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

by

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SECOND INSTALLMENT***

3. How Much Debt Over How Much Time?

The foregoing issues regarding prediction of future income and determination of proper expenditures arise in any case filed under chapter 13 as well as chapter 7 though the standards the court uses may be different in the two cases. In a chapter 7, however, there is one additional issue that remains to be decided: What percentage or amount of debt must be payable over how long a period of time before resort to a chapter 7 constitutes “substantial abuse”? S. 2000 required that a “reasonable portion of debts,” i.e., substantial percentage, be payable over a three to five year period.155 The legislative history indicated that “reasonable” in this context clearly meant 75% and could include lesser percentages.156 It is not clear what particular percentage is required under a “substantial abuse” test although there is some suggestion that the requisite percentage could even be higher.157 (How much higher?) A number of possibilities present themselves (assuming calculation of annual disposable income equals net after tax income reduced by necessary support expenditures): (1) ability to formulate a successful chapter 13 that would yield more than a chapter 7 liquidation; (2) ability to

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156See supra text accompanying notes 110–114.
pay off a reasonable percentage of debt (however defined) either in a chapter 13 plan or outside of it over a given period of time (three to five years); (3) ability to pay off a specified dollar amount of debt either in a chapter 13 plan or outside of it over a specified period of time; (4) ability to pay all debts as they become due.\textsuperscript{158}

A reading of section 707(b) that would foreclose chapter 7 relief whenever a successful chapter 13 plan could be confirmed would in effect destroy the availability of chapter 7 relief for a large majority of consumers and would be considerably more restrictive than its predecessors. Rather than give the debtor the choice of two options—immediate liquidation or periodic debt repayment—such a construction would effectively condition bankruptcy relief on the debtor's choosing the highest return for creditors, \textit{i.e.}, a debtor could not choose chapter 7 if 13 is higher and section 1325 already provides the converse through its "best interests of the creditors" test.\textsuperscript{159} It must be recalled that chapter 13 does not require that any minimal percentage of debt be repaid. At least with respect to unsecured creditors, section 1325 merely requires that section 507 priorities be paid in full over the life of the plan and that other unsecured creditors receive at least as much as they would have received in a chapter 7 (which in most cases is nothing).\textsuperscript{160} While section 1325 as amended does require that all of the debtor's disposable income for the three years following first payment be devoted to the plan,\textsuperscript{161} if this income is little or nothing, the plan may nevertheless be confirmed.\textsuperscript{162} Thus virtually all debtors are capable of formulating some chapter 13 plan and if they have any disposable income at all, such plan will generate a higher return than a typical chapter 7. In light of the legislative history indicating that the "substantial abuse" test was designed to afford debtors more leeway in choosing their form of relief than the predecessor test embodied in S. 2000,\textsuperscript{163} such an interpretation is unlikely.

At the other extreme, denying chapter 7 relief only to those debtors who could pay their debts as they become due would afford creditors little or no protection from the types of abuses Congress was interested in curb-

\textsuperscript{158}As noted infra text accompanying notes 222–231, factors focusing on past misconduct such as willful default on obligations or incidence of unnecessary debt may be relevant in determining "substantial abuse" but it is unlikely that these were the abuses Congress intended to curb.

\textsuperscript{159}See supra text accompanying notes 41–42.

\textsuperscript{160}11 U.S.C. § 1325(b).

\textsuperscript{161}"This is apparently true notwithstanding chapter 13's requirement that the debtor's income be "regular" since that requirement itself is defined in terms of ability to meet plan payments. See 11 U.S.C. § 101(24). Moreover, provided the plan meets the other requirements of § 1325, it need not be longer than 3 years. Cf. S. 2000, S. 445 (plan must be five years unless reasonable portion of debt can be paid in less time).

\textsuperscript{162}Sen. Rep. II, supra note 63, at 2 and 90.
ing. The initial impetus for limiting access to chapter 7 was the two-volume Purdue Study. 164 That study found that while a sizeable minority of chapter 7 debtors could repay their debts in full over three–five years and an even larger group could pay at least 75%165, the study did not suggest that debtors could do so without the ability to convert short-term debt into longer-term obligations. One suspects that persons who can pay obligations in full as they become due seldom file for bankruptcy. Accordingly, while such ability would almost certainly constitute an example of “substantial abuse,” those whose repayment ability falls below this standard should also qualify.

With ability to formulate a chapter 13 plan as too broad a test and ability to pay debts as they become due a too expansive one and eliminating past debtor misconduct as a probable basis for dismissal,166 we are left with a standard for “substantial abuse” essentially identical to that embodied in S. 2000.

The test of “substantial abuse” therefore appears to rest on the debtor’s ability to pay off some portion of his debts over some indeterminate period of time. But how much of his debt over how long a period? As noted earlier,167 the legislative history to S. 2000 indicates that dismissal is warranted only if a “substantial” percentage of debt—75% or more—could be paid over a three–five year period through a deferred payment plan. This, however, skirts several questions: (1) Should the focus of section 707 be on the percentage of debt payable out of future income as was the case under S. 2000 or the absolute dollar amount? (2) Why should a three–five year period be the relevant time-frame? (3) What if a substantial percentage of debt could not be paid over three years but only over five? (4) If the 75% ceiling is not a statutory minimum, and it is clearly not, how is the court to decide what degree of payment ability deprives the debtor of his access to chapter 7?

Should “substantial abuse” be based on the percentage of debt or the absolute dollar amount that would have been available to creditors relative to the dollar amount that would have been distributed under chapter 7? Consider the following two examples. Debtor A has $50,000 of disposable income (however defined) over the requisite three–five year period but $200,000 of debt. Since only 25% of his debt could be paid out of future income, the percentage is not substantial. Under S. 2000, since a “substantial percentage” of his debt could not be paid out of anticipated future income, the chapter 7 case would not have been dismissed.168 Debtor B has only

164 Supra note 13 and text accompanying notes 91–95.
165 See supra text accompanying notes 91–95.
166 See infra text accompanying notes 222–231.
167 Supra text accompanying notes 110–114.
168 This assumes, of course, that S. 2000 operated with a concept of disposable income, an assumption unclear from the statute but supported by the legislative history, see supra text accompanying notes 110–114.
$4,000 of disposable income but $5,000 of debts. Because his future income
could pay 80% of his obligations, under the “substantial percentage” test of
S. 2000 the chapter 7 should be dismissed. What result under present law?
One could argue that it is greater abuse to allow a debtor to shield $50,000
of income that by hypothesis is surplus than to protect only $4,000. For pur-
poses of determining whether the debtor is abusing the system, perhaps the
appropriate focus should be on how much the debtor is gaining, how much
income he is attempting to immunize from the claims of his creditors through
the filing of a chapter 7, rather than on what percentage of debt would be
paid off were that income distributed. A percentage test tends to discrimi-
nate against lower income debtors with little disposable income but whose
depts are not greatly in excess of that income.169 In point of fact, however,
because the margin of disposable income is so small and could easily be
eliminated by some increase in necessary expenses over the course of three
years, resort to chapter 7 is actually more justifiable than it is in cases where
the debtor clearly has income far in excess of his anticipated support needs
though that income could pay only a relatively small percentage of his debts.

While a dollar amount test (how much?) has considerable theoretical
merit, on balance it appears that percentage of debt would probably be the
predominant factor the court examines. Two reasons dictate this result.
First, S. 2000, the original reform proposal, clearly embodied a percentage
test170 and when S. 445 eliminated this test to condition dismissal on
“substantial abuse,” there is no intimation in the legislative history that the
court’s focus was to be significantly altered. In other words, while the
“substantial abuse” test was intended to be less rigorous than the mechanica-
“anticipated future income” standard of S. 2000 and would therefore
tend to be more deferential with respect to the debtor’s choice of relief,171 in
the absence of any indication in the statute or legislative history to the con-
trary presumably the court is still expected to evaluate the same underlying
data as it would have done under S. 2000, i.e., percentage of debt that future
income could pay.

Second, the purpose of dismissal is not punitive. Dismissal is for the
benefit of creditors and is warranted only where, as a result of the dismissal,
creditors will realize a significant gain. The extent to which creditors benefit
from dismissal can be determined only by reference to the percentage of

169See Ginsberg I, supra note 12, at 10–11, n.44.
171See, for example, supra text accompanying notes 150–153. (It is arguable that under § 707(b) debt-
or would be permitted to shield even income unnecessary for basic support although such income is
“disposable” within the meaning of § 1325 and would have to be distributed to creditors were the debtor
to seek relief under chapter 13.)
debt—the ratio of disposable income to total indebtedness—that would be paid and not by the dollar amount the debtor would have to surrender. If the basis of dismissal lies in the magnitude of creditor losses rather than the size of the debtor’s gain, a percentage test is clearly the more appropriate factor to consider.\footnote{In an economic sense, the loss of a $50,000 payment on a $1,000,000 debt is of considerably less significance to a creditor than the loss of a $3,000 payment on a $4,000 debt. See also infra note 206 (is the applicable percentage of debt measured by the dividend each creditor would receive in a chapter 13 or by what percentage of debt in the aggregate would be paid off?).}

This analysis, however, does not preclude an intermediate approach. While it may be true that no chapter 7 case should ever be dismissed unless the debtor’s surplus or disposable income is sufficient to pay a substantial percentage (however defined) of creditors’ claims, the ability to do so should not by itself necessarily warrant dismissal. The amount of income regarded as disposable that the debtor is attempting to shield through the use of a chapter 7 should be a relevant factor—which it was not under S. 2000—in determining whether the debtor’s use of chapter 7 is abusive. In the first place, the smaller the amount of projected disposable income, the more likely it is that the income as earned will in fact be nondisposable and necessary for support due to inflation, emergencies, or miscalculations on the part of the court. Moreover, while the “disposable income” test of chapter 13 may indeed compel the court to determine the debtor’s support needs down to the last dollar, a standard which conditions dismissal on “abuse” should afford the debtor considerably more leeway both with respect to what items are considered necessary expenses and the amount of money to be devoted to those items. Thus, if the total amount of the debtor’s disposable income is slight, a debtor may well be justified in choosing chapter 7 relief in lieu of having to propose a debt repayment plan that would leave him with little or no excess cushion. Conversely, if the “cushion” itself is overly generous, i.e., clearly in excess of what the debtor needs for family support, it may well be improper to shield it through the utilization of a “no asset” liquidation.

In sum, dismissal of the chapter 7 is proper (1) only if creditors could receive a substantial percentage of their debts out of that portion of debtor’s future income that is unnecessary to meet the debtor’s living expenses with due regard for the particular needs of the debtor but (2) only to the extent that the amount of such income is clearly excessive in relation to those anticipated expenses bearing in mind the debtor’s need for a cushion and potential inaccuracies in forecasting. Thus, while dollar amount is not dispositive, the debtor with $50,000 of disposable income is more likely to be guilty of abusive use of chapter 7 than the debtor with only $5,000
although the percentage of debt that could be repaid is identical in both cases, or indeed greater in the latter.\textsuperscript{173}

4. The Appropriate Time Frame for Assessing Repayment Ability
   a. Length of Chapter 13 Plan

   Under section 1325, as amended, as long as priority claims can be paid in full and other unsecured claimants receive as much as they would under chapter 7, a debtor cannot be compelled to propose a five-year plan even if under a three-year plan a substantial percentage of debt could not be paid off.\textsuperscript{174} In other words, as long as all disposable income is devoted to making payments under the plan for three years, a nonpriority unsecured creditor has no right to demand that a particular percentage of his debt be paid off. The redefinition of chapter 13 confirmation standards has a direct impact on what period the court should choose for determining “substantial abuse.”

