Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984

Jeffrey W. Morris
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* Associate Professor of Law, University of Dayton School of Law. The author gratefully acknowledges the financial assistance of the Research Council of the University of Dayton.
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Pangloss explained to him how everything was for the best. Jacques was not of this opinion.

"Men," said he, "must have corrupted nature a little, for they were not born wolves, and they have become wolves. God did not give them twenty-four-pounder cannons or bayonets, and they have made bayonets and cannons to destroy each other. I might bring bankruptcies into the account and Justice which seizes the goods of bankrupts in order to deprive the creditors of them."

"It was all indispensable," replied the one-eyed doctor, "and private misfortunes make the public good, so that the more private misfortunes there are, the more everything is well."

While he was reasoning, the air grew dark, the winds blew from the four quarters of the globe and the ship was attacked by the most horrible tempest in sight of the port of Lisbon.1

I. INTRODUCTION

More than two hundred years after Voltaire's Jacques expounded on the shortcomings of bankruptcy laws, Congress addressed his criticism in the Bankruptcy Reform Act of 19782 (Code). The drafters of the 1978 revisions knew that statistics supported Voltaire's claim. The goods of debtors were being seized more often to satisfy administrative costs than to satisfy creditors.3 The drafters attempted to resolve the problem by permitting debtors to retain more property. If debtors were allowed to retain more property, the drafters reasoned, bankruptcy trustees would be less likely to seize assets of limited value from debtors and liquidate

1. VOLTAIRE, CANDIDE OR OPTIMISM 12-13 (N. Torrey ed. 1949).
3. A Brookings Institution study reported that creditors received no distribution in approximately 84% of all straight bankruptcy proceedings, and that in nominal asset cases, the debtor's property was sold primarily to pay administrative expenses. D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEMS, PROCESS, REFORM 87-88, 175-76 (1971); see also COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, FINAL REPORT, H.R. Doc. No. 137, PART I, 93d Cong., 1st Sess. 109 (1973) (discussing the problem of administrative expenses in nominal asset cases) [hereinafter cited as REPORT, PART I].
them primarily to pay administrative expenses. Congress incorporated this reform into the Bankruptcy Code in the form of expanded exemption provisions.

Although the Bankruptcy Code resulted from nearly a decade of study and drafting, critics were quick to advocate major revisions. The consumer credit industry responded by attacking the federal exemption scheme at the state level. The industry lobbied state legislatures to "opt out" of the federal scheme under the authority of Code section 522(b). The industry's efforts have been successful. Approximately thirty-five states have opted out of the federal scheme, and they generally have placed tighter restrictions on the amount of property a debtor may claim as exempt from creditors' claims.

The liberal exemptions of the Code were not the only provisions which the consumer credit industry found unacceptable. The industry also complained that bankruptcy deprived them of their ability to collect claims from a debtor's future income. Industry spokesmen noted that a debtor's anticipated future income was the primary consideration in making consumer loans. The industry particularly was troubled by a debtor's ability to avoid liens on exempt property that otherwise secured their debts and by the


6. For a compilation of states which have opted out of the federal exemption system, see 7 COLLIER ON BANKRUPTCY (MB) 1 n.6 (15th ed. 1985).


proliferation of zero payment Chapter 13 plans. These concerns prompted the industry to mount a major lobbying effort seeking substantive changes to consumer bankruptcy laws. Congress adopted many of the credit industry’s proposed reforms in 1984 when it passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (Bankruptcy Amendments Act).

The Bankruptcy Amendments Act contains three titles. This Article focuses on Title III, which contains the amendments to the Bankruptcy Code, and reviews and critiques these provisions as they relate to consumer bankruptcy and debtor-creditor relations in general. This analysis reveals that creditors enjoy significantly greater protection now than they did before the 1984 amendments. The Article concludes, however, that although the Bankruptcy Amendments Act may satisfy previous critics of the Code, many of the credit industry’s criticisms were not well-founded, and in many instances the Congressional efforts were misdirected.

II. COMMENCEMENT OF THE CASE AND ELIGIBILITY FOR RELIEF

A. The Filing

The substantive changes in consumer bankruptcy embodied in the Bankruptcy Amendments Act will affect bankruptcy cases even before actual proceedings are initiated. Among the 1984 amendments is an addition to Code section 342, which now requires the bankruptcy clerk, “prior to the commencement of [the] case,” to “give written notice to [individual consumer debtors] that indicates each chapter of [the Code] under which such [an] individual only of the debtor’s "equity interest" in property and that debtor could not employ Bankruptcy Code § 522(f)(2) to avoid lien.

10. One industry spokesman stated that “in our view, [one of] the two most significant amendments would be... the one that suggests that future income ought to be used to pay debts to the extent that the debtors reasonably can pay those debts.” Hearings, Part I, supra note 7, at 50 (testimony of Professor Landers); see id. at 65 (statement of Claude Rice, Alvin O. Wiese, and Jonathan M. Landers); see also Cyr, The Chapter 13 “Good Faith” Tempest: An Analysis and Proposal for Change, 55 AM. BANKR. L.J. 271, 272 n.6 (1981) (noting the proliferation of zero payment Chapter 13 plans).


may proceed." The amendment does not indicate how the clerk should convey this information. Presumably, the clerk's office will provide some form of notice to all persons filing for bankruptcy relief indicating the chapters of the Code under which the debtor may proceed. Before the debtor actually files the petition, the clerk could provide a copy of the notice and, perhaps, require the debtor to acknowledge receipt of the notice in writing.

A number of problems complicate this attempt to provide consumer debtors with better information concerning their bankruptcy options. First, debtors rarely file their own petitions. The debtor's attorney or an employee of the attorney usually files the bankruptcy petition. The petition even may be filed by mail. In these situations, the clerk could not provide the debtor with requisite notice prior to the commencement of the case. When the debtor's attorney or the attorney's agent personally files the petition, the problem could be solved by requiring the individual physically filing the petition to sign a statement indicating that the debtor has received written notice of his bankruptcy options. This procedure, however, would not solve the notice problem for a petition filed by mail. A workable solution would be to require every consumer bankruptcy petition to contain a statement, signed by the debtor, acknowledging that the debtor has received a written notice which outlined the available bankruptcy options in a manner approved by the bankruptcy court. Other provisions of the Bankruptcy Amendments Act already require debtors and their attorneys to make similar declarations.

Congress also altered bankruptcy filing procedures by amending the Official Bankruptcy Forms. Official Bankruptcy Form No. 1 represents the basic voluntary bankruptcy petition. In the Bankruptcy Amendments Act, Congress amended this form by requiring

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15. Filing a bankruptcy petition through the mail rather than delivering it personally to the clerk, however, may create significant problems for the debtor. See In re Butchman, 13 Bankr. 452, 455 (Bankr. S.D.N.Y. 1980) (debtor's attorney mailed petition before foreclosure, but clerk received the petition two hours after the foreclosure was completed).
two additional statements. First, petitioners with primarily consumer debts must sign a statement that they are aware of their option to proceed under either Chapter 7 or Chapter 13 of the Code, but that they have chosen to proceed under Chapter 7.\textsuperscript{18} Second, if the petitioner is represented by an attorney, the attorney must sign a declaration indicating that the attorney has informed the debtor of the availability of either Chapter 7 or Chapter 13 relief and has explained the extent of relief available under each chapter.\textsuperscript{19}

These changes in the Official Forms are related closely to the new notice requirement imposed on the bankruptcy clerk. In fact, these attempts to ensure that consumer debtors become aware of their bankruptcy alternatives overlap to a large extent and are unnecessarily redundant. The notice required of the clerk undoubtedly will include some statement highlighting the debtor's choice of either Chapter 7 or Chapter 13 relief. This statement will contain the same information as provided by the debtor's attorney in the required counseling session, but it will be far less effective in conveying that information to the debtor.

Interestingly, the debtor's attorney need not inform the debtor of the possibility of Chapter 11 relief, although the clerk apparently must. Amended Code section 342(b) apparently requires the clerk to inform debtors of the Chapter 11 option because it directs the clerk to indicate to consumer debtors each chapter of the Code under which they may proceed. Consumer debtors eligible for Chapter 7 relief also are eligible, by definition, for Chapter 11 relief.\textsuperscript{20} Generally, a consumer debtor will have no reason to opt for Chapter 11 relief. In some instances, however, Chapter 11 may be more clearly applicable than Chapter 13 to a particular debtor's situation, making it easier for the clerk to explain the Chapter 11 option than it would be to explain Chapter 13. For example, if the debtor owes more than $100,000 in unsecured debts, the determination of eligibility for Chapter 13 relief may be extremely difficult because contingent or unliquidated debts are excluded from the

\textsuperscript{18} Id. \textsuperscript{16}.
\textsuperscript{19} Id. \textsuperscript{17} & exhibit "B".
$100,000 limitation.\(^2\) In such a situation, the new section 342(b) theoretically requires the clerk to exercise some legal judgment in determining whether to inform the debtor that Chapter 13 relief is available. The clerk clearly is not in a position to counsel debtors in this manner. Counseling in these matters is a fundamental obligation of the debtor's attorney.

Congress adopted the above-mentioned changes to encourage debtors to choose Chapter 13 proceedings. Congress may not have been completely successful. Although the amendments should increase debtor awareness of the alternatives, this increased awareness will not result necessarily in more Chapter 13 filings or fewer Chapter 7 filings. Reasons other than debtor ignorance may discourage Chapter 13 filings.\(^3\) To the extent that the use of Chapter 13 by consumer debtors is restricted by debtor ignorance, however, the proportion of Chapter 13 filings should increase.\(^4\)

**B. Preliminary Discretion to Dismiss Bankruptcy Filings**

If a consumer debtor decides to file for Chapter 7 relief after being informed fully of other alternatives, the petition remains subject to dismissal. The Bankruptcy Amendments Act added section 707(b) to the Bankruptcy Code, providing the bankruptcy courts with discretion to dismiss a Chapter 7 case if the court "finds that the granting of relief would be a substantial abuse of the provisions of [Chapter 7]."\(^5\) The amendment does not indicate what constitutes a "substantial abuse" of Chapter 7. Statements from both the House of Representatives and the Senate, however, suggest that "substantial abuse" occurs when a debtor would have

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\(^3\) The Bankruptcy Commission noted, for example, that malevolent attitudes of attorneys and bankruptcy judges toward Chapter 13 may explain the limited use of that form of relief. Report, Part I, supra note 3, at 157-58.

