the

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than the ability to inform the court at the outset that the debtor has substantial income because the former necessitates a showing of *scienter*, *i.e.*, intent to defraud, while the latter would not. *See* also *infra* note 134 (fraud agreement unavailing with respect to future income).

(Note that inaccurately stating projected income and expenses is *not* considered "concealment" of "property of the estate" under § 727(a)(2) because postpetition earnings are not "property of the estate" under § 541 although the court must take such income into account for purposes of § 707. If, however, a debtor misstated the amount of his *prepetition* assets, § 727(a)(2) would be an additional basis for a denial of discharge.)

[132]It is equally obvious that inflation may easily convert disposable income into amounts necessary for support. This, however, is essentially a difficulty in determining expenses rather than income. *See infra* text accompanying notes 136–153.

[133]At least in case of debtors, however, if anticipated income fails to materialize, conversion to chapter 7 is available since dismissal is without prejudice. *See* § 1307 (unchanged). But query if chapter 7 dismissed and debtor converts to chapter 13, does he then retain option to *dismiss*? *Cf.* § 1307(a) (conversion) with § 1307(b) (dismissal). *See also infra* text accompanying notes 211–221.

[134]Of course, even if later developments *may* be taken into account, there is no real way the court can find out about them. Such information will not appear on the debtor's schedules and both creditors and the trustee are barred from requesting dismissal. *See infra* text accompanying notes 237–257. Moreover, failure to supplement when there is no continuing duty to do so cannot be regarded as fraud for purposes of denial or revocation of the charge. Thus, regardless of what creditors could do with respect to *inaccuracies* in the debtor's schedules—*supra* note 131—there is little or nothing they could do with regard to future developments.

Interestingly enough, in the analogous area of chapter 13 relief, where the debtor's disposable income increases after confirmation of the plan, § 1329 currently provides that creditors may petition the court for upward modification. See *supra* text accompanying note 104. Thus, future income opportunities *are* taken into account and creditors have standing to inform the court about them. It is unclear whether either proposition holds true for chapter 7 cases.

theory that only where the debtor knows or anticipates substantial future income can the filing of the petition be improper? If so, how "certain" must this anticipated income have been in order to render the filing abusive? A related question is whether substantial abuse is to be determined solely on the basis of income the debtor actually earns (either on the date of the petition or later) or on the basis of income that the court believes the debtor has the capacity to earn were he to "try harder." Is it the role of the court to assess the legitimacy of the debtor's vocational choices? It can readily be seen that whether future or even potential income should be taken into account and, if so, how is the court to ascertain its existence, pose issues difficult of resolution both from the standpoint of policy and simple mechanics.[135]

2. *Definition of Expense*

The second issue is far more complex. After determining the debtor's present and future income, the court must then determine what portion of that income would be available for the payment of prepetition debt, *i.e.*, income less expenses, were the chapter 7 petition dismissed. Besides the inherent unreliability of estimates even with respect to concededly necessary expenditures in the light of inflation, unanticipated needs, and employment stability[136] (all of which can be taken into account later if debtor desires to convert a chapter 13 back to a chapter 7),[137] the statute apparently requires the court to be the arbiter and architect of the defendant's lifestyle. In determining how much of the debtor's income is disposable, the court must of necessity determine which of the debtor's expenses are justifiable.[138] This in

[135]The problems are addressed in greater detail in Breitowitz, *supra* note*, at text accompanying notes 150–162.

[136]Indeed, the demise of the fixed mortgage makes even basic housing costs impossible to calculate. Note that the Purdue Study added a 20% expense cushion to determine disposable income. *See supra* text accompanying notes 93–94. Neither § 707 nor § 1325 expressly permit that sort of calculation.

[137]*See* 11 U.S.C. § 349(a) as amended by § 302, Pub. L. No. 98–353: "[N]or does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109(f) of this title [relating to dismissal due to willful failure of the debtor to abide by orders of the court]." *See also 11 U.S.C.* § 1307(a) (unchanged): "The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable."

With respect to whether a chapter 13 case filed as a result of the chapter 7 dismissal is in itself a converted case, *see infra* text accompanying notes 211–221.