   Assume, for example, that a debtor could pay a substantial portion of his debt over five years,\textsuperscript{175} but over three years the percentage or dollar amount would be insubstantial. If the court hypothesizes a five-year repayment period, it will then dismiss the chapter 7 case on the grounds of “substantial abuse.” Such dismissal, however, will not necessarily result in creditors receiving a reasonable portion of their claims. Once chapter 7 is dismissed, the debtor may elect to file under chapter 13 (which after all does not require that a “reasonable portion of debt” be paid) and propose a three-year plan. Is dismissal on the basis of some alleged ability to pay justified where after dismissal creditors cannot guarantee recovery to the extent of that ability? Unless one takes the position that the ability to pay more of his debt

\textsuperscript{173} It bears repeating that the deference the court should show to the debtor’s choice of relief manifests itself in two separate respects: (1) in initially determining that items are “necessary” for support, e.g., music lessons, vacations, etc. with only the income in excess of those items regarded as disposable, see supra text accompanying notes 136–134; (2) even after excess income is determined, in allowing the debtor to proceed under chapter 7 to the extent that any excess cushion is not unreasonable. Perhaps a simpler way of describing the process would be to say that in determining the debtor’s expenses over the relevant payment period, the court should factor in a reasonable cushion for emergency needs, thereby reducing the amount of disposable income available for the repayment of debts. Cf., supra text accompanying notes 93–94. (In Purdue Study, expenses were inflated by 20% to account of emergency needs.)

\textsuperscript{174} In any case, where the debtor seeks relief under chapter 13, it is arguable that the court will not defer to the debtor in either of these respects. The debtor’s conviction as to what items are “necessities” will not necessarily be accorded any great weight nor is the debtor guaranteed an excess equity cushion. In the event unanticipated needs do arise, the debtor could always petition for dismissal, modification, or conversion. See 11 U.S.C. § 1307 and infra text accompanying notes 211–221.

\textsuperscript{175} See supra text accompanying notes 101–102. This is to be contrasted with the earlier approach of S. 2000 and S. 445 which mandated five year plans whenever a “reasonable portion” of allowed unsecured claims would not be paid over a lesser duration.

\textsuperscript{177} See supra text accompanying notes 168–172 whether this refers to dollar amount or percentage. Also, see supra text accompanying notes 132–135, regarding what income the court is to take into account.
under chapter 13 than under chapter 7 in and of itself constitutes an abuse of the provisions of chapter 7 without regard to the amount or percentage of debt that would be paid—a position that appears to be overly restrictive of the debtor's choice of remedies—dismissal on the basis of a five-year repayment schedule which the debtor could not be compelled to follow would appear to be unwarranted. The existence of "substantial abuse" must be calculated by reference to how much creditors would receive were the debtor to file the minimal plan under chapter 13 that he could get confirmed.

If, on the other hand, the debtor would have to propose a five-year plan because, for example, priority claims could not be paid in full over a shorter period, the matter becomes somewhat more complicated. Given the fact that upon dismissal of the chapter 7, the debtor's only bankruptcy option would be the filing of a five-year plan, at first blush it would appear that the hypothetical return to creditors upon which the decision to dismiss is predicated be measured on a five-year, rather than a three-year basis—a result consistent with earlier versions of the law.

This alone, however, does not fully answer the question. While it is true that the debtor may have sufficient disposable income to pay his debts over five years and it is also true that any chapter 13 plan the debtor proposes would have to have a duration of five years, it does not necessarily follow that completion of the chapter 13 would retire a substantial percentage of this debt. Section 1325 as amended does not require that the debtor utilize all of his disposable income for the fourth and fifth years in the event a plan longer than three years becomes necessary. Confirmation will merely depend on the plan being proposed in "good faith" which, under the Code, permitted minimal or even zero payment plans. Thus, in terms of what a debtor must make available to his unsecured creditors under chapter 13, there is essentially no difference between a three-year and a five-year plan. In both cases, creditors' absolute entitlement is limited to the debtor's

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176 See supra text accompanying notes 158–163.

177 Under prior versions of the bill, the use of a five year period was more appropriate. Assuming the same example, if a reasonable portion, which in the case of S. 2000 was clearly defined to mean a "substantial percentage," i.e., 75% or more, of debt could not be paid over three years but could over five years, S. 2000 and S. 445 would both require that a plan be proposed over 5 years. See supra note 184. While the five year plan itself would not necessarily mean that a reasonable percentage of debts would be paid off (since the ability to do hypotheses that all disposable income be devoted to the plan but § 1325 in its earlier version merely required a bona fide effort), one can at least make the argument that the bona fide effort test is substantially the same as requiring the use of all disposable income. Linking "substantial abuse" to a five year plan under the present law, however, is inconsistent with the statutory scheme.

178 Specifically, S. 2000 which always hypothesized creditors' return over a five year period. See supra text accompanying notes 110–114.

179 See supra note 59.
disposable income over the first thirty-six months of the plan period along with whatever indeterminate excess is necessitated by a nebulous “good faith” standard. Because it is impossible for a court to calculate exactly what surplus these unsecured creditors would receive under a five-year chapter 13 and hence, impossible to gauge the full extent of their loss through the debtor’s filing of a chapter 7, the use of a hypothetical three-year plan may well be the appropriate measure of comparative creditor benefit even where an extended plan would have been necessary to pay priority or secured claims in full.

This point could perhaps best be illustrated through the use of actual numbers. Assume a debtor is earning $100,000 annually, $30,000 of which is “disposable,” however defined. He owes $122,000 in back taxes entitled to sixth priority treatment under section 507 and general unsecured obligations of $40,000. His disposable income over three years is $90,000 and over five years, $150,000. He could not propose a three or four year plan since that would not result in the tax claim being paid in full. Were this debtor to seek relief under chapter 13, he would, therefore, have to propose a plan having a duration in excess of 48 months, e.g., five year plan. Over five years, were all of the debtor’s disposable income applied to plan payments, not only would the tax claims be paid in full but there would be $28,000 left over for unsecured claimants giving them a 70% dividend. Nevertheless, since the debtor under section 1325 would have no obligation to use this $28,000 to pay off his unsecured creditors, this figure should not be taken into account in determining whether the use of chapter 7 is improper. Indeed, on the facts given, the debtor could simply have proposed a forty-eight month plan with unsecured creditors getting nothing at all, provided that the “best interests of the creditors” test was met.\textsuperscript{180}

Accordingly, unless unsecured creditors would have received a substantial percentage of their debt out of the debtor’s disposable income for the first three years of a plan, the chapter 7 case should not be dismissed irrespective of what they could have received were the debtor to remit his disposable income for a longer period and even if a plan of longer duration would in fact have to be proposed.\textsuperscript{181}

b. Creditors’ Rights Under Nonbankruptcy Law

Chapter 13 itself is not compulsory\textsuperscript{182} and indeed, a mandatory chapter

\textsuperscript{180}See supra text accompanying notes 41–42.

\textsuperscript{181}Of course, the priority claimant who would have been paid in full over a five year plan should have some remedy against the debtor’s resort to a chapter 7 but dismissal of the case simply for the benefit of an isolated class of creditor is too draconian a remedy. See infra text accompanying notes 210–215 for a suggested approach.

A similar problem arises where the debtor could propose a three year plan but his income, although sufficient to pay a substantial percentage of his total debt were it distributed \textit{pro rata}, would result only in a small dividend to unsecured creditors because of the superior rights of priority claimants. In such instance dismissal of the chapter 7 would be improper. \textit{Id}.

\textsuperscript{182}11 U.S.C. § 305(a) and supra text accompanying note 34.
13 could run afoul of the 13th Amendment prohibition against involuntary servitude unless the debtor retained the option to dismiss or convert.\textsuperscript{183} Even if a chapter 7 case is dismissed on the grounds of "substantial abuse," there is nothing in the Code that compels the debtor to elect chapter 13 relief. If the debtor does not, then the ability of creditors to reach future income depends on the non-bankruptcy law of wage garnishments. In a number of states, wages are not subject to garnishment at all;\textsuperscript{184} in other states, only a small percentage can be garnished at the source.\textsuperscript{185} Indeed, under Title III of the Consumer Credit Protection Act\textsuperscript{186} binding on the states unless preempted by a substantially similar or more protective statutory scheme,\textsuperscript{187} no more than 25% of after-tax wages can ever be garnished regardless of the

\textsuperscript{183}Though no court has squarely addressed the issue, a number of commentators have suggested that a mandatory wage-earner plan through which an individual's earnings in excess of his support needs would be remitted to creditors is violative of the 13th Amendment. See H.R. Rep. No. 595, supra note 129, at 120; Countryman, quoted at fn. Rep. I, supra note 62, at 59; Ginsberg I, supra note 12, at 14. It has also been suggested that as long as the debtor retains the unqualified right to dismiss the chapter 13 case, that alone would remove the stigma of servitude. Ginsberg I, supra note 12, at 64–65 note 256. In any case, it is not entirely clear why a compulsory chapter 13 should be any more offensive, from a constitutional standpoint, than any wage garnishment.

\textsuperscript{184}This is the case, for example, in Pennsylvania, 42 Pa. Cons. Stat. Ann. § 886; South Carolina, S.C. Code § 37–5–104: and Texas, Tex. Const. art. 16, § 28. Note, however, that garnishment restrictions are applicable only to income being withheld at the source. Once the debtor collects the income, it is reachable by creditors subject only to general exemption laws.


15 U.S.C. § 1675:

The Secretary of Labor may by regulation exempt from the [garnishment] provisions . . . garnishments issued under the laws of any state if he determines that the laws of that State provide restrictions on garnishment which are substantially similar to those provided [under federal law].

See also 15 U.S.C. § 1677:

This title does not annul, alter, or affect, or exempt any person from complying with, the laws of any State

(1) prohibiting garnishments or providing for more limited garnishments than allowed under this title, or

(2) prohibiting the discharge of any employee by reason of the fact that his earnings have been subjected to garnishment for more than one indebtedness.
amount of disposable income.\textsuperscript{188} While Title III by its own terms does not apply to chapter 13 cases,\textsuperscript{189} it is certainly applicable where the debtor does not elect chapter 13 relief.

Thus, the fact that the debtor’s disposable income is sufficient to pay a substantial percentage or amount of his debts and the fact that the debtor would have to use this income and pay off these debts were he to seek relief under chapter 13 do not necessarily mean that these debts will be paid if, under nonbankruptcy garnishment restrictions, there is little or nothing that creditors can reach. Query whether dismissal of a chapter 7 on the grounds of debt repayment ability is justifiable if, in the final analysis, creditors are unable to realize on that ability anyway. It seems that the relevant inquiry should be not what this debtor would have to pay under a chapter 13 plan but what would the debtor have to pay under the most favorable option he would be able to elect if the chapter 7 were dismissed. This would require the court to examine nonbankruptcy as well as bankruptcy alternatives. A “disposable income” test does not accurately mirror the range of alternatives open to the debtor and since nothing in the statute limits these alternatives, there may at first blush be little point in denying the debtor access to chapter 7.