\(^4\) Other factors also affect the number of bankruptcy filings. For example, several witnesses who testified before the Senate suggested that the increase in bankruptcy filings after the Bankruptcy Reform Act of 1978 was attributable in part to attorney advertising which informed debtors of their rights and options under the bankruptcy laws. See, e.g., Hearings, Part I, supra note 7, at 42 (testimony of Professor Landers); id. at 298-300 (testimony of Richard Levin, an attorney in private practice who specializes in commercial bankruptcy reorganizations).

significant future income which would be protected from debts discharged in a Chapter 7 proceeding, but which could be used to repay some or all of these debts if a Chapter 13 plan were filed.\textsuperscript{25}

The court may consider the issue of substantial abuse only on its own motion. Section 707(b) specifically prohibits interested parties from suggesting to the court that dismissal for substantial abuse of Chapter 7 provisions would be appropriate.\textsuperscript{26} This restriction raises a practical problem of implementation because it does not explain how the bankruptcy court can become aware that a particular Chapter 7 petition constitutes a "substantial abuse" of the Code. If the focus is solely on the debtor's postpetition ability to generate funds sufficient to repay prepetition indebtedness in whole or in part, the court would be required to determine each Chapter 7 debtor's future financial status. Substantial clairvoyance is necessary to make such determinations, but the task is made easier because the Bankruptcy Amendments Act imposed an additional duty on debtors. Under Code section 521(1), Chapter 7 debtors must file a "schedule of current income and current expenditures."\textsuperscript{27} From this schedule, the court can extrapolate the debtor's financial status over a three year period to determine whether the


One court has addressed the operation of Section 707(b) on two occasions. The Bankruptcy Court for the Western District of North Carolina has held that allowing a debtor to proceed under Chapter 7 when he had the ability to repay a significant portion of his obligations out of future income under a Chapter 13 plan would be a substantial abuse of the provisions of Chapter 7. In re Bryant, 47 Bankr. 21 (Bankr. W.D.N.C. 1985). The same court has stated in dicta that allowing a debtor with limited future income to obtain Chapter 7 discharge of a sizeable tort judgment would not be a substantial abuse of Chapter 7. In re White, 49 Bankr. 869 (Bankr. W.D.N.C. 1985). The court in White held that Section 707(b) did not apply because the only claim against the petitioner, a tort judgment which arose out of an automobile accident, was not a consumer debt. The petitioner had not incurred the debt primarily for a personal, family or household purpose. Id. at 872-73.

\textsuperscript{26} 11 U.S.C.A. § 707(b) (West Supp. 1985). Section 707(b) provides that the court may dismiss a Chapter 7 case for substantial abuse only "on its own motion and not at the request or suggestion of any party in interest." A creditor, however, could seek an order of abstention under section 305(a) of the Code to bring the debtor's financial status to the court's attention. 11 U.S.C. § 305(a) (1982). The court then could decide on its own motion to dismiss the case under section 707(b).

debtor’s anticipated income, less expenses, will be sufficient to repay a significant portion of the debtor’s dischargeable debts.\textsuperscript{28} If sufficient income is anticipated, a complete discharge of the debtor’s obligations would constitute a substantial abuse of Chapter 7.

The wisdom of extrapolating current earnings and expenses over a future period is questionable.\textsuperscript{29} A major study of consumer debtors funded by the consumer credit industry suggested that this method of projecting future income is appropriate,\textsuperscript{30} but the criticisms of this study are more persuasive.\textsuperscript{31} Whichever side is correct, the bankruptcy courts must continue to rely on this data because they have no other way to determine independently whether a particular Chapter 7 petition should be dismissed as a “substantial abuse.”

C. Limitation of the Debtor’s Ability to Initiate Bankruptcy Proceedings

One other amendment to the Code will affect consumer debtors’ ability to initiate bankruptcy proceedings. The Bankruptcy Amendments Act added a new subsection (f) to Code section 109. Section 109(f) prohibits a bankruptcy filing by any individual who was

a debtor in a case pending under [the Bankruptcy Code] at any time in the preceding 180 days if: (1) the case was dismissed by the court for willful failure of the debtor to abide by orders of

\textsuperscript{28} The extrapolation must be for three years to reflect the new provision in Chapter 13 that requires debtors to apply all of their disposable income for three years to their Chapter 13 plans unless they pay all unsecured claims in full. 11 U.S.C.A. § 1325(b) (West Supp. 1985). See infra notes 296-347 and accompanying text.

\textsuperscript{29} For an excellent discussion of the problems inherent in making predictions of future income, see Limiting Access, supra note 11, at 1117-29.

\textsuperscript{30} Credit Research Center, Kranert School of Management, Purdue U., Monograph Nos. 23-24 (1982). This study frequently is described either as the “Johnson Study” after its director, Dr. Robert Johnson, or as the “Purdue Study.”

the court, or to appear before the court in proper prosecution of
the case; or (2) the debtor requested and obtained the voluntary
dismissal of the case following the filing of a request for relief
from the automatic stay provided by section 362 of [the Bank-
ruptcy Code].

The rationale underlying section 109(f) is that debtors should
not be permitted to disrupt the court’s processing of bankruptcy
cases. Debtors covered by section 109(f)(1) have had their chance
for bankruptcy relief, and have wasted it. This new subsection
represents an appropriate legislative response to isolated instances of
debtor misconduct.

Section 109(f)(2) addresses a somewhat different problem. In
many cases, Chapter 13 debtors have initiated bankruptcy pro-
ceedings to thwart creditors’ efforts to foreclose on their resi-
dences. In response, creditors often have sought immediate relief
from the automatic stay so they could continue foreclosure pro-
ceedings. If the bankruptcy court granted relief to a particular
creditor, the debtor would voluntarily dismiss the Chapter 13 pro-
ceedings, causing the automatic stay to terminate pursuant to
section 362(c). If the creditor subsequently reinstated foreclosure
proceedings, the debtor would refile under Chapter 13 to prevent
the second attempted foreclosure. Before the Bankruptcy Amend-
ments Act, courts responded to these actions either by employing
res judicata principles to lift the stay in the second bankruptcy
case, or by dismissing the first bankruptcy case with prejudice to

33. See, e.g., In re Martin-Trigona, 35 Bankr. 596, 602-03 (Bankr. S.D.N.Y. 1983) (dis-
missing Chapter 13 case because debtor refused to cooperate in the section 341 meeting of
creditors, failed to file schedules as required, and generally obstructed the bankruptcy
process).
34. See, e.g., In re Damien, 35 Bankr. 685 (Bankr. S.D. Fla. 1983); In re Sando, 30 Bankr.
35. 35 Bankr. at 687; 30 Bankr. at 475.
36. 11 U.S.C.A. § 362(c) (West 1979 & Supp. 1985) provides that the automatic stay of
acts against property of the estate terminates when the “property is no longer property of
the estate,” while the stay of all other acts terminates when the case is “closed” or
“dismissed.”
37. E.g., In re Bystrek, 17 Bankr. 894, 896 (Bankr. E.D. Pa. 1982). But see In re Bumpass,
any new bankruptcy filing for a stated period of time. Congress adopted the latter approach when it added section 109(f)(2) to the Code.

Section 109(f) may be an excessive restriction on debtor ability to refile bankruptcy cases. The statute provides no discretion for the bankruptcy courts to permit refileing in appropriate circumstances. For example, a debtor who initiates a Chapter 13 proceeding and subsequently becomes unemployed now may be unable to make the payments called for by the Chapter 13 plan, and will want to dismiss the proceeding voluntarily. If a creditor already has filed for relief from the automatic stay to continue repossession of the debtor’s second car, for example, section 109(f)(2) apparently would disqualify the debtor from further bankruptcy relief for 180 days after dismissal of the Chapter 13 proceedings. This disqualification still applies if the debtor subsequently becomes employed—even at a higher rate of pay. It also will prevent the debtor from refileing for bankruptcy even after the creditor completes repossession and takes possession of the collateral. The new statute addresses and resolves a problem which deserves attention, but its provisions are too broad and may prevent some honest but unfortunate debtors from obtaining the relief they need. The relatively short time restriction on refileing, however, should minimize the number of cases in which the statute operates unfairly.

If the strict operation of section 109(f) would cause undue hardship in a particular instance, a court might consider permitting the debtor to reopen the original bankruptcy case. The Code permits a court to reopen a case to “administer assets, to accord relief to the debtor, or for other cause.” In cases of undue hardship, a court might justify reopening the original case either to accord relief to the debtor or to benefit other creditors who might fare better in a Chapter 13 proceeding than otherwise. This proposed end run around new section 109(f)(2) may not be available, however, because the language of section 109(f) prohibits an individual from

being a debtor under the Bankruptcy Code, rather than from commencing a subsequent bankruptcy proceeding. Interpreted literally, the new provision would not permit the court to reopen an earlier case to bypass the mandated 180 day limitation.

The courts, however, may interpret section 109(f)(2) to retain some discretion to permit subsequent filings in appropriate circumstances. Section 109(f)(2) prohibits debtors from obtaining further bankruptcy relief for 180 days if they dismissed a prior case “following” a request for relief from the stay. The courts could construe “following” not in a chronological sense, but rather as meaning “in response to” or “because of.” Using this interpretation, the bankruptcy court could permit a subsequent filing if the debtor did not seek the first dismissal to avoid a creditor’s foreclosure after a request for relief from the automatic stay. This interpretation would permit bankruptcy courts to release debtors apparently caught in the net of section 109(f)(2).

III. DISPOSITION OF COLLATERAL

When an individual initiates a bankruptcy proceeding and the individual has assets subject to security interests arising from consumer transactions, the individual must “file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property.” The debtor must file this statement “within 30 days after the date of the filing of a [Chapter 7] petition . . . or on or before the date of the meeting of the creditors, whichever is earlier.” If the debtor is unable to file the statement within thirty

41. Two courts have construed section 109(f)(2). In In re Patton, 49 Bankr. 587 (Bankr. M.D. Ga. 1985), the court held that Section 109(f)(2) prevented a debtor from reinstituting bankruptcy proceedings during the statutory period only if the initial dismissal was in response to a creditor’s request for relief from the automatic stay. The court in In re Keziah, 46 Bankr. 551 (Bankr. W.D.N.C. 1985), however, held that it had no discretion to permit the second bankruptcy case, and it refused to consider the debtor’s alleged unrelated reasons for voluntary dismissal of the first case. The court’s analysis in Patton probably is appropriate and preferable to Keziah because it more correctly reflects the intent of Congress.
43. Id.
days, the court may grant additional time if the debtor requests it before the original period expires.\textsuperscript{44} After the debtor files this notice of intent, he has forty-five days to “perform his intention with respect to such property.”\textsuperscript{45} Once again, the court may extend the period if the debtor requests it before the forty-five day period expires.\textsuperscript{46}

Before the Bankruptcy Amendments Act, secured creditors had encountered delays in obtaining possession of collateral or arriving at other agreements concerning collateral securing consumer debts.\textsuperscript{47} The above-mentioned changes wrought by the Bankruptcy Amendments Act should accelerate the process considerably. Debtors often are concerned primarily with whether the court will permit them to retain possession of certain personal property. Previously, a debtor could continue to possess property for a substantial time without paying for it by holding it until the court ruled on a creditor’s request for relief from the automatic stay. The new time limits in section 521(2) will force debtors and their attorneys toseek prompt decisions concerning the disposition of secured property. The restrictions will force debtors with no right to retain certain collateral to surrender the collateral to secured creditors within seventy-five days after filing a bankruptcy petition unless the court specifically grants an extension. Debtors and their attorneys should be able to consider the options and act upon them within seventy-five days. If the debtor needs more time in a particular case, the court may grant an extension to meet emergency needs. This amendment represents a positive step in the efficient processing of secured claims. Besides benefiting secured creditors by resolving their status earlier, it also should benefit debtors by promoting quicker settlement of their affairs.