[138]The court must do so whether the debtor seeks relief under chapter 13, thereby necessitating a determination of "disposable income" or under chapter 7, where the court examines debt repayment ability for purposes of deciding whether use of chapter 7 constitutes a "substantial abuse." It is not clear, however, whether the inquiries into the debtor's expenditures necessary in both cases are equally intrusive or whether the "substantial abuse" test contemplates a greater degree of deference to the debtor's lifestyle. *See infra* text accompanying notes 150–153.

turn opens up a Pandora's Box of subjective and speculative value judgments of unparalleled intrusiveness.[139] Suppose for example the debtor lives in a home. Should the debtor be compelled to sell the home and move to an apartment at a lower monthly cost?[140] Is it substantial abuse to have two cars where one spouse can take the bus?[141] Are children entitled to music lessons or camping trips?[142] How many a year? What about movies and clothing?[143] Does charity or benevolence have any legitimate role to play?[144]

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[139]Some commentators have argued that the difficulties of courts determining appropriate expense levels are overstated and that bankruptcy courts are already making these judgments under existing provisions of the Bankruptcy Code. Under 11 U.S.C. § 523(a)(8), for example, educational loans for which payment first became due within five years of the commencement of the case are nondischargeable unless payment would impose an undue hardship on the debtor or his dependents. A court could not determine whether repayment of the loan constitutes a hardship unless it first determines how much of the debtor's income is needed for basic support. Thus, the "undue hardship" test already requires the court, albeit in a limited context, to resolve the same issue that it now must face under § 707 and chapter 13. *See* ABA Report, *supra* note 14, at 260. Indeed, to a lesser extent, the legitimacy of the debtor's expenditures is already subject to some judicial review even under the minimal "good faith" standard of § 1325. Thus, the argument goes that the "substantial abuse" test of chapter 7 and the "disposable income" standard of chapter 13 are nothing new and would impose no adjudicative difficulties on the bankruptcy court system beyond that which the system already bears. *Id. See* also cases cited *infra* notes 140–144.

The point that various provisions of the Code, in limited contexts, already require the court to be the architect of the debtor's lifestyle is well-taken; nevertheless, rather than supporting the argument for the enlargement of that authority, the experience courts have had underscores the subjectivity, lack of standards, and intrusiveness such adjudications invariably entail as well as the burdens they impose on the bankruptcy court system and cautions against the wholesale extension of such burdens to virtually every consumer bankruptcy.

For a good description of some of the difficult problems courts have faced in construing § 523(a)(8) and that can now materialize in virtually every chapter 7 because of § 707(b) *see* Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 117–124 (Nov. 1982), at 117–124 and Kalevitch, *Educational Loans in Bankruptcy*, 2 N. ILL. L. REV. 325, 349–358 (1982).

[140]*Cf. In re* DeAngelis [1978–1981 Transfer Binder] BANKR. L. REP. (CCH) ¶67,082 (Bankr. E.D. Pa. 1979), applying 20 U.S.C. § 1087-3 current version at 11 U.S.C. § 523(a)(8) (court refused to discharge a student loan on grounds of hardship where the debtor was paying a high rental because of neighborhood preference and would be able to make loan payments were he to move to a lower-class neighborhood); *In re* Manning, 5 Bankr. 1231 (Bankr. W.D.N.Y. 1980) (court, applying the § 1325 "good faith" standard, denied confirmation to a chapter 13 plan providing for little or no payments to unsecured creditors on the grounds that the debtor had a duty to rent out the second story of home to bring in a monthly rental although this would result in five persons having to share three bedrooms on the first floor); *In re* Brown, 18 Bankr. 219 (Bankr. D. Kan. 1982) (student loan held nondischargeable because, *inter alia*, rent deemed excessive), *In re* Packer, 9 Bankr. 884 (Bankr. D. Mass. 1981) (same).

[141]Under 11 U.S.C. § 523(a)(8), courts have routinely denied discharges for student loans where the debtor would be able to meet loan payments only by foregoing certain car payments. *In re* Ewell, 1 Bankr. 311 (Bankr. D. Vt. 1979); *In re* Packer, *supra* note 140; *In re* Rosetto, 10 Bankr. 378 (Bankr. W.D.N.Y. 1981); Perkins v. Vermont Student Assistance Corp., 11 Bankr. 160 (Bankr. D. Vt. 1980); *In re* Hayman, [1978–81 Transfer Binder] BANKR. L. REP. (CCH) ¶67,064 (Bankr. S.D. Fla. 1978) (under 20 U.S.C. § 1087-3).

[142]*Cf. In re* Price, 1 Bankr. 768 (Bankr. D. Hawaii 1980) (denial of student loan discharge on grounds that debtor was spending too much on educational and cultural activities for his children). *See* also *In re* Brown, *supra* note 140 (excessive recreation).

[143]*See In re* Brown, *supra* note 140.

[144]*See In re* Rice, 13 Bankr. 614 (Bankr. D.S.D. 1981) (student loan held nondischargeable where

The issues are innumerable, not susceptible to generalized legal standards, and not really subject to appellate review,[145] yet in the case of a chapter 13, the court is explicitly directed to determine the amount of income not reasonably necessary for support,[146] and such an examination would presumably have to be made in the context of a "substantial abuse" inquiry under chapter 7 as well.