\textsuperscript{188}Actually, 15 U.S.C. § 1673 provides that the maximum amount of wages that could be garnished weekly is the lesser of 25% or the excess of thirty times the hourly minimum wage. Since the minimum hourly wage is currently $3.35 an hour, see 24 U.S.C. § 206, the first $100.50 of the debtor’s salary is totally exempt. But see supra note 189 (funds may be reached once they are received by the debtor and deposited in his bank account). The excess over that amount is garnishable until the excess exceeds 25% of the whole. The garnishable amounts are increased for alimony and child support claims. See § 1673(b) (50%–65% of weekly wages may be garnishable depending on whether the debtor has dependents other than the person to whom the debt is owed and whether the support debt is more than twelve-weeks overdue).

Section 1674 also provides that no employer may discharge an employee “by reason of the fact that his earnings have been subjected to garnishment for any one indebtedness.” This protection is somewhat limited since it does not prohibit discharge in the event of multiple garnishments by more than one creditor. (See § 1677, however, which explicitly recognizes the authority of state law to prescribe the latter and a number of states have done so.) Moreover, § 1674 does not expressly give a discharged employee a private remedy providing only for the imposition of a $1,000 fine. Courts are divided whether a private remedy should be implied. Compare Stewart v. Travelers Corp., 503 F.2d 108 (9th Cir. 1974) (private right of action for wrongful dismissal recognized) with Smith v. Cotton Brothers Baking Co., Inc., 609 F.2d 738 (5th Cir. 1980) (no private right of action).

\textsuperscript{189}15 U.S.C. § 1673(b):

(1) The restrictions of subsection (a) do not apply in the case of .

(b) any order of any court of the United States having jurisdiction over cases under chapter 13 of title 11 of the United States Code;

. . .

Interestingly enough, a number of courts have concluded that Title III is equally inapplicable to chapter 7 cases, i.e., prepetition wages due and owing which under § 541 are property of the estate are to be distributed to creditors without regard to Title III subject only to the state or federal exemptions the debtor elects under § 522.
For a variety of reasons, however, the author finds this interpretation implausible and unworkable. First, the legislative history to S. 2000 clearly indicated that the court's sole concern should be the percentage of debt that could be repaid under a chapter 13 plan, not subject to Title III garnishment restrictions.\textsuperscript{190} (Otherwise, there is no particular relevance to the three to five year period.)\textsuperscript{191} Second, requiring the court to consider nonbankruptcy alternatives would introduce considerable additional complexity into the "substantial abuse" calculus necessitating an examination of the particular exemption laws of individual jurisdictions and the percentage or dollar amount of debt that would be paid through application of these laws (over how long a period?) as compared to the percentage or dollar amount that would be paid under a chapter 13 plan.

Third, state and federal restrictions on wage garnishment do not accurately indicate the amount of future income available for creditors' claims and in theory impose no limitations on the availability of such income. These restrictions do nothing more than prohibit compulsory withholding at the source; in theory, once funds are received by the debtor or deposited in his bank account, creditors may reach those funds in full subject only to whatever general cash exemption the state provides.\textsuperscript{192} (Indeed, these funds are reachable without regard to whether they are disposable income.) One cannot extrapolate the percentage or amount of debt that can be repaid from the percentage of income that can be garnished.

Moreover, although in theory a chapter 7 dismissal does not inevitably lead to a conversion to chapter 13, as a practical matter such conversion is likely to follow.\textsuperscript{193} Chapter 13 has enough built-in incentives—the automatic stay, retention of assets, and discharge\textsuperscript{194}—that any debtor

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\textsuperscript{190} See, e.g., Usey v. First National Bank, 586 F.2d 107 (9th Cir. 1978); Dunlop v. First National Bank, 399 F. Supp. 855 (D. Ariz. 1975); Miller v. Monreaux, 507 P.2d 771 (Alaska 1973). These cases have been criticized for erroneously interpreting the Supreme Court's opinion in Kokoszka v. Belford, 417 U.S. 642 (1974), which merely held that an income tax refund was not covered by Title III and hence would be payable to the trustee in a chapter 7 case in excess of Title III's ceiling. See Vukович, Debtors' Exemption Rights Under the Bankruptcy Reform Act, 58 N.C.L. Rev. 769, 791–792, notes 89–93.

\textsuperscript{191} See supra text accompanying note 189.

\textsuperscript{192} Actually, this particular line of reasoning is not conclusive. Since "substantial abuse" must be determined only by comparative reference to all of the debtor's alternatives, a repayment period in excess of 3–5 years could never be taken into account simply because a debtor could never be compelled to utilize a longer period. (He could file a chapter 13.) By the same token, however, since a debtor need not file a chapter 13, its requirement that all disposable income be applied to repayment of debts should not be the baseline against which a chapter 7 is deemed to be "substantial abuse." But see infra text accompanying notes 193–195 and note 207.

\textsuperscript{193} See supra note 184.

\textsuperscript{194} The term "conversion" is used here in a nontechnical sense. Whether the chapter 13 case is deemed a conversion or a new filing is a difficult and important question. See infra text accompanying notes 211–221.

\textsuperscript{195} See supra text accompanying notes 40–42.
denied access to chapter 7 would probably opt for chapter 13 in lieu of remaining subject to the vagaries of local collection law, the specter of harassing lawsuits and the like. Consequently, if a debtor does have the ability to pay a substantial percentage of debt out of future disposable income, dismissal of the chapter 7 is an indirect way of forcing him to do so de facto if not de jure.

Finally, focusing on the supposed ability of the debtor to shield much of his disposable income through the utilization of state and federal garnishment limitations ignores the crucial fact that under nonbankruptcy law debtors do not receive a discharge. Ultimately, regardless of how long it may take, creditors are legally entitled to collect 100% of their debt subject only to their own fortitude and perseverance. The evil that Congress sought to eliminate was the obtaining of a discharge by debtors who are able to repay a substantial portion of their debts out of future disposable income but fail to do so. Congress essentially made a policy judgment that where such ability exists, the extraordinary remedy of discharge should be conditioned on its utilization. Allowing dismissal of chapter 7 cases on the grounds of "substantial abuse" insures that this particular abuse will not occur. The debtor may indeed avoid the utilization of all his disposable income for debt repayment by remaining outside of the bankruptcy system but he may do so only at the cost of not obtaining a discharge. The availability of this alternative does not negate the fact that, under chapter 7, not only could the debtor shield his income but he could also get a discharge.

To summarize: a court determining the existence of "substantial abuse" should consider only the percentage or dollar amount of debt that would be paid under a three year chapter 13 plan (not five years) and not what would be payable were the debtor to invoke nonbankruptcy law. [That would always be 100% since with reference to nonbankruptcy law, the 3–5 year period has no particular relevance. Eventually, creditors can indeed receive payment in full.] The concept of chapter 13 is that a debtor should not be in servitude or bondage for more than a relatively short period of time before obtaining a discharge. Therefore, debt repayment ability beyond the compulsory duration of a chapter 13 plan should be ignored because: (1) It makes little sense to dismiss chapter 7 cases on the basis of debt repayment ability over, e.g., a period of ten years if, after dismissal, the debtor can file a chapter 13 plan and make payments for only three years. The abuse, if it is deemed to exist, is not cured by the dismissal. (2) As a matter of policy, chapter 7 relief can hardly be regarded as abusive merely because the debtor

\footnote{As noted earlier, this should probably be true even if the debtor were unable to get a three year plan confirmed due to an inability to pay priority or secured claims in full. See supra text and accompanying notes 178–181.}
did not choose to repay his debts over a prolonged period of time. As the structure of chapter 13 suggests, the debtor need not elect perpetual bondage as a condition to his receiving a discharge.

Conversely, however, debt repayment ability within the three year period should be measured by reference to all of the debtor's disposable income (just as would be the case were the debtor to file a chapter 13 plan) and not just by the amount of income that would be paid out were the debtor able to take advantage of garnishment limitations. The ability of the debtor to shield income through nonbankruptcy law does not cure the chapter 7 proceeding of its essentially abusive nature since under chapter 7 the debtor receives a discharge.

5. Dismissal of Chapter 7 Where Debtors are Ineligible for Chapter 13

Not all individuals are able to file for chapter 13 relief. In the first place, the individual must have "regular, stable" income (though he need not be a wage earner as was the case under Chapter XIII of old Bankruptcy Act). Second, his noncontingent debts must be less than $350,000 secured and $100,000 unsecured. Third, while section 1325 as amended does not require any minimal dividend to creditors as long as all of the debtor's disposable income for three years is applied to plan payments, two categories of creditors must be paid in full over the life of the plan: A) priority claimants under section 507, e.g., tax claims, wages—in case of consumers, tax claims are the most likely priority; B) creditors having a

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196 But see discussion supra text following note 150 whether the standards for measuring "substantial abuse" and "disposable income" are identical.

197 11 U.S.C. § 109(e): "Only an individual with regular income... may be a debtor under chapter 13 of this title."

198 11 U.S.C. § 101(24): "Individual with regular income means individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title, other than a stockbroker or a commodity broker." See supra note 40 and note 162.

199 Chapter XIII wage earner plans were first introduced in 1938. See Act of June 22, 1938, ch. 575 § 622 et. seq., 52 Stat. 883 (repealed 1979). Like the present chapter 13, Chapter XIII was a voluntary proceeding; unlike the Code approach, the plan required creditor acceptance and could be proposed only by persons whose principal income was derived from wages. Under 11 U.S.C. § 1325, creditor acceptance is not required and under 11 U.S.C. § 109(e), even self-employed individuals may file if their income is "regular." See generally Boshkoff, supra note 139, at 112–115. Concerning what constitutes "regular" income, see supra note 40 and note 162 (if "zero payments" plans are acceptable and income is deemed "regular" if it is sufficient to meet payments under the plan, would that not permit chapter 13 filings even by persons who have no income at all?).

200 Other than the relatively meaningless "best interests of the creditors" test. See supra text accompanying notes 41–42.

secured claim to the extent of the value of their interest in the collateral. 202 If the debtor's disposable income over three years is insufficient to pay these claims in full, the plan must be extended. If even within five years these claims could not be paid in full, no plan can be confirmed.

Assume the following hypothetical: debtor is employed and files for relief under chapter 7. The court finds that debtor could repay a substantial percentage of his debts over a three to five year period, e.g., 70%, but priority tax claims could not be paid in full. Is it a "substantial abuse" to seek chapter 7 relief where the debtor does have substantial debt repayment ability but would be unable to submit a valid chapter 13 plan? The same issue arises in the undoubtedly-rare situation where the individual debtor's liabilities exceed chapter 13 limits. 203

One can argue this case two ways. It could be said that the "substantial abuse" test was not designed to totally foreclose access to bankruptcy but simply to compel debtors to utilize a mode of relief that is more solicitous of creditors' rights. Where that mode is unavailable because of inability to meet statutory requirements, the chapter 7 should be allowed to proceed. 204 The counterargument is that section 707 as amended expresses a policy that debtors should not be allowed to receive a discharge through a no-or nominal asset liquidation whenever they could pay a substantial percentage or amount of their debts out of future income, without regard to the existence of a bankruptcy alternative that would permit them to do so. To hold otherwise would lead to the untenable result that debtors with huge debts could

202 11 U.S.C. § 1325(a)(9). Full payment is not required if the debtor surrenders the property to the secured party. Note, however, that although secured parties are entitled payments equal to the full amount of their allowed secured claim over the life of the plan, the plan may still constitute a significant modification of their rights by superseding or extending their repayment schedule. See 11 U.S.C. § 1322(b)(2) ("The plan may modify the rights of holders of secured claims").