Congress provided secured creditors with an additional safeguard by amending Code section 704. The amended section requires a Chapter 7 trustee to “ensure that the debtor shall perform

\textsuperscript{44} Id.

\textsuperscript{45} Id. § 521(2)(B).

\textsuperscript{46} Id.

\textsuperscript{47} See Ulrich, Comments on the Consumer Finance Industry’s Proposals to Improve the Position of Secured Creditors in Consumer Bankruptcy Cases, 39 Wash. & Lee L. Rev. 381, 392-93 (1982).
his intention as specified in section 521(2)(B)."48 Chapter 13 trustees have the same obligation.49 Perhaps recognizing the potential burden this new section imposes on trustees, Congress also increased trustee compensation.50 Trustees who ensure delivery of collateral to secured creditors, however, likely will argue that under section 506(c) they also are entitled to recover from the secured property "the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of [the secured] claim."51 In light of this provision, creditors who believe they can recover collateral with less expense than the trustee should maximize their recovery by collecting the property without the trustee's assistance. Unfortunately, any action taken by the trustee to effect the return of the collateral may automatically entitle the trustee to compensation under section 506(c), thus reducing the creditor's recovery.

IV. REAFFIRMATION AGREEMENTS

One of the options available to debtors for disposing of collateral is to reaffirm some or all of the underlying obligation owing to the secured creditor and to retain possession of the collateral. To exercise this option, a debtor must notify creditors of the intention to reaffirm shortly after the commencement of the case52 and must make the reaffirmation within forty-five days after the notification to creditors.53 As a result, the debtor and the debtor's attorney must engage in reaffirmation planning at the outset of the consideration of bankruptcy options.

Before the adoption of the Bankruptcy Code in 1978, the debtor's attorney played only an advisory role in reaffirmation matters. The debtor and creditors ultimately determined whether to reaffirm prebankruptcy obligations. The Bankruptcy Code, however, injected the bankruptcy judge into the process. Section 524(c)

49. Id. § 1302(b)(1).
50. Id. §§ 326(a)-(b), 330(b)-(c).
52. 11 U.S.C.A. § 521(2)(A) (West Supp. 1985); see supra notes 42-44 and accompanying text.
53. Id. § 521(2)(B); see supra notes 45-46 and accompanying text.
provided that reaffirmations of dischargeable consumer debts were unenforceable unless the court approved the agreement as not imposing an undue hardship on the debtor or his dependents and as being in the debtor's best interest. As a result, courts denied enforcement of many agreements reached by debtors and creditors. The consumer credit industry argued that this practice was paternalistic and otherwise inappropriate, and proposed that debtors and creditors be permitted to negotiate reaffirmation agreements without court oversight but with an expanded period for debtors to rescind agreements.

The Bankruptcy Amendments Act includes a significant change from both the Bankruptcy Code and the credit industry proposal for treatment of reaffirmation agreements. Section 524(c) now provides that reaffirmations of consumer debts are enforceable without court approval if the debtor's attorney, in essence, approves the agreement. If no attorney represented the debtor in negotiations with the creditor, the court's approval will remain a prerequisite to enforcement of the agreement. In most cases, however, the debtor's attorney will have participated in the negotiations and therefore will have to issue, or decline to issue, the approval. Either way, the process will remain "paternalistic," although usually the debtor's attorney rather than the court will exercise the paternalism.

Presumably, Congress expected to increase the number of reaffirmation agreements by removing bankruptcy court approval as a condition of enforceability. Whether debtors' attorneys generally

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56. Hearings, Part I, supra note 7, at 90-91 (Recommending Note accompanying Proposed Consumer Bankruptcy Improvements Act).
57. Id. The credit industry suggested that a sixty-day recission period was sufficient to protect debtors.
59. Id. § 524(c)(6).
will offer their approval of these agreements, however, is questionable. The new reaffirmation agreement approval process also has the disadvantage of thrusting the debtor’s attorney into an inappropriate position. The attorney should counsel and advise the debtor concerning a proposed reaffirmation agreement, but the attorney should not have the power to decide for the debtor whether a particular reaffirmation is inappropriate. The new provision forces attorneys into that position, however, because a reaffirmation agreement is unenforceable until the debtor’s attorney approves it. Consequently, whether the number of reaffirmations increases or decreases rests to a large extent on the judgment of debtors’ attorneys, a result probably not anticipated by Congress and certainly not requested by the interests that sought a change in the Code’s reaffirmation provisions.

V. Exemptions

Congress also amended the exemption provisions contained in section 522 of the Bankruptcy Code. These exemptions are of somewhat limited significance because most states have opted out of the federal exemption scheme. In these states, the amendments will have no effect on consumer bankruptcy cases. In the remaining states, however, the three changes to the exemption provisions outlined below will apply.

A. "Spillover" of the Unused Portion of the Residence Exemption

The federal bankruptcy exemptions are listed in Code section 522(d). Prior to the Bankruptcy Amendments Act, a debtor was able to claim an exemption for any interest in a residence up to a value of $7500. The debtor also was able to claim an exemption for an interest in any property up to a value of $400 plus the unused portion of the $7500 residence exemption. This provision enabled the debtor to "spill over" the unused portion of the residence exemption into the $400 general exemption.

62. See supra note 6.
In the Bankruptcy Amendments Act, Congress placed a $3750 limit on the amount of the unused portion of the residence exemption that can “spill over” into the general exemption. This amendment represents a slight reversal in policy, because it favors homeowners over renters. For example, a homeowner who has a $4000 interest in a residence may claim the interest as exempt, and may claim an additional $3900 exemption through the “spill-over” provision of section 522(d)(5), for a total of $7900 in exempt property. If the same debtor rented an apartment, however, the debtor could claim only a total of $4150. Although the restriction on “spillover” represents a limitation on renters’ exemption rights, it was a logical step because renters presumably have adequate exemptions without need for the protection of an equity interest in a residence. The categories of exempt property listed in section 522(d) should be sufficient to permit a “fresh start” for any debtor.

B. The Household Goods Exemption

The second change made by the Bankruptcy Amendments Act to section 522(d) also limits debtors’ ability to exempt certain property. Section 522(d)(3) originally exempted the debtor’s interest “in any particular item, in household furnishings, household goods, wearing apparel, appliances [and certain other goods] . . . held primarily for . . . personal, family, or household use.” The original statute limited the value of the exemption for each individual item to $200, but it placed no cap on the aggregate amount

67. The value of a debtor’s interest in property subject to a lien or liens is the excess of the fair market value of the asset over the amount of the liens on the property. See, e.g., In re Henderson, 11 BANKR. CT. DEC. (CRR) 101 (Bankr. D.N.M. 1983).
68. 11 U.S.C.A. § 522(d)(5) (West Supp. 1985). The $3900 exemption would come from the $3500 which “spills over” from the residence exemption of section 522(d)(1) after the $4000 interest in the residence is deducted, plus the $400 general exemption.
69. Id. The $4150 exemption would come from the $3750 maximum which “spills over” from the unused portion of the residence exemption of section 522(d)(1), plus the $400 general exemption.
a debtor could claim under section 522(d)(3).\textsuperscript{72} Consequently, although the provision was intended to permit debtors to keep household goods and furnishings of limited value to avoid large replacement costs, section 522(d)(3) also permitted debtors to engage in exemption planning before filing a bankruptcy petition.\textsuperscript{73} The Bankruptcy Amendments Act placed a $4000 aggregate value limit on property that the debtor may exempt under section 522(d)(3). This amendment does not, of course, prevent debtors from engaging in prebankruptcy planning. It does, however, limit the benefit of that planning to $4000. Given the purpose underlying section 522(d)(3), this limitation seems appropriate.\textsuperscript{74}

C. The Choice of Federal or State Exemptions in Joint Bankruptcies

The final change which Congress made to the exemption provisions in 1984 probably was the most significant. Code section 522(m) originally allowed bankruptcy exemptions to apply separately to each debtor in a joint bankruptcy case.\textsuperscript{75} In joint bankruptcies, each spouse could claim totally separate exemptions.\textsuperscript{76} In states which had opted out of the federal exemption system, each debtor could choose the applicable state exemption and claim the

\textsuperscript{72} See, e.g., In re Wahl, 14 Bankr. 153, 154-56 (Bankr. E.D. Wis. 1981) (each knife, fork, and spoon in a set of sterling silverware is a separate item for purposes of the exemption available under § 522(d)(3)).

\textsuperscript{73} See generally Resnick, Prudent Planning or Fraudulent Transfer? The Use of Non-exempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy, 31 RUTGERS L. REV. 615 (1978).

\textsuperscript{74} The exemption statute proposed in the Bankruptcy Commission's report served as a guide for subsequent congressional proposals. The Commission's exemption provision, section 4-503(c)(1), proposed a limit of $1,000 on the amount of household furnishings and related items that a debtor could claim as exempt to avoid abuse of this exemption. See COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, FINAL REPORT, H.R. DOC. NO. 137, PART II, 93d Cong., 1st Sess. 125 (1973) [hereinafter cited as REPORT, PART II].

A recent nonbankruptcy federal action will affect debtors' exemption claims significantly. The Federal Trade Commission has promulgated a new rule that prohibits creditors from taking non-purchase money security interests in certain household goods. 16 C.F.R. §§ 444.1-5 (1985). Although the definition of household goods in the rule is somewhat limited, the rule should operate in conjunction with the exemption provisions of the Code and state law to expand protection for debtors.