Vesting bankruptcy courts with such decisions is disturbing on several grounds. First is the question of institutional competence. Does any court, or governmental body for that matter, have the ability to determine what the appropriate lifestyle is for a particular person? What a judge may regard as a luxury may in fact be regarded by the debtor as a necessity. It is one thing to determine whether expenditures are incurred in good faith (as was required under the Code); it is quite another to determine whether they are excessive or unnecessary. Should courts be making personal judgments on a lifestyle where there are no legal standards to provide guidance or instruction?[147] How can these decisions be reviewed? Can a body of principled precedent emerge? Is not any decision of this nature inescapably based on the arbitrary predilections of the trier of fact and should we repose such decisions in courts?[148]

Second, and somewhat related, are the disturbing moral implications in having any governmental body decide what a person "needs" for food and shelter. "Need" is hardly an objective concept and the notion that a third party will decide a family's needs is offensive to a widespread belief that such decisions be left to individuals. Indeed, a similar proposal over 50 years ago which provided that a debtor could not receive a bankruptcy discharge unless he agreed to turn over for a period of two years all of his income

debtor was providing money to assist his children in excess of his legal obligation of support); *In re* Breckenridge, 12 Bankr. 159 (Bankr. S.D. Ohio 1980) (chapter 13 plan was not proposed in good faith where plan calls for lower payments to creditors to enable debtor to pay church title); *In re* Townsend [1978–81 Transfer Binder] BANKR. L. REP. (CCH) ¶67,140 (Bankr. E.D. Pa. 1978) (debtor must reduce charitable contributions before chapter 13 plan will be confirmed).

[145]In discussing the British practice under which discharges are generally granted only if the debtor is unable to pay his debts, Professor Boshkoff notes that cases are very rarely appealed. The same is true for hardship determinations under § 523(a)(8). Boshkoff, *supra* note 139, at 119–120. Moreover, because decisions regarding the appropriate level of expenses turn on the facts of each individual case, decisions of higher tribunals provide only limited guidance for future cases.

[146]11 U.S.C. § 1325(b)(2) as amended by § 317, Pub. L. No. 98–353.

[147]*See generally* SEN. REP. I, *supra* note 62, at 59–60, especially excerpt from Judge Dean Gandy testifying on behalf of the Conference of Bankruptcy Judges.

[148]As one court noted in connection with § 523(a)(8): "It is also regrettable that so much is therefore left to the individual view of each judge who, after all, brings a sum of who and what he was, what he has become, and what he sees through his own eyes to this basically disagreeable task." New York State Higher Education Service Corp. v. White, 6 Bankr. 26, 29 (Bankr. S.D.N.Y. 1980).

beyond that necessary for living expenses[149] was killed in committee as a result of vehement opposition.[150]

A further complication is introduced when one considers that the standards for "disposable income" under chapter 13 may differ from what the court is supposed to examine in chapter 7 cases. In determining "substantial abuse," must the court hypothesize what creditors would receive if all disposable income were to be applied to the repayment of debt—which is indeed required under amended section 1325—or are the debtor's decisions regarding expenditures to be taken at face value, at least if they are "reasonable," made in "good faith," or comply with some external standard, whatever that may be? In other words, are the standards relating to the definition of "disposable income" and those to be applied in assessing "substantial abuse" identical or does the "substantial abuse" standard afford the debtor greater discretion in determining the allocation of his resources than would be the case were he to seek relief under chapter 13? It is arguable that, although a debtor filing under chapter 13 must surrender all of his disposable income to make payments under the plan, a debtor should be entitled to invoke chapter 7 relief to shield his disposable income even for certain classes of nonnecessitous items without being guilty of abusing the process. Thus, to take one example, while income "necessary" for music lessons would probably be regarded as disposable under section 1325's definition, retaining the ability to continue paying for such lessons may be a legitimate nonfraudulent consideration favoring the choice of chapter 7 relief. The "substantial abuse" test may not have been intended to foreclose

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[149]Boshkoff, *supra* note 139, at 112–113. Actually, the 1932 proposal was a bit more complicated. Under the creditors' proposal, the debtor would receive an immediate discharge if creditors received at least fifty cents on the dollar or the debtor could show that bankruptcy was caused by circumstances for which he could not justly be held responsible. Only if neither showing could be made would the debtor have to remit his disposable income for the two year period. *See* UNIFORM SYSTEM OF BANKRUPTCY: JOINT HEARINGS ON S. 3866 BEFORE SUBCOMMS. OF HOUSE AND SENATE COMMS. ON THE JUDICIARY 72nd Cong., 1st Sess. 100–101 (1932) [1932 JOINT HEARINGS].