203 In an analysis of S. 2000, Ginsberg points out that the problem may similarly arise if the debtor's income is not sufficiently stable or regular to qualify for chapter 13 relief. Ginsberg I, supra note 12, at 15, n.63. That particular conflict is highly unlikely because to the extent the debtor's income is unstable or irregular, a court will generally be unable to determine that a substantial percentage or amount of debt could be repaid and that the chapter 7 case should therefore be dismissed. There may, however, be rare situations where the debtor will clearly receive sufficient income in the future to pay a substantial portion of his debt but such income may nonetheless be irregular. (Query: does regularity connote periodicity?) Moreover, to the extent the court could assign a probabilistic value to an uncertain future income stream, a court could possibly find the chapter 7 petition to be a "substantial abuse" although by virtue of the uncertainty, the debtor would be ineligible for chapter 13 relief. See supra note 134. These instances are rare. The author would assume that in the vast majority of cases where chapter 7 petitions are dismissed debtors will have regular, stable income and insolvency for chapter 13 will be based either on the debtor's exceeding debt limitations or, more commonly, on his inability to pay priority and secured claims in full over the life of the plan. The analysis in the text will therefore focus on these two instances.

204 See also infra note 207 for an additional reason why the chapter 7 cases of debtors ineligible for chapter 13 not be dismissed (where garnishable income exceeds disposable income).
file under chapter 7 but debtors having fewer debts could not. It would be anomalous to link chapter 7 access to the magnitude of creditor losses, at least where by hypothesis the debt repayment ability is present in both cases.

Let us go one step further in the argument. Assume, for the reason just stated, that a chapter 7 case could indeed be dismissed on grounds of "substantial abuse" notwithstanding the debtor's inability to formulate a chapter 13 plan provided only that a substantial percentage or amount of his debts can be paid out of future income. What would be the period of time relevant in making this determination and what would be the amount of future income considered available? If, for example, the debtor could not pay a substantial percentage of his debt (however defined) over three to five years but could do so over a longer period of time, would that be sufficient grounds to warrant dismissal? The reason it normally is not lies in the fact that, even after dismissal, creditors would have no mechanism for reaching that future income in light of the debtor's ability to propose a chapter 13 plan. (Dismissal therefore serves no purpose.) Where the debtor is unable to file a chapter 13 plan, however, the consequence of dismissal is to place all of the debtor's future income (subject to nonbankruptcy garnishment and exemption laws) at the disposal of creditors. Why then should "substantial abuse" be viewed only by comparison to what creditors would receive under a hypothetical chapter 13 plan which in fact could never be confirmed? By definition, outside of bankruptcy creditors always have a right to receive 100% of their claims though exemption laws as a practical matter may

\[20^a\] Note, however, that under any interpretation of the "substantial abuse" test, this is already largely the case since chapter 7 dismissal is warranted only where the debtor's debts are primarily consumer debts. Debts in excess of $100,000 are not likely to qualify. But see infra note 207-a.

\[20^b\] A related issue arises in the case where the debtor is in fact able to retire a substantial percentage or amount of his debt over a three or five year period but, because of the priority rules of chapter 13, would have been compelled to allocate his funds in such a manner that some creditors receive 100% of their claims and others receive, e.g., 40 or 50%. If dismissal is warranted only because, as a result of dismissal, creditors receive a "substantial dividend," in this case they would not for although the income is there, it would not be allocated pro rata. This is yet another problem stemming from the fact that, although the ostensible purpose of chapter 7 dismissal is to redirect the debtor to seek relief under chapter 13, see Sen. Rep. 1, supra note 62, at 14, 36-37, which in turn supposedly insures that creditors will receive a substantial portion of their claims, the failure to link dismissal either to the eligibility or the distributional requirements of chapter 13 often prevents this goal from being attained.

Note, however, that in the case hypothesized, dismissal would clearly be justified if (1) the focus of the "substantial abuse" test is not on the percentage of debt that could be paid out of future income but rather on the absolute dollar amount the debtor is attempting to shield, see supra text accompanying notes 167-173; or alternatively (2) even if the focus of the test is on percentage (the ratio of payment to debt), percentages are determined by reference to the total debt and not by the dividend that would be received by each individual creditor. As long as, e.g., 70% of the debt could have been paid off under a chapter 13 plan, resort to chapter 7 could arguably constitute an abuse even if under chapter 13, some, or indeed most, creditors receive less than 70% (or whatever figure is deemed to be "substantial").
severely curtail collectability. Arguably then, filing a chapter 7 under circumstances where creditors would be guaranteed the right to collect prior claims in full (with the debtor being unable to limit that right through a chapter 13 plan) is in and of itself "substantial abuse," at least if there is sufficient "disposable income" over an indefinite period of time to pay those claims.\textsuperscript{207} In sum, even if "substantial abuse" is defined as "ability to pay substantial percentage of debt out of future income," see S. 2000, two questions remain unanswered:

(1) Is dismissal of the chapter 7 petition linked with the eligibility for chapter 13 relief or can the chapter 7 case be dismissed even if debtor could not file under chapter 13?\textsuperscript{207} (2) If "substantial abuse" can be found to exist notwithstanding the debtor's ineligibility for chapter 13 as long as he can repay a substantial percentage of debt out of future income, how long a period of time will the court examine in making its calculation and what will be the relevant income base? (garnishable income or disposable income)

The absence of an express linkage between "substantial abuse" and chapter 13 eligibility becomes even more acute in light of section 1326's new requirement that payments under a chapter 13 plan commence within 30 days of filing even prior to confirmation.\textsuperscript{208} Thus, even debtors who could pay their debts in full over a period of three years would not necessarily be able to comply with chapter 13's strict timing requirement. (Although

\textsuperscript{207}The supposed 100\% return under a nonbankruptcy system would not in itself warrant dismissal even where the debtor is unable to avail himself of the chapter 13 alternative. Garnishable income may or may not be identical to "disposable income" though the two bear a close relation. Under nonbankruptcy law, the amount of future income reachable by creditors is not a function of its being disposable but is rather a stated percentage, e.g., 25\% under Title III of the CCPA. See supra note 188. Substantial repayment ability out of garnishable income should not be a basis for dismissal unless that garnishable income is also disposable. To the extent such income is in excess of what the debtor reasonably needs for support, the policy of § 707(b) precluding resort to chapter 7 is activated.

\textsuperscript{208}One point that needs further elaboration is that the issue posed in the text, i.e., whether chapter 7 dismissal should depend on chapter 13 eligibility, need not be resolved on an all or nothing basis. Even if the availability of chapter 13 relief would not be a necessary prerequisite to a chapter 7 dismissal, perhaps the court should examine why a chapter 13 plan could not be confirmed. In the situation where the debtor is capable of making an allocation equivalent to that required under chapter 13 but is simply ineligible because the amount of debt exceeds chapter 13 limitations, it could be plausibly argued that dismissal is justified notwithstanding this ineligibility as a means of compelling the debtor to pay off these debts on his own. By contrast where confirmation is denied because although the debtor does have substantial disposable income he would be unable to pay off his debts in the manner that Congress deemed appropriate over the length of time that Congress deemed appropriate, dismissal would be unwarranted because it would never culminate into the distribution scheme that chapter 13 envisioned.

Nevertheless, for the reasons stated in supra note 207, even in the first category of cases chapter 7 dismissal should be linked to chapter 13 eligibility and § 707(b) should be amended to so provide. This is so notwithstanding the anomaly of giving debtors with large debts greater access to chapter 7 than debtors with smaller debts.\textsuperscript{209}

amended section 1326 would presumably permit the utilization of a graduated payment plan and payment need not be the same for all months, some payment would have to be made.)

6. Dismissal of Chapter 7 Where Debtor is Eligible For Chapter 13 Relief but Disposable Income Would Not Go to General Creditors

As noted earlier,²⁰⁹ the failure to expressly link chapter 7 dismissal with chapter 13 eligibility requirements may lead to the unfortunate conclusion that debtors are foreclosed from chapter 7 relief although they have no available bankruptcy alternative. Even where debtors are eligible for chapter 13 relief, however, the failure to link chapter 707(b) dismissal to the distribu-
tional scheme of chapter 13 means that in many cases dismissal on the basis of future income produces little or no benefit to general creditors and would therefore be unjustified.

Even if the debtor has sufficient disposable income to pay a substantial percentage of all his debt, general unsecured creditors will not necessarily benefit from a chapter 7 dismissal since disposable income will not be allocated pro rata but rather priority and secured creditors will receive payment in full with unsecured creditors receiving only the surplus, if any (subject to the "best interests of the creditors" test). Should a court dismiss a chapter 7 case on the grounds of substantial debt repayment ability if, even after dismissal and conversion to chapter 13, general creditors will only receive an amount that itself is only nominal or at least insubstantial, however that term is defined?²¹⁰ A chapter 7 case should not be dismissed on the grounds of "substantial abuse" unless the court finds that, under chapter 13, general unsecured creditors would receive a substantial percentage of their debt out of the debtor's disposable income.

7. Rights of Debtors Who Refile Under Chapter 13

Involuntary dismissal of chapter 7 cases may raise additional problems for debtors whose supposed future income fails to materialize. If a chapter 7 case is dismissed on the grounds of "substantial abuse" and the debtor then seeks and obtains relief under chapter 13, at some point he may be unable to make the payments required under his plan. A debtor unable to meet his obligations may either petition the court for plan modification under section 1329 or convert the case back to a chapter 7 provided he no longer has the substantial surplus income that resulted in chapter 7 dismissal in the first

²⁰⁹See supra text accompanying notes 197–208.
²¹⁰The focus of a court must always be on what creditors receive under chapter 13 and not simply what percentage of debt would be repaid if all the debtor's income would be distributed pro rata. Compare the wording of S. 2000 which took precisely the latter approach, blithely ignoring the distributional imperatives of chapter 13.
place. (It will be recalled that section 707(b) dismissal is without prejudice to a later petition.)

Can the debtor simply dismiss the case? Under section 1307(b), the debtor is granted an absolute right to have the chapter 13 dismissed only if the case was not previously converted from a chapter 7. The debtor has no right to seek dismissal of a chapter 13 case that was originally filed as a chapter 7 and that the debtor later converted. Commentators have raised the question whether a compulsory debt repayment plan is violative of the 13th Amendment, at least where the debtor does not retain the power to escape the plan through dismissal. This of course is a problem applicable to any converted chapter 13 case and not unique to those filed in response to a section 707 dismissal. Suffice it to say that the voluntary initiation of chapter 13 coupled with the debtor's unqualified ability to convert to a liquidation appears to remove those characteristics associated with involuntary servitude. Even if the inability to dismiss poses no constitutional problem, however, should a debtor who erroneously chose chapter 7 and was forced out be treated more severely than a debtor who initially chose chapter 13? The limitations of section 1307(b) make perfect sense where a debtor chose chapter 7 and then voluntarily sought conversion. Under section 707, a court may dismiss even a voluntary chapter 7 only “for cause.” Allowing chapter 13 debtors in converted cases the same unqualified right to dismiss that other chapter 13 debtors have would effectively obliterate these limitations by allowing chapter 7 debtors to first seek conversion under section 706(a) and then dismissal under section 1307(b). To insure the continued viability of section 707 limitations on dismissal, it was necessary to provide that the unqualified right of dismissal in section 1307 (b) was inapplicable to converted cases.

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211 Under § 1307(a), the debtor has an unqualified right to convert a chapter 13 case to a chapter 7 at any time, apparently even if the chapter 13 was itself a converted case. Cf. language in § 1307(b).