\textsuperscript{76} See, e.g., Cheeseman v. Nachman, 656 F.2d 60, 64 (4th Cir. 1981).
amount available under the applicable state law.\textsuperscript{77} In states which had not opted out, the debtors had an even wider variety of choices. They could both choose the state exemptions, both choose the federal exemptions, or one spouse could choose the state exemptions while the other chose the federal exemptions. The last situation posed the greatest problem.\textsuperscript{78}

Several states that had not “opted out” of the federal exemption system provided for more extensive exemptions than the federal system allowed.\textsuperscript{79} These state statutes, however, frequently limited the exemptions to heads of households, and did not allow separate election by each spouse.\textsuperscript{80} In this situation, the head of household could choose the state exemptions while the other spouse chose the federal exemptions, thus providing the joint debtors with more favorable treatment than if they both had chosen either the state or the federal exemption scheme. For example, California formerly allowed heads of households to exempt any property up to $45,000 in aggregate value.\textsuperscript{81} Under the old statute, if the head of household chose the California exemptions while the other spouse claimed the federal exemptions, the joint debtors could exempt

\textsuperscript{77} See Cannady v. Wilson, 653 F.2d 210, 214 (5th Cir. 1981).

\textsuperscript{78} Id. For example, a debtor in Texas who is a head of household formerly could claim up to $30,000 in personal property as exempt from attachment. Tex. Rev. Civ. Stat. Ann. art. 3836(a) (Vernon Supp. 1980) (repealed 1984). If that debtor initiated a joint bankruptcy proceeding along with the debtor’s spouse, the debtor/spouse could exempt additional personal property pursuant to section 522(d) of the Bankruptcy Code. Arguably, the state exemption already protected the debtor’s spouse, but under section 522(m) each debtor could make a separate claim of exempt property. The bankruptcy court in Cannady unsuccessfully attempted to prevent this perceived “double-dip” of exemptions. See 653 F.2d at 213-14 (reversing bankruptcy court holding concerning the exemption issue).


\textsuperscript{80} E.g., Alaska Stat. § 09.38.010(b) (1983) (individual homestead exemption of not more than $27,000 also available to co-owners of property, but aggregate value not to exceed $27,000).

$52,900 equity in a residence along with the other varieties of exempt property set out in section 522(d). This method of choosing exemptions seemingly allowed debtors to claim more exemptions than were intended by either Congress or the state legislatures. Section 522(m) of the original Code, however, clearly provided that the exemption provisions applied separately to each joint debtor. The courts interpreted that provision literally and upheld the separate exemption claims of each spouse.

Because this “mix or match” method of exemption planning expanded the exemptions debtors could claim beyond the intended amount, Congress eliminated that choice for joint debtors in the Bankruptcy Amendments Act. Debtors may continue to choose either the state or the federal exemption, but they both must choose the same statutory scheme. If the joint debtors cannot agree on which exemption scheme to choose, section 522(b) provides that the federal exemptions will apply.

One loophole remains with respect to spouses attempting to choose separate exemption schemes. The new statute applies to debtors who file joint petitions under section 302 and to individual

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84. For example, the Alaska homestead exemption protects a maximum of $27,000 equity in a residence whether the property is individually or jointly owned. See supra note 80. Permitting joint debtors to add another $7900 to the state exemption probably would contravene the Alaska legislature’s intention to limit the total household exemption to $27,000.

85. See, e.g., Cannady v. Wilson, 653 F.2d 210 (5th Cir. 1981); Ageton v. Cervenka, 14 Bankr. 833 (Bankr. 9th Cir. 1981); In re Jones, 31 Bankr. 20 (Bankr. W.D. Wash. 1983).

86. 11 U.S.C.A. § 522(m) (West Supp. 1985). This new section provides that the exemption provisions apply separately to each debtor, subject to the limitation on the splitting of exemption claims between those allowed under state law and those set out in section 522(d) of the Bankruptcy Code.

debtor's choice of exemptions when the court orders their bankruptcy proceedings to be administered jointly. The statute does not apply, however, to a spouse who initiates an individual bankruptcy proceeding when joint administration of the estates is not appropriate or when the court already has concluded the other spouse's bankruptcy proceedings. For example, if the head of household initiated a bankruptcy proceeding and claimed an available state exemption, the court could process and close the case without considering the other spouse. After the court closed the case, the other spouse could initiate a bankruptcy proceeding and claim exemptions under section 522(d). In effect, the spouses would be claiming the same expanded exemptions that they could have claimed in a joint case before the Bankruptcy Amendments Act.

Several methods are available, however, to prevent spouses from circumventing the new restriction on the choice of exemptions. First, the court could find that Congress intended to prevent separate exemption choices by spouses in all instances, and could prohibit different exemption choices whenever both spouses file bankruptcy petitions. This approach would disregard the explicit language of the statute in favor of effectuating congressional intent. A "do as I mean, not as I say" approach is not without precedent in recent bankruptcy case law, but the court might not want to take such a position if an alternative were available.

88. Id.
89. Bankruptcy Rule 1015 provides that the bankruptcy court "may order a joint administration of the estates [of a husband and wife]." Bankr. Rule 1015(b), 11 U.S.C.A. (West 1984). The rule is discretionary, not mandatory. When a court exercises this discretion, the rule requires it to "give consideration to protecting creditors of different estates against potential conflicts of interest." Id. In most joint bankruptcy cases, joint administration is appropriate. See In re Coles, 14 Bankr. 5, 6 (Bankr. E.D. Pa. 1981).
90. The treatment of the dischargeability of educational loans provides an interesting example. Congress amended the Higher Education Act in 1977 to provide that educational loans were not dischargeable in bankruptcy unless the obligation imposed an undue hardship on the debtor or his dependents or the discharge was granted more than five years after the date on which payments first were due on the loan. 20 U.S.C. § 1087-3 (1976) (repealed 1978). Congress repealed that statute in the Bankruptcy Reform Act of 1978. Pub. L. No. 95-598, § 317, 92 Stat. 2549, 2678. Congress replaced the repealed statute with a similar provision, id. § 101, ch. 5, § 523(a)(8), 92 Stat. at 2591 (to have been codified at 11 U.S.C. § 523(a)(8)) (amended 1979 prior to codification), but overlooked the fact that the new provision did not become effective until October 1, 1979. Id. § 402(a), 92 Stat. at 2682; see S. Rep. No. 230, 96th Cong., 1st Sess. 2, reprinted in 1979 U.S. CODE CONG. & AD. NEWS 936, 937. The new provision also inadvertently did not cover all of the student loan programs covered
Fortunately, an alternative position is available. In appropriate circumstances, creditors could initiate an involuntary bankruptcy proceeding against the nonfiling spouse.\textsuperscript{91} If an order for relief were entered,\textsuperscript{92} parties in interest could seek to have the bankruptcy proceedings jointly administered, thereby invoking the new restriction on available exemption choices. If the court had closed the first spouse’s bankruptcy proceedings before the second spouse filed, creditors or the trustee still could pursue this alternative by asking the court to reopen the first bankruptcy proceeding\textsuperscript{93} and to order joint administration of the two estates.

The bankruptcy court has discretion to order joint administration of separately filed proceedings when the individual debtors are entitled by section 302 of the Code to file jointly\textsuperscript{94} but they fail to do so. Bankruptcy Rule 1015(b) provides that if “two or more petitions are pending in the same court by or against . . . a husband and wife, . . . the court may order a joint administration of the

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\textsuperscript{91} Involuntary bankruptcy proceedings are governed by 11 U.S.C.A. § 303 (West 1979 & Supp. 1985). An amendment to section 303 contained in the Bankruptcy Amendments Act could make involuntary bankruptcy relief much more difficult to obtain. Creditors whose claims are the “subject of a bona fide dispute” are not eligible to initiate involuntary cases. 11 U.S.C.A. § 303(h)(1) (West Supp. 1985).

\textsuperscript{92} If the debtor does not controvert an involuntary petition, or if the court finds that the debtor is not paying his or her debts as they come due or a custodian was appointed within the preceding 120 days to take charge of less than substantially all of the debtor’s property, the bankruptcy court must enter an order for relief. 11 U.S.C.A. § 303(h) (West 1979 & Supp. 1985).


estates.” The Rule further requires the court to “give considera-
tion to protecting creditors of different estates against potential
conflicts of interest” in determining whether to order joint admin-
istration of separate proceedings. Joint administration is very dif-
ferent from consolidation of the estates, in which the debtors’ as-
sets and liabilities are combined for all purposes, including
purposes unrelated to administration. Joint administration pri-
marily involves simply the appointment or election of the same
trustee for both bankruptcy estates. The trustee still must ac-
count separately for property received by and distributed from
each bankruptcy estate. Congress authorized joint administration
to reduce administrative costs because it assumed that the spouses’
assets would be located in the same place or reasonably nearby, the
spouses would have many of the same creditors, and the spouses
might have books and records located together. To effectuate
this purpose, courts generally will order joint administration of
spouses’ estates, and the new limitations on exemption choices al-
most always will apply when bankruptcy cases are pending against
a husband and wife.

VI. PREFERENTIAL TRANSFERS

A “voidable preference” may occur when, under certain circum-
stances, an insolvent debtor transfers property to a creditor. Any
allegedly preferential transfer will be considered a voidable prefer-
ence under the Bankruptcy Code if it meets the following require-
ments: (1) the transfer must be to or for the benefit of a creditor,

96. Id.; see supra note 89.
97. The Advisory Committee Note to Bankruptcy Rule 1015 indicates that consolidation
of estates is appropriate when the assets and liabilities of two or more entities are so inter-
mingled that the court cannot separate them. Joint administration is not as restricted, how-
ever, because it involves only “the joint handling of . . . purely administrative matters that
may aid in expediting the cases and rendering the process less costly,” and not any substan-
tive consolidation of debtors’ assets and liabilities. Bankr. Rule 1015 advisory committee
99. Id. Rule 2009(f).
100. See Bankr. Rule 1015 advisory committee note, 11 U.S.C.A. (West 1984); supra note
97; see also Seligson & Mandell, Multi-Debtor Petition—Consolidation of Debtors and Due
(2) the transfer must be for or on account of an antecedent debt, (3) the debtor must have been insolvent at the time of the transfer, (4) the transfer must have been made within ninety days before the debtor filed the bankruptcy petition, and (5) the transfer must have enabled the creditor to collect more than he would have received if the transfer had not occurred and the trustee had distributed debtor's assets under the provisions of Chapter 7. The main purpose of the Code's preference provisions is to promote equality in the distribution of the debtor's estate to creditors. To accomplish this goal, the Code prevents certain creditors from receiving payments shortly before the debtor initiates bankruptcy proceedings. Without this protection, debtors could deplete the assets that otherwise would be distributed fairly to all creditors on a pro rata basis. Preferential transfer rules also discourage creditors from racing to the court house to dismember the debtor during his slide into bankruptcy . . . thus afford[ing] the debtor [an opportunity] to work his way out of a difficult financial situation through cooperation with all of his creditors."

In the Bankruptcy Amendments Act, Congress adopted several changes in the preference provisions of the Code which bear on consumer bankruptcy cases. The Act altered the provisions governing preferential transfers to insiders, preferential transfers of less than $600, and debts repaid in the ordinary course of business. These changes must be analyzed in light of Congress' overall objectives in regulating voidable preferences.