Interestingly enough, unlike present law, the 1932 proposal did not mandate dismissal on the basis of *anticipated future income*, but rather on the size of the chapter 7 dividend or on the circumstances which precipitated the bankruptcy. Thus, if creditors received a 50% dividend in liquidation, an immediate discharge would be granted notwithstanding the fact that they could receive a significantly higher dividend or even payment in full out of the debtor's future income. Present law does not explicitly condition dismissal on the size of the chapter 7 dividend though presumably that could be a relevant factor. Conversely, if the 50% dividend level is not met (and the debtor is responsible for his financial decline), all of the debtor's disposable income must be remitted to creditors *even though the amount of debt thereby discharged is insubstantial*, *e.g.*, 20%. While the focus of the two schemes is totally disparate, both necessitate a determination of disposable income.

[150]Among other things, the proposal was castigated as "absolutely out of step with our conception of liberty" and "shocking." Statement of M. Feibelman, 1932 JOINT HEARINGS at 546–547, quoted in Boshkoff, *supra* note 139, at 113, n. 169. As Professor Countryman noted, to his knowledge this was the only proposed bankruptcy legislation to be characterized by witnesses as un-American. *See* testimony of V. Countryman, quoted in SEN. REP. I, *supra* note 62, at 57.

that alternative (though S. 2000 probably did).

If in fact the standards are not identical, what standard going beyond bare necessity is the court supposed to apply?[151] Obviously, the court cannot respect all of the debtor's expenditure decisions since such deference would almost certainly obliterate the possibility of ever finding abuse.[152] A divergence of standards, with no statutory guidance as to how they differ, compounds the confusion already inherent in having a court decide how well a debtor should legitimately live.[153]

Finally, the issues of disposable income and substantial abuse will impose severe burdens on an already overburdened bankruptcy court. It would require an extensive and detailed examination of the budget of every debtor seeking relief under either chapter 7 or 13. It is somewhat disingenuous to speak about "adjustment periods" and some provisional uncertainty in the application of standards.[154]

(Continued in Winter Issue)

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[151]Of course, even with respect to chapter 13, it is not entirely clear that a debtor would be compelled to live at a subsistence level. However parsimonious § 1325 is, it does not necessarily follow that a debtor refusing to make those sacrifices is abusing the provisions of chapter 7.

[152]Possibilities include a "good faith" standard similar to that applied in chapter 13 cases under the Code, *see supra* note 59; objective reasonableness (relative to what?); or most generously, limiting the debtor and his family to the standard to which they are accustomed.

[153]If one accepts the above argument, a debtor would be permitted to seek relief under chapter 7 although were the case to be dismissed and the debtor were to file under chapter 13, a substantial percentage or dollar amount of such debtor's debts would be paid off in the plan. Thus, the availability of a significantly higher chapter 13 dividend does not necessarily render the use of chapter 7 abusive. A further example, and one that is implicit in the statutory scheme, is the case of an individual whose debts are not primarily of a consumer nature. If such an individual files under chapter 13, § 1325 requires the utilization of all his disposable income. If, on the other hand, such an individual files under chapter 7, he will be allowed to proceed notwithstanding the amount of his disposable income and the percentage of debt that would be paid were he compelled to seek relief under chapter 13. This is so because the "substantial abuse" test applies only to "individuals whose debts are primarily consumer debts." *See infra* text accompanying notes 257–269.

While § 707(b) dismissal is apparently designed to indirectly coerce the debtor to elect chapter 13 relief where such relief would be of significant benefit to creditors, the linkage is imperfect. As already noted, the availability of chapter 13 relief does not necessarily mean that chapter 7 will be dismissed even where the disposable income is substantial and the converse is true as well. A chapter 7 case may be dismissed on the grounds of "substantial abuse" even where the debtor is not eligible for chapter 13 relief. See *infra* text accompanying notes 197–208.

[154]Sen. Rep. I, *supra* note 62, at 37:

> There will undoubtedly be an adjustment period for the courts during which the integration of the new principles set forth in this section will cause some uncertainty in eligibility determinations for individual debtors. Experience with other provisions of the Code indicates, however, that the responsibilities placed upon the courts . . . can and will be successfully assimilated.

Indeed, the Report argues that denial of access to chapter 7 may actually have the effect of *reducing* litigation on such issues as redemptions, dischargeability, and reaffirmations which arises out of creditors' attempts to reach future income. *Id.*, at 37–38.