2111 U.S.C. § 1307: “(b) On request of the debtor at any time if the case had not been converted under section 706 or 1112 of this title, the court shall dismiss a case under this chapter.”

2112 See authorities cited supra note 183.

214 Note too that a debtor can always default on a plan which would justify dismissal under § 1327(c)(5) (motion by “party in interest”). Query, however, whether a debtor could file a motion to dismiss on grounds of his own default. Is a debtor a “party in interest?”

2113 11 U.S.C. § 707:

The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including,

(1) unreasonable delay by the debtor that is prejudicial to creditors; and

(2) nonpayment of any fees and charges required under chapter 123 of this title.

2114 11 U.S.C. § 706(a): The debtor may convert a case under this chapter to a case under chapter 11 or 13 of this title at any time, if the case had not been converted under section 1112 or 1307 of this title.

2115 Under § 706(b), only the debtor may convert a chapter 7 case into a chapter 13. Just as there can be no involuntary chapter 13 proceeding initially so too there can be no involuntary chapter 13 through the conversion of a previous case, whether that case was itself voluntary or involuntary. Since conversion by the debtor requires no showing of cause and the debtor in chapter 13 has an unqualified right to
The situation is entirely different, however, where the debtor converted to chapter 13 because he was ineligible for chapter 7 relief, though he originally believed he was. In the later case, there is no particular reason why the limitations of section 707 on chapter 7 dismissals should be applicable at all if the court finds that the debtor should have filed under chapter 13 in the first place and accordingly the debtor should clearly be entitled to have his case dismissed under section 1307(b) notwithstanding the fact that it was originally a chapter 7.

This result can and should be reached under the present wording of the statute on one of two grounds: (1) that a chapter 13 case filed after a chapter 7 has already been dismissed is not a conversion of an existing case but a new filing ab initio 218 (which therefore may be dismissed at will); or (2) on the theory that a case is deemed converted only if the debtor was entitled to the relief he originally sought, if a court finds that the debtor could not file under chapter 7, the debtor has no chapter 7 case that is capable of being converted. 219 Nevertheless, in the interest of clarity, the Act should be amended to explicitly state that a chapter 13 filed subsequent to a section 707(b) dismissal should not be regarded as a conversion for purposes of section 1307(b). This suggestion becomes imperative in light of the author’s later proposal 220 that the dismissal be stayed to enable the debtor to refile under chapter 13 without losing the protection of the automatic stay. If the debtor files under chapter 13 before the chapter 7 dismissal is even effective, the chapter 13 case more closely resembles a typical conversion and there is a greater need to specify that it is not. 221

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218 Indeed, this argument would be true even if the debtor qualified for relief under chapter 7 but the case was later dismissed for cause. The second argument, however, predicators lack of a conversion on the debtor’s ineligibility for the relief originally sought.

219 The problem of treating the chapter 13 as a converted case was especially acute under S. 2000 which stayed dismissal for a period of 15 days to enable the debtor to “file a motion for conversion . . . to chapter 13 . . . pursuant to section 706.” S. 2000, § 4 amending 11 U.S.C. § 305. While this is a laudable approach for a number of reasons, see infra text accompanying notes 253–256, by specifically designating the chapter 13 filing as a conversion under § 706, the limitations on dismissal contained in § 1307(b) would automatically be applicable. This result should not be followed under present law.

220 See infra text accompanying notes 253–256.

221 This is clearly true where the court finds that use of chapter 7 was a “substantial abuse” from the time of the initial filing and the debtor was never entitled to the relief he sought. It is somewhat less clear that no conversion occurs where the court finds that the chapter 7 filing was originally proper but dismissed on the grounds of subsequent developments such as an unanticipated increase in income. (Even there, there should be no conversion if the chapter 7 case is dismissed before the debtor refills under chapter 13.) As noted earlier, however, such a case would probably not be covered by § 707(b) anyway. See supra text accompanying notes 134–135.
8. May Substantial Abuse Take Other Forms?

S. 2000, notwithstanding its ambiguities, at least conditioned dismissal on a single defined factor—the percentage of debt that could be payable out of anticipated future income. Thus, the exclusive focus of the court would have been on the debtor's future earning power. While this undoubtedly remains a relevant and indeed primary factor under present law, a preliminary question is whether the "substantial abuse" test allows dismissal on the basis of other abuses as well.

Conceivably, a "substantial abuse" inquiry could focus on past misconduct rather than future earning ability. While creditors are already adequately protected against most forms of such prebankruptcy misconduct by the nondischargeability provisions of section 523 and section 727, and indeed foreclosing access of debtors to chapter 7 may actually be detrimental to creditor interests since the scope of discharge under chapter 13 is considerably broader, there are a number of instances of prebankruptcy conduct not covered by section 523 or section 727 which could arguably be subsumed under substantial abuse. One example would be the willful non-payment of debts where the debtor was previously able to do so although by the time of the commencement of the case, the accumulated burden could not be paid off. In other words, rather than focusing on whether the debtor could pay off his debts out of future income, the inquiry would focus on whether he could have paid off such debts with income earned in the past which has now been dissipated. A second example would be the careless and improvident incurrence of debt, particularly for nonnecessities or "luxury items," in the belief that bankruptcy would furnish an "easy way out."

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222See supra text accompanying notes 31–32.
223See supra text accompanying note 53.
224This would not be covered by the nondischargeability provision in 11 U.S.C. § 523(a)(2) which excludes only debts incurred by fraud or with intent not to pay and not debts which the debtor later decides not to pay.
225The Code did not specifically address this problem. 11 U.S.C. § 523(a)(2) did (and does) provide that debts incurred through false pretenses or false representations were nondischargeable. Courts have held that incurring debts with an intention not to pay them may be tantamount to fraud and fall within § 523(a)(2) despite the absence of an express representation. See, e.g., In re Baniaski, BANKR. L. REP. (CCH) ¶67,767 (Bankr. M.D. Fla. 1981), (credit buying spree shortly before bankruptcy may be evidence of fraud); In re Ratajczak, 5 Bankr. 583 (Bankr. M.D. Fla. 1980); In re Hell, 6 BANKR. CT. DEC. (CRR) 1193 (Bankr. D. Colorado 1980); In re Brewster, 5 BANKR. CT. DEC. (CRR) 783 (Bankr. E.D. Va. 1979); In re Cushingberry, 5 BANKR. CT. DEC. (CRR) 954 (Bankr. E.D. Mich. 1977). See also Sommer, supra note 2, § 14.4 at 120. On the other hand, creditors have also encountered many difficulties in proving such fraud. In re Lyon, BANKR. L. REP. (CCH) ¶67,750 (Bankr. D. Me. 1981) (debtor's honest belief that he or she will pay even if ill-founded negates the existence of fraudulent intent).

The Amendments do address in a limited fashion the problem of "loading up" by creating a rebuttable presumption of fraud for certain types of debts incurred within forty days preceding bankruptcy, see 11 U.S.C. § 523(a)(2). The statement in the text merely suggests that § 707(b) may be an alternative route.
There is indeed some indication in the legislative history that Congress was annoyed at a "certain irresponsibility and nonchalance towards the entire concept of bankruptcy" on the part of many debtors and at their feeling that bankruptcy carried no particular social stigma. It is unlikely, however, that these are the abuses that section 707 was designed to attack. First of all, the legislative history of section 707's predecessors, S. 2000 and S. 445 and its reliance on the Purdue Study demonstrate that Congress was concerned with debtors filing for chapter 7 notwithstanding their ability to pay their debts out of future income. There was little or no reference to how this debt was created or how morally culpable the debtor was in incurring the debt or even in failing to pay it. That Congressional concern was on future repayment ability is further evidenced by section 521 which now requires the debtor in a chapter 7 case to file a schedule of income and expenses. A retrospective analysis is thus clearly inconsistent both with the thrust of earlier reform proposals and with the debtor's duty to file income and expense schedules in chapter 7, as well as chapter 13, cases. The legislative history further suggests that the "substantial abuse" formulation was intended to narrow the court's authority to dismiss chapter 7 cases, rather than expand it. Since, under S. 2000, prepetition misconduct by the debtor was clearly not grounds for dismissal, presumably the same would be true under present law.

Second, prebankruptcy misconduct has historically not been the basis for dismissal of the case but has normally been redressed through the invocation of dischargeability sanctions and avoidance powers. Indeed, section 523 as amended adopts precisely this approach for the so-called "loading up" problem by providing that debts for nonnecessities incurred within forty days before the commencement of the case are presumptively fraudulent. Misconduct pertaining to particular transactions should be, and has normally been, remedied by particularized sanctions targeted at the specific misconduct needing rectification and not by a blunderbuss approach affording relief to all creditors because of injustices suffered by some.

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As reflected by the Brimmer survey, attitudes of many debtors further indicate a certain irresponsibility and nonchalance toward the entire concept of bankruptcy. When asked what social impact bankruptcy had on debtors and their families, an amazingly high 65 percent responded that there was none. Moreover, 12 percent of the respondents believed that bankruptcy had no financial effect on them or their families.


229See 11 U.S.C. § 523(a)(2) as amended by § 307, Pub. L. No. 98–353. This is true only if such debts exceed $500 to a single creditor. Note, too, that § 523(a)(2) debts are dischargeable under chapter 13 as long as the debtor completes payments under the plan. See 11 U.S.C. § 1328(a) and supra text accompanying note 53. Thus, the holders of such claims are better off under chapter 7 than under chapter 13. Any dismissal of a chapter 7 predicated on a desire to protect such creditors would be misguided.
Finally, it should be noted that predating dismissal on debtor misconduct would in no way obviate the difficulties courts face in determining the debtor's future income and expenses. Unless the debtor's future income can in fact pay off a reasonable percentage of his prepetition debt, dismissal of the chapter 7 is of very little benefit. Under chapter 13 (as amended), a chapter 13 plan can be confirmed although it provides for little or no payment to creditors if there is little or no disposable income available.\textsuperscript{230} Garnishment of wages under nonbankruptcy law, even where it is not prohibited outright, is a cumbersome procedure with 75% or more of the debtor's wages exempt under state or federal law.\textsuperscript{231} Thus, regardless of the nature of "substantial abuse," the focus of the court must inevitably be directed towards the debtor's future earning capacity since that is the only way the advantages of a dismissal could be ascertained.

VI. PROCEDURE FOR DETERMINING DISMISSALS

A chapter 7 case may be dismissed on the grounds of "substantial abuse" only on the court's own motion and not at the request or suggestion of any party in interest."\textsuperscript{232} As was true under S. 445, the court may dismiss a petition only if it is voluntary.\textsuperscript{233}

In delineating the role that creditors or the trustee can play in the process, current law departs from S. 445 in one important respect. S. 445 pro-

\textsuperscript{230}As repeatedly noted, the 1984 Amendments do not preclude confirmation of minimum or zero payment plans as long as all disposable income for a three year period is applied to plan payments, secured and priority claims are paid in full, the minimal "best interests of the creditors" test is satisfied with respect to general unsecured claims. See supra text accompanying note 102.

\textsuperscript{231}See supra text accompanying notes 184–188.

\textsuperscript{232}U.S.C. § 707(b) as added by § 312, Pub. L. No. 98–353.