A. Preferential Transfers to Insiders

Allegedly preferential transfers often involve a debtor who pays an obligation to an "insider" to the detriment of other creditors. The Code definition of "insiders" includes relatives of the debtor,

103. Id. at 177, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 6138.
105. Id. § 547(c)(7).
106. Id. § 547(c)(2).
partnerships in which the debtor is a general partner, general part-
ners of the debtor, relatives of general partners of the debtor, and
corporations of which the debtor is a director, officer, or person in
control. A relative is defined as an "individual related by affinity
or consanguinity within the third degree as determined by the
common law, or [an] individual in a step or adoptive relationship
within such third degree." Under this definition, the debtor's
spouse, parents and children all are insiders for the purposes of the
Code. Debtors often owe money to these insiders, and may have
repaid some of the obligation through the transfer of money, other
property, or a security interest.

The Code's insider preference provisions were amended in the
“Miscellaneous Amendments” portion of the Bankruptcy Amend-ments Act. Despite their classification as “miscellaneous,” these
changes will have a significant effect on some consumer bank-ruptcy cases. Before the Bankruptcy Amendments Act, transfers to
insiders which occurred between ninety days and one year before
the debtor filed the bankruptcy petition were deemed voidable
only if they met all the other requirements of the preference sec-
tion. The bankruptcy trustee had the power to avoid these prefer-
tential transfers only if the insiders “had reasonable cause to be-
lieve the debtor was insolvent at the time of such transfer.” If
the transfers occurred within ninety days before the bankruptcy
filing, however, the trustee could avoid the transfers regardless of
whether the insider creditors knew of the debtor's insolvency.
The Bankruptcy Amendments Act removed the requirement that
the insider have “reasonable cause to believe the debtor was insol-
vent” for the entire year before the debtor filed for bankruptcy. Con-
sequently, Congress removed the major difference between the

107. Id. § 101(28).
108. Id. § 101(37).
109. Id. § 547(b)(4)(B).
ence provisions appeared in section 462 of the Act. Id. § 462(b)(2), 98 Stat. at 378.
1985).
113. Id. § 547(b)(4)(A); see H.R. Rep. No. 595, supra note 102, at 178-79, reprinted in
1978 U.S. CODE CONG. & AD. NEWS at 6139.
treatment of preferential transfers to insiders and the treatment of preferential transfers to other creditors.

One significant difference between the two types of preferential transfers still remains. Section 547(f) provides that "the debtor is presumed to have been insolvent on and during the ninety days immediately preceding the date of the filing of the petition." This presumption does not apply to transfers made more than ninety days before the debtor filed the bankruptcy petition. To avoid these transfers, the trustee must prove that the debtor was insolvent at the time of the transfer. Although the new insider provision retained this distinction, the provision still will have a significant impact because trustees will find proving that the debtor was actually insolvent at the time of the transfer will be much easier than proving that the insider had "reasonable cause to believe" that the debtor was insolvent at the time of the transfer.

Considering the nature of insider transactions, the new provision may not further the goals of voidable preference legislation. Congress originally placed the one year limitation on certain insider transactions rather than the ninety day limitation applicable to other preferences because many debtors can refrain from filing a bankruptcy petition until a short time limitation has passed. Debtors are especially willing to do this when insider transactions are involved because they often want to repay family debts first. The "reasonable cause to believe that the debtor was insolvent" requirement made sense for insider transactions that took place between ninety days and one year before bankruptcy because if the insider was close enough to the debtor to justify the concerns that prompted the insider preference provision, the insider presumably


116. Day v. Central Fidelity Bank, 6 BANKR. CT. DEC. (CRR) 1239, 1240 (Bankr. W.D. Va. 1980). Section 547(g) now provides explicitly that the trustee has the burden of proving all the elements of a voidable preference set out in section 547(b). 11 U.S.C.A. § 547(g) (West Supp. 1985).


would have gained sufficient knowledge from which a reasonable person would conclude that the debtor was insolvent.119 Because the new section lacks this reasonableness standard, it will allow trustees to avoid transfers that do not implicate any legitimate insider preference concerns. For example, a trustee could invoke the new section to avoid a transfer in which a debtor repaid an honest family debt eleven months before filing a bankruptcy petition, even though the debtor did not intend to deny other creditors their rightful share of the estate and the creditor had no reason to know of the debtor’s insolvency.

Advocates of the new insider preference provision certainly could advance cogent reasons for Congress’ removal of the “reasonable cause to believe” language.120 Regardless of whether the amendment was necessary or proper, however, it is now the law. If an insider receives an apparently preferential transfer from the debtor within one year before the debtor filed for bankruptcy, the trustee no longer needs to prove that the insider had reasonable cause to believe that the debtor was insolvent at the time of the transfer to recoup the transferred assets for the estate.

B. Exclusion for Preferential Transfers of Less Than Six Hundred Dollars

The Bankruptcy Amendments Act also added a new subsection (7) to Code section 547(c).121 The new subsection provides that the trustee may not avoid an otherwise avoidable transfer “if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.”122 This new provision not only creates the problem of identifying “an individual debtor whose debts are primarily consumer debts,”123 but it also leaves many other questions unanswered.

122. Id.
123. "Consumer debts" are debts "incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(7) (1982); see In re Burgess, 22 Bankr. 771,
One such question is how the court should determine when "the aggregate value of all property that constitutes or is affected by such transfer is less than $600." Interpreted literally, section 547(c)(7) seems to apply to single transfers only, because the introductory language of section 547(c) speaks in terms of a single transfer and the new subsection (7) refers to "such transfer." In spite of this language, the new section appears to extend to aggregations of value involving the transfer of several types of property in a single transaction between the debtor and a single creditor. For example, suppose the debtor made three monthly payments of $250 to a creditor in repayment of a consumer loan, that each of these transfers occurred less than ninety days before the debtor filed the bankruptcy petition, and that the transfers otherwise satisfied the preference criteria of section 547(b). In this situation, the "aggregate value" of property transferred to the creditor during the preference period would be $750 but the value of each individual transfer would be only $250. Because the language of section 547(c)(7) suggests that it applies to individual transfers, each $250 transfer would be protected. Suppose, however, that the debtor simultaneously transferred a $500 automobile and $500 in cash to the same creditor. Under section 547(c)(7), the two elements of the transaction must be aggregated. As a result, the transfer would be valued at $1000 and it would fall outside the.
protection of section 547(c)(7). Only if the debtor had transferred
the two kinds of property separately would section 547(c)(7) shel-
ter each transfer from a trustee's preference attack.

Like the other exceptions to preference recoveries set out in sec-
tion 547(c), the section 547(c)(7) exception is of the all-or-nothing
variety. To the extent that the exception is operative, it will pro-
tect the transfer in its entirety. If the transfer value equals or ex-
ceeds $600, however, the trustee may avoid the entire transfer, not
just the amount over $600. This all-or-nothing nature could be-
come even more burdensome for creditors if a court construed the
aggregation directive of section 547(c)(7) to require the aggregation
of all transfers to a particular creditor during the preference
period, as a court conceivably could do in spite of the "single
transfer" language in the section.\textsuperscript{125} If a court interpreted section
547(c)(7) in this manner, a creditor who received a potentially
preferential transfer and feared the debtor might file a bankruptcy
petition would be well advised to accept no more than $599 in pay-
ments during any ninety day period. In this way, the creditor still
could qualify for the full protection of section 547(c)(7). The most
effective way to avoid section 547(c)(7) problems, however, would
be for the creditor to obtain a security interest of $599 or less in
the debtor's property.\textsuperscript{126} The creditor thus could avoid the trus-
tee's potential preference attack by adding $599 to the amount of
debt secured by the collateral through a series of "separate"
transfers.\textsuperscript{127}

\textsuperscript{125} A court which interpreted section 547(c)(7) in this manner still would have to deter-
mine how much of a transfer was avoidable. The trustee obviously would prefer to avoid the
entire transfer, but the court could decide to limit the trustee's recovery to amounts trans-
ferred in excess of $600.

\textsuperscript{126} The debtor's grant of a security interest is a transfer of property which may consti-
tute a voidable preference if it satisfies all the requirements of § 547(b). Section 101(48)
defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or
involuntary, of disposing of or parting with property or with an interest in property, includ-
ing retention of title as a security interest and foreclosure of the debtor's equity of redemp-
tion." 11 U.S.C.A. § 101(48) (West Supp. 1985); see, e.g., Time Oil Co. v. Wolverton, 491
F.2d 361, 364-65 (9th Cir.), cert. denied, 417 U.S. 947 (1974); In re Loe Prod., Inc., 1 BANKR.
CT. DEC. (CRR) 1301, 1303 (Bankr. S.D. Cal. 1975).

\textsuperscript{127} The trustee could attack the transfers, however, by claiming that the debtor made
them "with actual intent to hinder, delay or defraud" other creditors. 11 U.S.C.A. §
Section 547(c)(7) contains problems even more fundamental than its difficulty in application or its potential loopholes. As enacted, section 547(c)(7) does not advance the purposes which an exception to the preference provisions should achieve. The reasons originally advanced to support the exception were that small payments made in the ordinary course of the debtor's financial affairs generally do not result from significant creditor pressure on the eve of bankruptcy, and that the small preference recoveries trustees might obtain without this exception probably would be consumed by the administrative costs associated with the effort, leaving nothing to distribute to other creditors on a pro rata basis. As enacted, however, the new exception actually may increase the likelihood of creditor pressure on debtors. Creditors may pressure a debtor to pay obligations in a manner which aids the creditors' ability to qualify for the exception in the event that the debtor seeks bankruptcy relief shortly thereafter. By orchestrating transactions to gain the protection of section 547(c)(7), creditors could push a debtor into filing for bankruptcy relief. Because these creditors all have the same interest and simultaneously could seek to enter into transactions with the debtor to obtain section 547(c)(7) protection, the potential for this scenario is high. The new exemption will protect creditors in these situations from any preference attack by the trustee even though the transactions were conducted outside both the ordinary course of the debtor's financial affairs and the ordinary course of the creditors' businesses and the creditors had reasonable cause to believe at the time of the transaction

548(a)(1) (West Supp. 1985). The debtor should be able to defend against the attack, however, by claiming that the transfers were intended not to defraud any other creditors, but rather to repay one creditor.

128. See Hearings, Part I, supra note 7, at 93 (Recommending Note accompanying Proposed Consumer Bankruptcy Improvements Act). The consumer credit industry proposed to limit protection from preference attacks to transfers which met three conditions: (1) the transfers occurred during the preference period for the repayment of consumer debts; (2) the transfers occurred in the ordinary course of both the debtor's and the transferee's financial affairs; and (3) the aggregate of all such transfers to the transferee did not exceed $750. Id. at 92 (section 10). The requirement that transfers be in the ordinary course of business, however, was not included in the version enacted by Congress. As a result, the arguments advanced by the consumer credit industry to support its own proposal do not fully support the preference exception which Congress adopted. Moreover, both the industry proposal and the final version limit the exception to individual debtors, even though the policies underlying the exception apply just as strongly to business bankruptcy proceedings.
that the debtor was insolvent. The addition of section 547(c)(7), therefore, may encourage the specific conduct that Congress intended to discourage through the preference provisions.

C. Repayment of Debts in the Ordinary Course of Business

The third change which Congress made to the preference rules, like the first change discussed in this section, was made by a “miscellaneous” amendment to section 547(c)(2). Under the original Bankruptcy Code, a bankruptcy trustee could not avoid transfers of a debtor’s property in payment of debts incurred by the debtor not more than forty-five days before the payment if the payment was made in the ordinary course of the debtor’s and creditor’s business or financial affairs. The Bankruptcy Amendments Act removed the time limitation in section 547(c)(2). As a result, if the debtor pays a debt during the preference period, and both the debt and the payment were in the ordinary course of the debtor’s and the creditor’s business or financial affairs, the transfer is not a voidable preference.

By removing the forty-five day limitation, Congress expanded the protection of section 547(c)(2) to a wide variety of transactions which it previously deemed unworthy of protection. Under the new section, for example, installment payments made by the debtor on or before the date on which the payments would have become delinquent are not recoverable as a preference, even if the debtor incurred the original debt long ago and the creditor had no other collateral to secure the obligation. Similarly, the amendment protects installment debts secured by collateral with a value less than the total outstanding indebtedness as long as the debtor makes the payments according to the installment repayment schedule. The number of otherwise preferential transfers that may fall under this subsection is limited only by the requirement that the repayment must be made in the ordinary course of both the debtor’s and creditor’s business or financial affairs. Consequently, virtually all timely payments of installment obligations will be protected under

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section 547(c)(2) because timely payments almost always are in the ordinary course of the creditor's business and the ordinary course of the debtor's financial affairs.

Because late or early payments usually would not be in the ordinary course of the debtor's affairs, section 547(c)(2) may not protect the creditor when some or all of the debtor's payments were untimely. This conclusion is not inescapable, however. For example, if the debtor paid only some obligations on time, the creditor might argue successfully that the exception should apply because the ordinary course of the debtor's financial affairs was the current payment only of selected debts. Even if the debtor made all his payments on delinquent or future obligations, the creditor could assert under certain circumstances that the repayment of selected debts was the ordinary course of the debtor's financial affairs. This argument might be persuasive, for example, if the debtor had a history of making payments in the same manner as the allegedly preferential transfers in question.

Creditors also may contend that the receipt of delinquent payments or prepayments is the ordinary course of their business affairs. This contention would be especially probative if the debtor's payment history with the particular creditor is similar to the payment history during the preference period. Creditors who face potential preference attacks by bankruptcy trustees, therefore, should examine the debtor's entire payment history to determine if section 547(c)(2) is available to protect the transfers. If a payment history sufficient to support a section 547(c)(2) defense is not available, the creditor should review the debtor's general credit history and repayment habits to bolster a defense to any preference challenge. Section 547(c)(2) also may work in tandem with the new exception in subsection (c)(7) to provide creditors with multiple protection against preference attacks. For example, if a debtor made both current and delinquent payments to a creditor within a single preference period, the creditor could employ section 547(c)(2) to protect the current payments and section 547(c)(7) to

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132. 11 U.S.C.A. § 547(c)(7) (West Supp. 1985) (exclusion for preferential transfers of less than $600); see supra notes 121-28 and accompanying text.
The three changes Congress made to the Code's preference provisions in the Bankruptcy Amendments Act have strengthened substantially creditors' ability to defend preference actions in consumer bankruptcy cases. The "safe harbor" created by subsection (c)(2) is especially significant. This exception seems broad enough to encourage creditors to raise the defense in all but the most egregious cases of repayment of consumer obligations during the ninety days immediately before the bankruptcy filing.

VII. Dischargeability of Debts

Congress also made several changes in the dischargeability provisions which will affect consumer bankruptcy cases. Specifically, Congress expanded the category of nondischargeable alimony and child support claims, excepted from discharge certain debts connected with injuries and property damage caused by a debtor's intoxicated driving, and eliminated dischargeability for consumer debts for luxury items and credit card advances obtained shortly before the bankruptcy petition was filed. Congress also altered section 523(d) of the Bankruptcy Code to reduce the likelihood that attorney fees will be awarded to consumer debtors who successfully defend dischargeability cases brought under section 523(a)(2).

A. Nondischargeable Alimony and Child Support Claims

The general rule of section 523(a)(5) is that debts for "alimony to, maintenance for, or support of [the debtor's] spouse or child, in connection with a separation agreement, divorce decree, or other order of a court of record or property settlement agreement" are

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133. The delinquent amounts also might be protected under section 547(c)(2) if the creditor could establish that the delinquent payments were in the ordinary course of the debtor's and creditor's business or financial affairs. 11 U.S.C.A. § 547(c)(2) (West Supp. 1985).
136. Id. § 523(a)(2)(C).
137. Id. § 523(d).
nondischargeable if the "liability is actually in the nature of alimony, maintenance, or support" and the original obligee has not assigned the claim to another entity.\textsuperscript{138} Under the original Code, assignment to another entity always rendered the debt dischargeable in the hands of the assignee.\textsuperscript{139} In 1981, however, Congress adopted an exception to section 523(c)(5) under which claims assigned pursuant to section 402(a)(26) of the Social Security Act retained their nondischargeable character.\textsuperscript{140} The Bankruptcy Amendments Act further expanded the protection of government assignees by providing that debts assigned "to the federal government or to a state or any political subdivision of such state" also will remain nondischargeable.\textsuperscript{141} Thus, contrary to prior law, assignment of child support claims to state or local governmental agencies no longer will make these debts dischargeable.

In addition to government assignees of child support and alimony claims, Congress added another category of claimants to the coverage of section 523(a)(5). Originally, the only claims made nondischargeable by this section were claims arising out of separation agreements, divorce decrees, or property settlement agreements.\textsuperscript{143} Some courts, applying this language literally, had held debts for child support due under paternity orders dischargeable.\textsuperscript{144} Congress closed this loophole by amending the language of section 523(a)(5) to include any "other order of a court of record" that establishes liability for alimony, maintenance, or support.\textsuperscript{145} As a result, debts for child support arising from paternity actions now

\textsuperscript{142} See supra note 139 and accompanying text; see also Lake County Dep't of Pub. Welfare v. Marino, 29 Bankr. 797, 801 (N.D. Ind. 1983) (claim had not been assigned, but a court had directed that support payments be made directly to the welfare department; bankruptcy court nevertheless found the debt dischargeable).
are nondischargeable. No good reason had existed for distinguishing child support ordered in a divorce decree from child support required by a paternity order. This amendment, therefore, represents an appropriate expansion of nondischargeability protection.

B. Other New Categories of Nondischargeable Claims

The Bankruptcy Amendments Act also created two nondischargeable claim categories which relate closely to previously existing nondischargeable claim categories. The first category, claims against debtors who drive while intoxicated and cause injuries or property damage\(^1\) may be considered a subcategory of willful and malicious injury claims, which already were nondischargeable under section 523(a)(6).\(^2\) The second, claims for luxury items and credit card advances obtained shortly before the debtor filed for bankruptcy\(^3\) actually is a subcategory of fraudulently obtained money, property, or services claims, which already were nondischargeable under section 523(a)(2).\(^4\) To understand the scope and purpose of these new categories, one must consider the treatment of these claims both before and after Congress enacted the Bankruptcy Code.

1. Claims for Injury or Property Damage Attributed to Driving While Intoxicated

Section 523(a)(6) of the original Code\(^5\) and section 17(a)(2) of the old Bankruptcy Act\(^6\) each declared debts nondischargeable if they arose from willful and malicious injuries inflicted by the debtor upon another entity or its property. Persons injured by debtors who were driving while intoxicated often sought to have their claims against the debtor held nondischargeable under these

\(^{146}\) Id. § 523(a)(9).


\(^{149}\) Id. § 523(a)(2)(A).


These attempts enjoyed mixed success. Some courts held the debts nondischargeable because drunken driving was sufficiently reckless to constitute willful and malicious conduct. Reaching the same result, other courts suggested that the debtor acted willfully and maliciously because the debtor drove with knowledge that an intoxicated driver was more likely to injure others than a sober driver. Other courts, however, held the claims dischargeable because the debtor had not intended specifically to injury the claimants.

In the 1984 amendments, Congress added section 523(a)(9), which provides that a debt will not be dischargeable if it was created by a “judgment or consent decree entered by a court of record” finding that the debtor operated “a motor vehicle while legally intoxicated under the laws or regulations of any jurisdiction within the United States or its territories” and caused injuries to persons or property. The limitation relating to judgments and consent decrees may cause some problems. The existence of the limitation suggests that these claims still are dischargeable unless, before the debtor filed for bankruptcy, a court of record had entered a final order which determined that the debtor injured the creditor by driving while intoxicated. The amendment does not explain how bankruptcy courts should treat these debts if no court has resolved the underlying cause of action. Because a bankruptcy court does not have jurisdiction to hear personal injury and wrongful death claims, it cannot resolve the underlying issue of liability. The creditor must establish the claim in a federal district court or an appropriate state court. The bankruptcy court also cannot hold the bankruptcy proceedings in abeyance pending the outcome of the tort litigation because it would unduly delay the administration of the case.

152. For a listing of some representative cases, see supra note 147.
158. See id.
Section 523(c) may resolve the problem. This provision requires only those creditors holding claims alleged to be nondischargeable under subsections 523(a)(2), (4), or (6) to file complaints to determine the dischargeability of their debts. Injured creditors who hold section 523(a)(9) claims need not seek a dischargeability determination from the bankruptcy court because section 523(a)(9) does not appear on the list in section 523(c). Section 523(a)(9) debts automatically are nondischargeable once an appropriate court determines that the injury was caused by the debtor's intoxicated driving. Nonetheless, prudent counsel for parties injured by intoxicated drivers should consider seeking relief from the stay to pursue the action against the debtor and, in appropriate circumstances, a specific exception from the discharge for the creditor's claim in the event that a nonbankruptcy court subsequently enters judgment against the debtor.

2. Claims Relating to Luxury Good Purchases and Credit Card Advances

The second new category of exceptions to discharge is contained in section 523(a)(2)(C). This section makes claims nondischargeable if they result either from the debtor's purchase of luxury goods or services worth more than $500 within forty days before the order for relief or from cash advances to the debtor of more than $1000 made within twenty days before the order for relief. Because section 523(c) specifically mentions section 523(a)(2), a creditor holding such a claim must initiate an adversary proceeding in the bankruptcy court to determine the dischargeability of the associated debt. If the creditor does not act in a timely fashion, the bankruptcy court will discharge the claim.