\textsuperscript{233}Note, however, that although creditors do not have standing to petition the court for a chapter 7 dismissal, it is arguable that a decision not to dismiss is appealable even by creditors. See infra note 235. Moreover, if creditors discover that the debtor's income statements are inaccurate, they may be able to call this inaccuracy to the attention of the court though this is far from certain. See infra text accompanying notes 249–252. Even if they could not forward this information in the context of a motion for dismissal, they could present it to the court at a later date as the basis for a denial of discharge under § 727 (such a motion can be made up to sixty days after the creditors' meeting, see Bankruptcy Rule 4004—or even for a revocation of discharge on the grounds that it was procured by fraud, i.e., that the chapter 7 case would have been dismissed had the debtor's current income or expenses been accurately stated. Cf. supra text accompanying notes 134–135 (concerning unanticipated increases in income where a fraud argument would be unavailing).

\textsuperscript{234}Unlike S. 445, however, present law adds the further qualification that the individual's debts must be primarily consumer debts. See infra text accompanying notes 257–258. It should be noted that although present law does not specifically grant the debtor the right to appeal a § 707(b) dismissal as did S. 445, that right undoubtedly exists. The only reason S. 445 mentioned that right specifically was because "substantial abuse" dismissal originally appeared in § 305 dealing with nonreviewable abstentions. By contrast, the right to dismiss under current law arises under § 707 and is thus automatically not subject to § 305's nonreviewability standard.
vided that in determining "substantial abuse," the court could act only on its own motion and not at the request or suggestion of any party in interest; no creditor or representative of a creditor could appeal a refusal to dismiss; and no creditor or representative of a creditor could participate in proceedings relating to "substantial abuse" except upon the request of the court. Section 707(b), as presently written, incorporates only the first requirement that the court act on its own motion and deletes any language pertaining to either the right of participation or the right of appeal on the part of the trustee or creditors. If this deletion is significant—and it is not at all certain that it is—this may imply that although neither the trustee nor creditors may "request" or "suggest" that the court dismiss a chapter 7 case on the grounds of "substantial abuse," both may participate without leave of court in proceedings relating to "substantial abuse" and both may appeal a decision of the court not to dismiss. When does permissible "participation" by a "party in interest" shade into an improper "request" or "suggestion" is a crucial issue that the statute fails to address. For example, could parties in interest call to the court's attention discrepancies or inaccuracies in schedules or the like? Probably not, at least if the court had not yet issued its rule to show cause.235

The procedure that is apparently contemplated is that some time after the filing of the debtor's income and expense statement, the court will send the debtor the equivalent of a notice to show cause why the chapter 7 case should not be dismissed on the grounds of "substantial abuse." (It is unclear whether section 707(b) imposes any particular standard of fortitude or belief before the judge can issue tentative findings. Can the judge initiate the process on the basis of suspicion, probable cause, preponderance of the evidence, etc.? May the judge permit or authorize intervention prior to the issuance of his complaint?) By rule or court order, the debtor will be expected to respond by a certain date. The court's notice may also schedule a hearing (though it need not) at which the debtor would be permitted to present evidence relating to his financial condition.236 On the basis of the income statement and evidence produced at the hearing, the court will either enter an order of dismissal or a denial.237 The decision is appealable by debt-

234S. 445, § 203.
235See infra text accompanying notes 249–252.
236While § 707(b) authorizes dismissal only after "notice and a hearing," under 11 U.S.C. § 102(1), this requires only such "opportunity for hearing as is appropriate in the particular circumstances" and only if such hearing is timely requested by a party in interest. "Notice and a hearing" does not necessarily mandate a trial-type evidentiary procedure.
237It will be recalled that § 707(b) provides, as did S. 445, that there is a "presumption" in favor of the relief the debtor seeks. While the term "presumption" is undefined in the Bankruptcy Code, under the Federal Rules of Evidence which are applicable in bankruptcy cases pursuant to Rule 1101, the concept
or—whether other parties can do so is open to question.\textsuperscript{238} If the court decides to dismiss, the dismissal is effective immediately unless the court's order is stayed pending appeal.\textsuperscript{239} Under amended section 349(a), however, such a dismissal is without prejudice allowing for an immediate refiling in the event of a change of circumstances.\textsuperscript{240}

This procedure is problematic from a number of standpoints. First, it substitutes the equivalent of an inquisitorial system for the more traditional adversary one. Requiring the court to act \textit{sua sponte} deprives the court of necessary input vital to the decision-making process. It places the burden of discovery solely on the shoulders of an already burdened court system. Without the assistance of creditors, how is the court supposed to discover, for example, that the debtor's schedules are inaccurate or that the debtor has future anticipated sources of income\textsuperscript{241} which did not have to be listed on the schedule.\textsuperscript{242} Or to take another example, assume debtor's schedules are accurate but debtor is underutilizing his earning capacity. If such conduct forms the basis for "substantial abuse,"\textsuperscript{243} a court would be hard pressed to discover it unless creditors and/or the trustee would be able to call the matter to the court's attention, which section 707(b) apparently prohibits them from doing at least prior to the time the court schedules its hearing.\textsuperscript{244} Courts neither have the time nor the authority to engage in the ex-

\textsuperscript{238}Unlike S. 2000, current law does not specifically state that parties in interest have no right of appeal. Since the court's authority to dismiss is found in § 707(b), not § 305, the inference would appear to be that any party could appeal. Note, however, that if the bankruptcy court simply did nothing creditors could probably not appeal a failure to dismiss since that would be tantamount to "requesting" or "suggesting" that the bankruptcy court act a certain way. [Query, however, could creditors appeal the failure of the bankruptcy court to hold a hearing?] Should the situation be any different if the bankruptcy court initiated the process but decided on the merits that dismissal was unwarranted? An appeal under those circumstances could also be characterized as a "request." Thus, the deletion of creditors' lack of standing to appeal does not necessarily mean that they now could.

Of course, even if they could appeal, the probability of a reversal with respect to a standard so dependent on the discretion of the finder of fact is extremely rare. \textit{See} Boshkoff, \textit{supra} note 139, at 119–120 (discussing British practice and earlier proposals).

\textsuperscript{239}Motions for stay of judgment pending appeal must be made in the first instance in the bankruptcy court subject to district court review. \textit{Bankr. R. 8005}.


\textsuperscript{241}Assuming such income can be taken into account in determining "substantial abuse," \textit{see} \textit{supra} text accompanying notes 134–135.

\textsuperscript{242}Note that unlike S. 445 and S. 2000 which gave the bankruptcy court the option of presiding over the § 341 meeting, current law continues the Code's prohibition. Accordingly, the court is foreclosed from obtaining information by its own attendance.

\textsuperscript{243}\textit{See} \textit{supra} text at notes 134–135.

\textsuperscript{244}"Party in interest," though undefined, clearly includes a trustee.
tensive discovery procedures available to litigants. Considering the huge number of consumer bankruptcies, one can wonder whether placing the burden of ferreting out abuse on the shoulders of the court will result in no more than pro forma cursory approval of debtor petitions with only the most egregious and obvious instances coming to the court’s attention. Perhaps that result is not entirely negative; what is certain, however, is that the abuses in the system Congress sought to correct cannot be eliminated by the procedure it has adopted to correct them. The process is not well-suited towards achieving its designated end.

Moreover, requiring the motion to be made by the court creates the unseemingly spectacle of a debtor litigating against the very person who is deciding the case, raising serious questions of neutrality and at least the appearance, if not the substance, of impropriety. It may also have a psychologically-inhibiting effect on the debtor’s own ability to present his side of the case. The adversary system is said to serve two important values: (1) it improves the quality and accuracy of the decision-making process because it is more likely to generate all relevant and material evidence by placing the burden of production on parties who have a built-in incentive to strengthen their case and point out the weaknesses in the other; (2) it preserves the substance and appearance of neutrality by having a disinterested third party adjudicate disputes. Both these values are disregarded through the adoption of a sua sponte procedure.

It is true that allowing creditors to move for dismissal creates the potential for some abuse. One would expect, however, that instances of harassment motions will be relatively infrequent. First, if debtor does not in fact have a substantial debt repayment capacity, what do creditors hope to gain by filing a motion to dismiss? What strategic effect will the filing of such a motion have on a debtor? Will he voluntarily dismiss his case rather than risk an adverse court finding? Probably not, since, at worst, all the court will do is dismiss the case anyway. There is no real cost in “sweating it out.” Thus, unless there is significant income at stake, creditors have little incentive to file motions, especially since these motions may not have a significant effect on debtor conduct. To the extent that giving creditors the right to

245See statistics cited supra note 66.
247This last proposition may be questionable on two grounds. First, creditors may indeed file spurious
petition for dismissal does create the risk of spurious motions and the con-
comitant risk of foreclosing necessitous debtors from chapter 7 relief, this
risk could be minimized through the imposition of attorneys’ fees on
creditors who unsuccessfully petition for dismissal and through enhanced
scrutiny of reaffirmations, an approach similar to that utilized in other areas
of bankruptcy law.248 In any case, one must balance the evils of a creditor-
initiated system with the risks of error and omission in a court-initiated one
and on balance the latter appears superior provided the system has disincentives for creditor abuses.

On a purely technical level, section 707(b) fails to provide guidance as to
the permissible extent of creditor involvement in the case. What constitutes
unlawful requests or suggestions on behalf of parties in interest? Specifically,
1) May creditors or the trustee forward information to the court or the clerk
of the court regarding the debtor’s financial condition as a basis for the court
issuing notice to show cause as long as they don’t request dismissal? 2) May
they participate in judicial proceedings relating to the issue of “substantial
abuse” as long as the court initiated the proceeding on its own motion? May
they do so only if they adopt a nonadversarial posture? Are they able to pre-
sent evidence but not argument? Facts but not law? What form would such
presentation take? 3) Do they have the right to appeal a decision not to dismisss249 In short, what exactly is the distinction between “participation”
and “request or suggestion”?

At least three interpretations are possible. The first approach would
distinguish between evidence and argument. Parties have an unqualified
right at any time whether before or after the court schedules a hearing to
forward evidence to the court concerning the debtor’s financial condition

motions with the debtor unable to pay for additional court appearances. The debtor may then default
because he is literally too poor to afford bankruptcy although he/she is entitled to relief. Cf. United
States v. Kras, 409 U.S. 424 (1973) (no constitutional right to in forma pauperis relief in bankruptcy
cases). Presumably, under a court-instituted regimen, the incidence of such spurious motions will be
greatly reduced if not eliminated since a court would only act on the basis of probable cause. Second, the
threat of creditor action moving for complete dismissal may result in coercive reaffirmations. In other
words, the debtor may agree to pay one particular debt to avoid the risk of total exclusion from chapter 7
with a resultant forfeiture of discharge of all other debts. Nonetheless, as indicated in the text, on balance
these abuses are better addressed through attorneys’ fees and enhanced scrutiny of reaffirmations rather
than through a wholesale abandonment of the adversary system.

248Essentially, the problem of harassing threshold litigation on the question of chapter 7 eligibility is
the same as under §523 and the imposition of attorneys’ fees unless the creditor acted in good faith or was
substantially justified can solve the former just as it solves the latter. Compare old 11 U.S.C. § 523 (at-
torneys’ fees generally assessed against creditors who unsuccessfully petition for denial of discharge
under § 523(a)(2)) with new § 523 (fees assessed only if creditors were not “substantially justified”). It
should also be kept in mind that the award of attorneys’ fees deters coercive creditor conduct in two
ways: (1) a creditor will be less likely to file a spurious lawsuit in the hope of coercing a dismissal or reaf-
firmation on the part of the debtor since if debtor doesn’t go along the cost will be borne by creditor; (2)
debtor is less likely to accede to creditor demands since the cost to the debtor of not acceding has been
minimized.