160. See id. § 523(a)(9).
161. Id. § 523(a)(2)(C).
162. See supra note 159 and accompanying text.
164. Bankruptcy Rule 4007(c) sets a time limit on creditors' ability to exercise their rights under section 523(c) to object to dischargeability. The rule provides:
   A complaint to determine the dischargeability of any debt pursuant to § 523(c) of the Code shall be filed not later than 60 days following the first date set for the meeting of creditors held pursuant to § 341(a). The court shall give all
By adding this category of nondischargeable debts, Congress intended to prevent debtors from "loading up" before they file for bankruptcy by purchasing many items for which they do not intend to pay.\textsuperscript{165} Although these claims arguably were nondischargeable already under section 523(a)(2)(A),\textsuperscript{168} the enactment of section 523(a)(2)(c) removes any doubt. Creditors no longer have to prove that the debtor incurred these obligations without an intent to repay to make the debts nondischargeable.\textsuperscript{167}

As presently drafted, however, section 523(a)(2)(C) contains language which may lead to the discharge of some claims Congress intended to include in the exception to dischargeability. The major shortcoming of the amendment is that it sets a time limit on its coverage of these debts. As a result, the debtor may avoid the statute simply by not filing for bankruptcy until the relatively short time period provided in the new section has passed. If the debtor waits twenty-one days to file a bankruptcy petition, or forty-one days if credit card advances are involved, the claims will not be governed by section 523(a)(2)(C). The claims might be nondischargeable under section 523(a)(2)(A),\textsuperscript{168} but creditors who attempt to gain nondischargeable status under this section must

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creditors not less than 30 days notice of the time so fixed in the manner provided in Rule 2002. On motion of any party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be made before the time has expired.


\textsuperscript{167} The amendment to § 523(a)(2) creates a presumption of nondischargeability for specified debts. 11 U.S.C.A. § 523(a)(2)(C) (West Supp. 1985). The presumption may be characterized more appropriately as one of fraud rather than nondischargeability. See infra notes 173-75 and accompanying text.

\textsuperscript{168} See infra note 179 and accompanying text.
prove that the debtor did not intend to repay the debt at the time it was incurred.\textsuperscript{169}

Creditors generally will not be able to avoid the time limit of section 523(a)(2)(C) by initiating involuntary bankruptcy proceedings against debtors because the time limits are based on the date that the court enters an order for relief and not the date on which the bankruptcy petition is filed.\textsuperscript{170} When a creditor files an involuntary petition, the debtor has twenty days to respond.\textsuperscript{171} If the debtor denies the creditor's allegations in the answer, the bankruptcy court probably could not resolve the issue and grant an order for relief within the next twenty days.\textsuperscript{172} Because the twenty and forty day time limits in section 523(a)(2)(C) will pass before the court grants the order for relief, the creditor will not be able to qualify for nondischargeability under this section. In short, the debtor and his attorney always can avoid nondischargeability under section 523(a)(2)(C) by waiting to file a voluntary petition until the time period expires and by objecting to any involuntary proceedings filed by creditors. Consequently, the addition of section 523(a)(2)(C) should have only a slight effect on nondischargeability under the Bankruptcy Code.

Another problem with the new section is that it provides only a presumption that debts from “loading up” are nondischargeable. Because nondischargeability only is presumed, bankruptcy courts

\textsuperscript{172} The debtor need not respond to the summons and complaint until twenty days after service. \textit{Id.} If the debtor denies the allegations in the complaint, the creditor immediately could file a motion for summary judgment. \textit{Id.} Rule 7066 (Fed. R. Civ. P. 56, governing summary judgments, applies in “adversary proceedings”); \textit{id.} Rule 1018 (Rule 7066 applies in all “proceedings related to a contested involuntary petition”). Fed. R. Civ. P. 56(c) requires that the debtor receive at least ten days notice of a hearing on the creditor’s motion for summary judgment. Because of these procedural obstacles, the presumption of nondischargeability will not apply in an involuntary bankruptcy case unless the court shortens the time for the debtor to respond to the complaint and motion, Bankr. Rule 9006(c), 11 U.S.C.A. (West 1984), or the creditor files the involuntary bankruptcy petition within ten days after the debtor makes a credit purchase of luxury goods covered by § 523(a)(2)(C). The presumption in involuntary cases is eliminated entirely for credit card cash advances, unless a court order under Rule 9006(c) has mandated an extraordinarily expedited response to the creditor’s petition, because the applicable time limit is only twenty days, not forty. See 11 U.S.C.A. § 523(a)(2)(C) (West Supp. 1985).
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should permit debtors to rebut the presumption. For example, if a debtor could show an intent to repay the debt at the time it was incurred, and a financial status which made that intent reasonable, the court should discharge the debt unless the creditor can carry the ultimate burden of persuasion concerning the debtor’s intent. To carry this burden, the creditor must provide clear and convincing evidence of the debtor’s fraudulent intention and the creditor’s reasonable reliance. When a debtor presents credible evidence to support an intent to repay the debt, therefore, the proceeding will resemble a dischargeability determination under the pre-amendment provisions of section 523(a)(2). As a result, the presumption included in the language of section 523(a)(2)(C) will limit even further the impact of the section upon dischargeability determinations under the Code.

Creditors and debtors also may face a definitional problem in section 523(a)(2)(C) litigation. The term “luxury goods or services” appears in quotes as if it were self-defining. Congress’ imprecise wording will invite prolonged litigation because courts will have to determine what a “luxury” is every time a creditor seeks to invoke the new provision. Obvious cases, such as debts for rent on an apartment, purchase of staple grocery items or, on the other end of the spectrum, the purchase of a “big screen” television by a debtor who already owns a working color television set, will not cause interpretational problems. In these situations, the creditor on the losing end would be ill-advised to contest the issue because such a contest could trigger liability for the debtor’s attorney fees at the conclusion of the case. The gray area between these extremes, however, is substantial. For example, the court could not

173. See Zaretsky, supra note 166, at 1081-83.
176. The provisions concerning cash advances under an “open end credit plan” should not cause a problem because that term is defined in the Consumer Credit Protection Act. 15 U.S.C. § 1602(i) (1982); see also 12 C.F.R. § 226.2(a)(20) (1985) (regulatory interpretation).
178. Id. § 523(d); see infra notes 184-200 and accompanying text; cf. American Express Co. v. Waldman, 33 Bankr. 328, 330 (Bankr. S.D.N.Y. 1983) (court suggested that pre-
decide easily whether mechanical repairs on a debtor's pleasure craft were luxury services. The services certainly relate to a luxury item, but the services themselves arguably are not a luxury in the same sense that an ocean cruise would be a luxury. The purchase of an expensive antique dining room table when the debtor could have purchased another table for one tenth of the price also would cause interpretational problems. Should the determination be different if the debtor owned no other table? What if the debtor already owned matching chairs?

These questions cannot be answered simply by considering the statutory language. Courts must address these issues on a case-by-case basis, and the likelihood of arriving at a consensus is not great. Too many goods and services will fall under this provision to allow the courts to establish a uniform test quickly or easily. The problem is complicated further by the question of whether courts should consider a debtor's socioeconomic background when determining if a particular item is a "luxury" item.

The problems courts will face in defining "luxury" for the purposes of section 523(a)(2)(C) will detract significantly from the usefulness of the provision. The problems created by the time limitations on nondischargeability and the rebuttability of the presumption in the new section will have a similarly negative impact. Given these difficulties and the availability of section 523(a)(2)(A) as an alternative method of establishing nondischargeability, the value of section 523(a)(2)(C) as an addition to the Bankruptcy Code is open to serious question.

C. Chapter 13 and the New Categories of Nondischargeable Debts

The provisions of Chapter 13 also may significantly limit the effectiveness of the recent amendments creating new categories of nondischargeable debts. Claims arising from driving while intoxicated, credit card advances, and purchases of luxury goods still may be discharged under the full payment discharge provision of

bankruptcy shopping spree "established a prima facie case that [the] debt was nondischargeable under Bankruptcy Code § 523(a)(2)(A)," although it dismissed the case because the creditor failed to file a timely complaint).

179. 11 U.S.C.A. § 523(a)(2)(A) (West Supp. 1985) (exception to discharge for "false pretenses, a false representation, or actual fraud").
Chapter 13. Changes to Chapter 13 provisions made in the Bankruptcy Amendments Act may reduce the effect of the Chapter 13 full payment discharge, but these provisions do not eliminate the possibility that otherwise nondischargeable claims may be discharged under Chapter 13 and the full payment discharge provision. The impact of such an occurrence would be substantial because each category of otherwise nondischargeable claims could involve a substantial sum of money. For example, damage claims by individuals injured because of the debtor's drunk driving could exceed other claims against the debtor by tenfold or more. The debtor also could incur massive debts for luxury goods and services by "loading up" just before filing for bankruptcy. Consequently, partial payment of these claims under a Chapter 13 plan could result in a full discharge even though Congress clearly indicated in Section 523 that the claims should be completely nondischargeable.