249See supra note 238.
and future income prospects as long as they don't "request" the court to take particular action. While this interpretation has the merit of providing the court with the necessary information to make a reasoned and accurate determination of the debtor's repayment ability, it would essentially eviscerate whatever protection to the debtor the sua sponte procedure was designed to afford. No realistic or workable distinction can be drawn between "mere" presentation of evidence and advocacy of a specific position; limiting creditor participation to the former draws a line too fine to be applied and in any case would compel the debtor to respond to charges that were, at least indirectly, levelled by creditors.

A second reading would distinguish between permitted and prohibited interventions based on when they occur. While parties in interest cannot initiate or request the court to initiate a section 707(b) proceeding, they may fully participate, even to the extent of advocating or requesting dismissal, once the court has set the proceedings in motion. Even this standard poses a host of problems. Given the fact that under current law the judge may not attend the section 341 meeting and, consequently, his only sources of information respecting the debtor's future earning capacity are the income and expense schedules filed pursuant to section 521, how will the judge know that these statements are accurate? Even if the statements are accurate regarding current income, what if the debtor anticipates future income or is under-utilizing his earning capacity? In short, in the absence of meaningful input from creditors or the trustee, how will the court even know whether to issue a complaint in the first place?

A third interpretation would be still more restrictive. It would provide that even after the court schedules a hearing, creditors and trustee may not present evidence without authorization from the court. This interpretation is even more problematical—may creditors at least request intervention or is the request itself considered improper? Perhaps the most sensible thing for a judge to do is to immediately request participation of all parties sua sponte as soon as he determines the probability of "substantial abuse" (but how does he do that?) but there is no requirement that he be sensible and it is doubtful whether creditors can even file a motion requesting intervention. Certainly they cannot do so before the court has decided to issue a complaint.

Finally, as noted earlier, it is not clear whether an appeal after the fact constitutes a prohibited request or suggestion that the court act a certain way.

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230 This is to be contrasted with the approach of S. 445 where creditors had to receive the court's permission even to participate and it was not clear they could even ask for it. See supra text at note 234.

231 This of course would be identical to the standard adopted in S. 445 except that the proscription would be extended to the trustee.

232 See supra note 238.
In short, the role adverse parties play in the determination of substantial abuse is in desperate need of clarification.

As a final point, the provision for immediate dismissal is unduly harsh. Upon the commencement of the case, a debtor is immediately entitled to the protection of the automatic stay until dismissal of the case or the granting of the discharge (at which time the section 362 stay terminates only to be immediately followed by the section 524 discharge injunction). If the purpose of a “substantial abuse” dismissal is to indirectly force the debtor to elect chapter 13 relief, there is little justification for depriving the debtor of stay protection before he has had a chance to refile under the proper chapter. Moreover, since there is no indication that the order of dismissal will be stayed pending appeal, debtors in the interim may be subject to harassment, abusive collection tactics, and piecemeal dismemberment of whatever estates they may possess even if the chapter 7 case is ultimately reinstated. Thus, in lieu of immediate dismissal, the statute should be amended to provide for a stay of dismissal pending appeal or, in the alternative, a continuation of the automatic stay for a specified period to enable the debtor to refile under chapter 13. Interestingly enough, S. 2000 took precisely this approach by providing that upon granting of a motion to dismiss “the order of dismissal shall take effect fifteen days after the determination upon the motion,” during which time the section 362 stay remains in effect. Moreover, if the debtor did file a motion for conversion to chapter 13, the stay remained in effect pending determination of the motion. This feature was dropped in S. 445 and present law but, as a matter of fairness and equity to debtors, should be restored. The adverse consequences to creditors are slight. After all, in a chapter 7 liquidation, the debtor has little, if any, nonexempt unencumbered assets and even if the case is dismissed, he is likely to remain judgment proof, at least in the immediate future. The purpose of dismissal is not to allow creditors to seize debtor’s currently-owned tangible property but to permit them to reach substantial future income. The availability of that future income is not impaired by a short-term continuation of the stay. (While the stay may permit dissipation of assets, there is little the debtor can do with respect to dissipating that which has not yet been earned.)

254Of course, this argument may be somewhat less compelling in view of the fact that a chapter 7 case may be dismissed even where the debtor is not eligible for chapter 13 relief. See supra text accompanying notes 197–208. At least where he is, however, he should be given some breathing room to rectify the error of seeking relief under the wrong chapter by treating a refiling like a conversion. See supra text accompanying notes 211–221 (filing should not be treated as a conversion for purpose of § 1307).
256Id.
VII. PERSONS COVERED

Section 707(b) singles out for disparate treatment only those individual debtors whose debts are primarily consumer debts.\(^{257}\) Corporate and partnership debts are not included as well as those individuals whose debts are primarily business, rather than consumer, obligations. It is significant that both S. 2000 and S. 445 applied across the board to all individuals, regardless of the nature of their debts.\(^{258}\)

Corporations, for example, are perfectly free to elect chapter 7 treatment giving creditors little or nothing or, in the alternative, propose a chapter 11 plan calling for nothing more than a minimal payment essentially no better than a liquidation which the court must confirm even over the objections of most creditors provided at least one class consents.\(^{239}\) Chapter 11, however, is not a realistic option for a consumer.\(^{260}\) If a consumer does

\(^{257}\) Although chapter 7 dismissal applies only in cases of individuals whose debts are primarily consumer obligations, section 1325’s requirement that all disposable income be utilized in a chapter 13 plan applies to all individuals including debtors engaged in business. It is somewhat anomalous to make chapter 13 more rigorous for all debtors but at the same time allow some debtors the unfettered discretion to seek relief under chapter 7. A possible explanation may be that debtors engaged in business have less incentive to seek chapter 7 relief even when available because they usually do have substantial assets committed to the business and indeed from a creditors’ standpoint, perhaps chapter 7 is not so bad. See also infra end of this section for additional justifications.

\(^{239}\) Note, too, that while S. 2000 applied to voluntary and involuntary petitions, both S. 445 and present law limit dismissal to cases filed by the debtor. This distinction makes eminent sense; if the court dismisses a chapter 7 petition brought by the debtor, the debtor may at least seek relief under chapter 13. Indeed, inducing him to do so is the very purpose of dismissal. If the involuntary petition of creditors is dismissed, they are deprived of any bankruptcy relief at all since chapter 13 is not compulsory. Note, however, that although an involuntary chapter 7 may not be dismissed on the grounds of “substantial abuse” nonassenting creditors or the debtor may seek an abstention dismissal under § 305. (Dismissal or denial of a motion for dismissal under § 305 is nonappealable.) In any case, involuntary chapter 7 petitions filed against consumers are so rare as to be virtual nonoccurrences.

\(^{260}\) Under 11 U.S.C. § 1129, a chapter 11 plan may be confirmed by the court only if, inter alia, each claim within a class receives as much as it would have under chapter 7 and at least one class of claims has accepted the plan. (If, however, there are dissenting classes, the plan must be “fair and equitable,” and not “unfairly discriminate” which, in the context of an unsecured claim, means nothing more than providing that junior interests, e.g., subordinated creditors, receive nothing until senior claims are paid in full. These standards do not require that the senior claims in fact be paid in full unless they are priority claimants under 11 U.S.C. § 507). Under § 1126, a class is deemed to have accepted a plan if the plan has been approved by creditors holding two-thirds in amount and more than one-half in number of the claims held by creditors who voted on the plan, i.e., 2/3 of voting claims, not 2/3 of all claims. Note, too, that the additional requirements that the plan be “fair and equitable” and not “unfairly discriminate” are triggered only if there are dissenting classes and not if they are dissenting creditors within a class. With respect to the latter, their rights are limited to the “best interests of the creditors” standard.

\(^{260}\) In theory, any person that may be a debtor under chapter 7 (except a stockholder or commodity broker) is eligible for chapter 11 relief. 11 U.S.C. § 109(d). In practice, the cost of a chapter 11 and the cumbersome procedures it employs as compared to a chapter 13 essentially rule it out as a viable consumer option.
propose a debt repayment plan, it will invariably arise only under chapter 13 which now requires that all of his disposable income be devoted towards necessary payments. Nor will the debtor be able to elect chapter 7 if his debt repayment potential is significant. Thus, while corporations and partnerships can effectively escape their obligations at little or no cost by choosing between a no-asset liquidation and a minimal payment out of future income, these options are no longer open to the typical individual.

The reasons for this discrimination are not readily apparent. On one hand, this differential may just be further evidence of an overall anti-consumer bias in the Act. On the other hand, it is somewhat odd that, from the creditor's viewpoint, lenders are afforded no protection against the abuses they may encounter in dealing with debtors whose debts are not primarily for consumer purposes. Put differently, why should business lenders be subjected to a higher risk of no return in the event of bankruptcy than those who advance money for consumer credit? Is there a discernible policy to provide more incentives for consumer lending by minimizing the risk of liquidation? What is that policy?

One way of justifying the disparity would be to suggest that business lenders do not need the protection afforded to consumer lenders, that they are able to fend for themselves, conduct their own credit checks, and deny credit to marginal high-risk cases. This argument, however, is a "red herring." Consumer credit is hardly limited to intra-family loans and the like. It is a billion dollar industry every bit as sophisticated as commercial lending. Indeed, many lenders engage in both types of transactions. One lender is as likely to be able to bear the cost of default as the other; indeed, because of high volume, the extender of consumer credit may actually find it easier to spread the loss with less disruption in normal operations.

Nevertheless, on balance this disparate treatment may in fact be justified on several grounds. First, at least in the case of corporations and partnerships, to the extent abuses do exist, foreclosing access to chapter 7 relief will do little or nothing to curb them. The potential for abuse has virtually nothing to do with the bankruptcy system and could be remedied only by far more fundamental changes in our legal structure. Nonindividual debtors who file under chapter 7 neither receive a discharge nor can claim any exemptions. As a practical matter, however, a corporation or partnership can always be dissolved (under state law) and no longer survives as an entity capable of liability on its debts. Alternatively, even without dissolution it

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261See supra text accompanying notes 68-75.
262See 11 U.S.C. § 522(b): "[A]n individual debtor may exempt . . . " and § 727(a): "The court shall grant the debtor a discharge unless—(i) the debtor is not an individual . . . " (emphasis added).
can, after liquidation, cease doing business in which case it exists as an empty shell. In either case, since shareholders of a corporation are not personally liable on corporate debts, even the nondischargeable debts of a corporation remain uncollectible. This is true whether the corporation files under chapter 7 or whether it formally dissolves or even simply ceases doing business. The absence or presence of chapter 7 relief in no way affects the ability of a corporation to escape liability from its debts through the surrender of its assets. This is equally true in the case of a partnership; while individual partners do remain liable for partnership deficiencies and their access to a chapter 7 discharge would be of considerable benefit, the partnership as an entity can effectively avoid its obligations with or without chapter 7 relief and there is little benefit to creditors in allowing dismissal of a chapter 7 on the grounds of "substantial abuse."

This argument, however, does not explain why individuals whose debts are not primarily consumer should be permitted to file for relief under chapter 7 notwithstanding their ability to pay debts out of future income. After all, in the absence of a discharge, those individuals would have no way of escaping their obligations. Indeed, the partnership situation provides a perfect example. Assume a partnership which has little or no assets but whose partners have substantial future income and whose major debt is their contingent liability for the obligations of the partnership. Both the partnership and the individual partners file for bankruptcy under chapter 7. Under section 707(b), the court may not dismiss any of the petitions on "substantial abuse" grounds since the partnership is not an individual and the partners are not debtors whose primary debts are consumer obligations. Yet although it is true that a dismissal of the partnership petition would be of

263 Transfers of corporate assets to third parties, however, may be attacked as fraudulent conveyances allowing creditors of the corporation to invalidate the transfers. Moreover, corporation law has a panoply of doctrines that allow "piercing the corporate veil" to impose personal liability on shareholders, directors, officers, and controlling persons. See generally, Clark, The Duties of the Corporate Debtor to Its Creditors, 90 Harv. L. Rev. 505 (1977).

264 It is a basic principle of partnership law that general partners remain personally liable for debts incurred by the partnership in the event partnership assets are insufficient to satisfy these debts. For one codification of this rule, see § 15 of the Uniform Partnership Act which, as of this writing, has been adopted in forty-one states and the District of Columbia.

265 Under 11 U.S.C. § 109, any "person" may be a debtor under chapter 7 except railroads, insurance companies, and banks. Under § 101(30), "person" includes individuals, partnerships, and corporations. Thus, the Bankruptcy Code clearly recognizes the concept of partnership bankruptcy as distinguished from the bankruptcy of individual partners. See generally Kennedy, Partnerships and Partners Under the Bankruptcy Reform Act and the New Bankruptcy Rules, 27 St. Louis U.L.J. 507 (1983).

Under 11 U.S.C. § 303(b)(3), any general partner in a partnership may file an involuntary petition against the partnership provided grounds can be established. (See supra note 26 for what these grounds are.) If all general partners join in the petition, the case is a voluntary one under § 301 for which no grounds need be established.
little or no value to creditors, the dismissal of the individual partners' petitions would allow creditors to reach their substantial future income.266

Nevertheless, there are two additional considerations that should be borne in mind. It must be recalled that at least one of the purposes behind chapter 7 dismissal was not the protection of creditors but rather the continued availability of consumer credit at reasonable prices, the theory being that minimizing the bankruptcy [noncollectibility] risk makes it more likely that consumers will have access to credit markets.267 As long as current lending practices result in six billion dollars of losses annually, lenders must necessarily pass on the cost to their borrowers in the form of higher interest rates and the like. These increased costs are said to have the long-range detrimental effect of driving consumers out of the credit market. Dismissal is said to minimize these lending costs, furnish incentives to extend credit, and promote consumer access.

If one views dismissal as a mechanism for encouraging consumer lending by removing the disincentives that the bankruptcy system otherwise creates, a plausible distinction can be drawn between the consumer debtor, i.e., one who borrows money for personal, family, or household use, and the business debtor. The distinction does not lie in the fact that consumer credit is regarded as being of greater social utility than business lending; rather the incremental costs that supposedly exist as a result of unfettered access to chapter 7 have a greater impact or disincentive effect in the consumer context than they do in the business area, and consequently, there is a greater need for these costs to be pared down. It is not the business lender that can better fend for itself, but rather the business borrower.

Accepting the hypothesis that the bankruptcy risk drives up the cost of credit and that "substantial abuse" dismissal will lower those costs, a hypothesis that admittedly is sheer speculation, the business borrower is better able to bear those costs by passing them on to his own consumers and hence, is in less need of the "protection" afforded by the courts' power of dismissal.268 Consumers, on the other hand, have no means of passing on

266In all probability, the partners would be eligible for chapter 13 relief since, unlike Chapter XIII of the 1898 Act, the present version is not limited to wage earners but covers any individual who has regular income and whose income is sufficiently stable to enable him to make periodic payments under the plan. In any case, the Amendments do not link chapter 7 dismissal with chapter 13 eligibility. See supra text accompanying notes 197-208.

267See supra text accompanying notes 86-90 and ABA Report, supra note 14, at 253-255.

268The irony in referring to a chapter 7 dismissal as being for the protection of the debtor is obvious. Indeed, it is hardly in the interests of the particular debtor whose case is being dismissed. On a more generalized level, however, minimizing the possibility of a "no asset" chapter 7 may facilitate the availability of credit and may ultimately benefit debtors as a class. At least, this appears to be a component of the economic theory underlying the Act. Of course, calling the Act a "consumer protection bill" certainly ranks with calling dictatorships "People's Republics" and propaganda offices "Ministries of Truth." Perhaps it's no accident that the bill was enacted in 1984. See G. Orwell, 1984.
these costs and, if the incremental "bankruptcy" cost becomes excessive, will simply find themselves shut out of the market. The need to reduce costs was therefore regarded as more imperative in the consumer context to facilitate credit.269

Second, Congress enacted the "substantial abuse" test to prevent debtors from utilizing chapter 7 where they have little or no current assets but are able to pay a substantial portion of their debts out of future disposable income. It is likely that the abuse is far more prevalent in the case of consumers than in the case of businesses. Businesses, whether in the form of sole proprietorships, partnerships, or corporations generally contemplate and depend on sustained, long-term relationships with trade creditors, commercial lenders, and the like and their continued existence as well as their prospects for rehabilitation depend on the maintenance of good will with all parties concerned. Consequently, it is highly unlikely that a business able to meet a substantial percentage of its obligations would ever elect a no asset liquidation because the short-term gain in immediate relief will be more than offset by an inability to reestablish a working relationship sufficient to revive the enterprise, or even to reestablish it in another form. Consumers, on the other hand, tend by their very nature to take the short-term, immediate view of things since their involvement with creditors tends to be isolated and sporadic, narrowly focused on discrete, individual transactions. Thus, Congress targeted the consumer bankruptcy because to the extent debtors have abused the process (and whether they have is open to question), this is the area where it has occurred and where it would have been likely to occur in the future in the absence of change.

In sum, the Amendments provide for dismissal of a chapter 7 on the grounds of "substantial abuse" only in the case of an individual whose debts are primarily consumer debts. Corporations, partnerships, and nonqualifying individual debtors are free to invoke chapter 7 regardless of their ability to pay debts out of future income. This disparate treatment, while almost certainly resting in part on anti-consumer bias, may be justified on four grounds:

(1) In the case of corporations and partnerships, dismissal of the chapter 7 would be of no benefit to creditors.

269 This is an extremely simple-minded economic theory. It is obvious that higher interest rates and demands for security do have a significant impact on commercial borrowing as well as on consumer credit and these cost cannot simply be recouped by passing them on to customers since, as the price of goods increases, consumer demand may well slacken and business will borrow less — the identical situation consumers face. It is patently obvious that higher interest rates mean less borrowing, whether the borrower is a consumer or a business, with the result that the economy as a whole suffers. The issue seems to be one of degree.
(2) The incremental costs to prospective borrowers if dismissal is not allowed is more severe in the case of consumers than in the case of businesses. The need for change is therefore greater.

(3) The utilization of chapter 7 where there is substantial disposable future income is more prevalent in cases of consumers than in the case of businesses, thereby necessitating creditor sanction against such perceived misconduct in the former more than in the latter.

(4) Yet another reason may be that individuals engaged in business are more likely to have assets committed to the business than are consumer debtors with the result that chapter 7 is not necessarily as catastrophic to creditor interests and there is accordingly less need to limit chapter 7 access.

VIII. POLICY EVALUATION

The foregoing analysis has attempted to demonstrate the definitional and operational problems inherent in the "substantial abuse" standard and the deficiencies in the procedure adopted. In concluding this analysis, there are, however, two additional policy considerations which must be borne in mind. First, limiting access to chapter 7 relief may have the effect of encouraging improvident loans. Creditors may be more likely to extend credit in marginal cases if the risk of a no-asset bankruptcy is minimized (especially since chapter 13 requires utilization of all disposable income). In the event that debtor later runs into financial difficulty but either is or may be ineligible for chapter 7 relief, the lender is then in a position to refinance the outstanding balance at a substantially higher interest rate. Should Congress adopt a system that relieves creditors of the burden of assessing credit risks? Should Congress adopt a system that encourages the extension of credit to high risk [bankruptcy-prone] debtors when those debtors are not likely to police themselves from overextension? These are policy judgments that need further thought.

Second, the underlying assumption of the Amendment as well as of its predecessors is that dismissal of the chapter 7 will result in substantial returns to creditors by their realizing on the debtor's future income. This ignores the basic psychological fact that if all of the debtor's disposable income must be applied to the repayment of debts, the amount of that disposable income is likely to diminish. As Professor Vern Countryman noted:

Voluntary composition and extension agreements have been successfully employed. . . . but an involuntary composition or extension agreement forced upon a debtor seeking relief under Chapter 7 can be expected to work about as
well as compulsory marriage counselling for a spouse bent on a separation or divorce. . . . A debtor who is forced into Chapter 13 would not reasonably be expected to have the same incentive or to make the same effort to produce the earnings necessary successfully to perform the plan. . . .

Thus, ultimately, all of the anticipated future income that formed the basis of the chapter 7 dismissal may simply fail to materialize. Debtors will either seek modification of their chapter 13 plans or those plans will be dismissed, leaving creditors to the little they can eke out under state wage garnishment laws. Indeed, after much time and expense, in the final analysis many of these cases will end up precisely as they began—as “no asset” chapter 7 liquidations. Is the game worth the candle?

IX. CONCLUSION

In theory, there can be no real objection to a statute which conditions bankruptcy relief on the absence of “substantial abuse” on the part of the debtor who requests it. Just as most of us favor motherhood, peace, and apple pie, so there may indeed be a general consensus that bankruptcy is a “special” remedy, necessary at times but one that should not necessarily be available as a matter of course and at no significant cost. While the number of persons abusing the process may be quite small, this too would be no reason to discard the “substantial abuse” test provided its application would be limited to those isolated instances.

The real questions are what constitutes such abuse and whether the introduction of such a vague, undefinable standard into the Bankruptcy Code means that debtors will be foreclosed from the relief they seek, and need, even if their conduct is not in fact “abusive.” On balance, a general standard giving the court the flexibility and discretion to examine the particular circumstances of each case is probably preferable to an unequivocal, rigid statutory directive such as that contained in S. 2000. The very generality of the standard, however, increases the risk of its being erroneously, or at least inconsistently, applied. The burden of the court is a heavy one; “substantial abuse” cannot be determined mechanically but only through a detailed evaluation of all the debtor’s circumstances—projected income including sources which have not yet materialized, expenses both of the support and the nonsupport variety, the probable return to creditors in the event of a

271 Relying on the Purdue Study, creditors have argued that a large number of debtors are capable of easily paying a substantial percentage of debts out of surplus income. See supra text accompanying notes 91-94. Others contend this number is relatively small. See Shuchman, supra note 95. This contention, however, hardly argues against dismissal in the allegedly small number of cases where such abuse does exist.
dismissal, the eligibility of the debtor for other forms of bankruptcy relief, i.e., chapter 13, and the dollar amount of income the debtor is attempting to shield are only some of the factors that enter into the calculus.272

Recognizing that one of the primary purposes of bankruptcy legislation is to afford debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,"273 a court should use its power of dismissal sparingly though, when warranted, such a tool can be a potent weapon in curbing abuses. Hopefully, courts will approach these issues with sensitivity to the needs of debtors as well as creditors and will reach their decisions with due deference to the debtor's choice of relief and to his desire for a fresh start and a decent standard of living for himself and his family.

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272Indeed, perhaps the most serious shortcoming of the test is that courts are simply unable to perform the task adequately. One can imagine something like a rubber stamp process in one direction or the other where petitions for relief are routinely dismissed (with the debtor too poor to appeal) or motions for dismissal are routinely denied. See supra text accompanying notes 154 and 245.