D. Debtors' Attorney Fees Associated with Dischargeability Determinations

The final change which Congress made to the Code's dischargeability provisions in 1984 affected the standard of review which the court must apply to determine whether debtors who successfully defend dischargeability cases under section 523(a)(2) are entitled to recover attorney fees. Under the original Code, the court was directed to grant judgment "in favor of the [successful]
debtor for the costs of, and a reasonable attorney's fee for, the proceeding to determine dischargeability, unless such granting of judgment would be clearly inequitable."\textsuperscript{184} The consumer credit industry objected to this provision and sought to have it amended.\textsuperscript{185} Congress responded by allowing bankruptcy courts to enter judgment in favor of the debtor for costs and reasonable attorney fees only "if the court finds that the position of the creditor was not substantially justified [and, in any event, not] if special circumstances would make the award unjust."\textsuperscript{186}

The reasons for consumer credit industry dissatisfaction with the original language of section 523(d) were illustrated in a 1983 decision of the United States Court of Appeals for the Sixth Circuit. In \textit{Thorp Credit, Inc. v. Carmen},\textsuperscript{187} the first circuit court opinion to construe the section, the court held that the debtor was entitled to costs and reasonable attorney fees because the creditor failed to produce any evidence that the debtor made a materially false statement with intent to deceive the creditor.\textsuperscript{188} According to the court, "the bankruptcy court was required to award fees in [the] case" because this "primary element" of the creditor's case was absent.\textsuperscript{189} The dissent, however, asserted that the majority's ruling left creditors in an untenable position because creditors generally must prove a debtor's intent to deceive through circumstantial evidence. According to the dissent, even if a creditor presented circumstantial evidence of the debtor's intent to deceive the creditor, the creditor often would be required to pay attorney fees because the court might not be persuaded by the creditor's evidence.\textsuperscript{190}

The dissenting judge read more into the court's opinion than the majority actually stated. The court specifically noted that "the bankruptcy court found that [the creditor] had failed to produce any evidence on the element of intent to deceive."\textsuperscript{191} The creditor

\textsuperscript{185} See Hearings, Part I, supra note 7, at 84.
\textsuperscript{187} 723 F.2d 16 (6th Cir. 1983).
\textsuperscript{188} Id. at 18.
\textsuperscript{189} Id.
\textsuperscript{190} Id. at 19 (Wellford, J., dissenting).
\textsuperscript{191} Id. at 18 (emphasis added).
also did not appeal the bankruptcy court's decision on the dischargeability of the debt, which caused the majority to consider that issue closed in the appeal and to consider only the award of attorney fees under section 523(d).\textsuperscript{192} Contrary to the interpretation reflected in the dissent, the court established only that if a creditor fails in an attempt to have the court declare a consumer debt nondischargeable under section 523(a)(2) because of the creditor's failure to produce any evidence concerning intent to deceive, the debtor will be able to recover any costs and attorney fees that were incurred in defending the action. The consumer credit industry, however, reacted in the same way as the dissenting judge in \textit{Thorp Credit}. The industry was concerned that other courts would give \textit{Thorp Credit} a broad interpretation—an interpretation that would permit an attorney fee award every time a debtor prevailed in a dischargeability proceeding, regardless of the reason for the debtor's success.\textsuperscript{193}

Congress' amendment to section 523(d) may not resolve the industry's concerns totally. The amended statute still provides that the court "shall grant judgment."\textsuperscript{194} The legislative history of this language in the original section suggests that bankruptcy courts generally should award costs and fees to all debtors who successfully defend section 523(a)(2) cases. Although the Senate version of section 523(d) provided that "the debtor may be awarded costs and a reasonable attorney's fee for the proceeding to determine the dischargeability of a debt if the court finds that the proceeding was frivolous or not brought by its creditor in good faith,"\textsuperscript{195} the House version provided: "The cost-attorney's fees provision is mandatory."\textsuperscript{196} The final version fell between these extremes, but

\textsuperscript{192} See id. at 16.
\textsuperscript{193} See \textit{Hearings, Part I, supra} note 7, at 84.
\textsuperscript{196} See H.R. Rep. No. 595, \textit{supra} note 102, at 131-32, \textit{reprinted in} 1978 U.S. Code Cong. & Ad. News at 6092-93 (describing section 523(d) of H.R. 8200, the House version of the Bankruptcy Reform Act of 1978). The House version also allowed the court to grant the debtor "any actual pecuniary damages, such as loss of a day's work, that the debtor might have suffered as a result of the litigation." \textit{Id.}
it bore a much greater resemblance to the House version. Consequently, bankruptcy courts generally focused on the mandatory language of original section 523(d), and they routinely applied the House analysis to justify judgments under that section in favor of debtors.

As amended, section 523(d) relaxes the restrictions on courts that might prefer to deny a debtor’s request for costs and fees. The new section, however, still allows bankruptcy judges to construe the statute liberally to favor debtors and to award fees and costs. By finding that a creditor’s case is not substantially justified unless the creditor offers some strong evidence supporting each element

197. The resemblance to the House version is demonstrated by two distinct similarities. First, the final version was phrased in the same mandatory fashion as the House version. 11 U.S.C. § 523(d) (1982) (“the court shall grant judgment against such creditor”). Second, the Senate language requiring that the action not be “frivolous” or “not brought by its creditor in good faith” was dropped from the final act. Id.


In cases in which debtors were denied awards under the original section 523(d), the courts focused on the debtors’ conduct rather than the creditors’ good faith in denying the debtors’ requests for costs and fees. E.g., Camden Nat’l Bank v. Archangeli, 6 Bankr. 50, 53 (Bankr. D. Me. 1980) (creditor demonstrated debtor’s actual intent to deceive, making award of attorney fees to debtor inequitable). But cf. Thorp Credit, Inc. v. Carmen, 723 F.2d 16, 18 (6th Cir. 1983) (attorney fees awarded because creditor produced no evidence of debtor’s intent to deceive, in spite of dissent’s objection that the court clearly was in error in holding that the creditor had produced no such evidence). Courts justified these decisions by noting that if a creditor could prove intentional misrepresentation by the debtor, a decision to award costs and fees to the debtor merely because the creditor could not also prove reasonable reliance on those misrepresentations would be “clearly inequitable.” Camden Nat’l Bank, 6 Bankr. at 53.


200. These restrictions had been a serious deterrent to courts that wished to exercise discretion concerning attorney fee awards. For instance, in First Serv. Corp. v. Schlickmann, 7 Bankr. 139 (Bankr. D. Mass. 1980), the judge lamented:

I am mindful that in interpreting [section 523(d) to require the payment of attorney fees] as I have, honest creditors who might already be bearing the burden of a watered-down dividend on the debt owed to them will also be strapped with the expense of seeking to honestly and faithfully protect their rights. While in many cases I would be reluctant to saddle creditors with this additional cost, I feel my hands are tied. Section 523(d) does not provide for judicial discretion in this manner.

Id. at 140-41.
of the case, bankruptcy courts could minimize the actual impact of amended section 523(d). Absent strict appellate court directives, the amendment to section 523(d) may not alter the actual criteria for awards of costs and attorney fees applied in some districts.

VIII. Chapter 13 Amendments

Although Chapter 13 of the Bankruptcy Code is available to individuals who conduct a business, consumer debtors initiate the vast majority of Chapter 13 cases. Indeed, Congress intended Chapter 13 to become more generally used by consumers than its predecessor under the former Bankruptcy Act, Chapter XIII. Chapter 13 use had risen, but not as much as Congress had hoped. Moreover, some debtors arguably had abused the system of relief which Congress intended to make available through Chapter 13.

Congress addressed the lack of consumer filings and the perceived debtor abuses of Chapter 13 through several changes contained in the Bankruptcy Amendments Act. One of these changes, the notification requirements designed to encourage consumers to choose Chapter 13 rather than Chapter 7, is discussed earlier in this Article. The following discussion focuses on the changes designed to eliminate the perceived abuses of Chapter 13.


202. The most recent available statistics indicate that for the twelve month period ending June 30, 1983, debtors initiated 7746 business and 94,455 nonbusiness Chapter 13 cases.


204. Compare supra note 202 (102,201 Chapter 13 cases commenced in the twelve-month period ending June 30, 1983) with DIRECTOR OF THE ADMIN. OFFICE OF THE U.S. COURTS, 1979 ANNUAL REPORT A-118 (table F-2) (39,442 Chapter XIII cases commenced in the last full fiscal year of operation of the old Bankruptcy Act).

205. See, e.g., United States v. Eustus, 695 F.2d 311, 316-17 (8th Cir. 1982) (finding an abuse which prevented confirmation of the debtor's Chapter 13 plan under 11 U.S.C. § 1325(a)(3), requiring that the debtor propose the plan in "good faith"); Hearings, Part I, supra note 7, at 106-43 (testimony and statement of Paul J. Pfeilsticker, representing the Consumer Bankers Ass'n); ABA Report, supra note 165, at 257-58.

206. See supra notes 14-23 and accompanying text.
A. The Codebtor Stay

Among the innovations Congress adopted in the original Bankruptcy Code was a codebtor stay in Chapter 13 cases.\textsuperscript{207} Section 1301 of the original Code prohibited creditors from attempting to collect debts “from any individual that is liable on such debt with the debtor, or that secured such debt,” for the duration of the Chapter 13 proceedings, unless the codebtor was a compensated surety.\textsuperscript{208} Creditors with claims against codebtors could obtain relief from the stay under section 1301(c). This subsection allowed the court to grant relief if the creditor could demonstrate: (1) that the codebtor actually received consideration for the claim held by the creditor, (2) that the debtor’s Chapter 13 plan proposed not to pay the claim, or (3) that the creditor’s interest would be harmed irreparably by a continuation of the stay.\textsuperscript{209}

Although some creditors sought relief from the codebtor stay under the original Code by attempting to demonstrate that the first\textsuperscript{210} or third\textsuperscript{211} condition had been met, most creditors sought relief from the stay by trying to prove that the debtor’s plan proposed not to pay the creditor’s claim.\textsuperscript{212} Unsecured creditors often were able to demonstrate that this condition existed because Chapter 13 required a debtor to pay creditors only that which they would have received in a Chapter 7 proceeding.\textsuperscript{213} Because debtors without significant nonexempt property often would have paid little or nothing to unsecured creditors under Chapter 7, they were able to propose Chapter 13 plans under which they paid little or

\textsuperscript{208} 11 U.S.C. § 1301(a) (1982).
nothing to unsecured creditors. If the unsecured creditors also held claims against codebtors, as was often the case, the section 1301 stay prevented the creditors from pursuing these claims. In this situation, creditors usually sought relief from the stay by showing that the second condition had been met.

The issue in most cases that arose under the original version of section 1301(c)(2) was whether the debtor's plan would pay the creditor's claim in full. The court usually did not conduct extensive fact finding or formal hearings to resolve the issues raised. Instead, the court simply determined whether the debtor's Chapter 13 plan proposed to satisfy the creditor's claim in full. If part of the debt would remain unpaid under the plan, the court usually modified the stay to permit the creditor to collect the unsatisfied portion from the codebtor. This judicial relief adequately protected the interests of creditors who held claims against codebtors, but it required too much time, especially considering that the cases rarely involved any disputes concerning material facts.

Congress addressed this problem in the Bankruptcy Amendments Act by adding a new subsection (d) to section 1301. Subsection (d) requires the court to terminate the codebtor stay twenty days after a creditor files a request for relief under section 1301(c)(2) "unless the debtor or any individual that is liable on such debt with the debtor files and serves upon [the creditor] a written objection to the [requested relief]." The new subsection does not change the substantive grounds for relief from the stay. It merely forces the debtor or codebtor who would receive the benefit of the stay to act to protect that benefit if the creditor seeks relief from the codebtor stay under section 1301(c)(2).

If the debtor or codebtor believes that the debtor's proposed plan will pay the creditor's claim in full, the new subsection requires a written objection to the creditor's action to preserve the protection of the stay. If the court faced such an objection, it presumably would schedule a hearing promptly to decide the issue. If

214. See generally Cyr, supra note 10, at 271.
215. See supra note 212.
217. See id.
the debtor's proposed plan did not provide for full payment of the creditor's claim, the court would not continue to protect the debtor and codebtor because the creditor would collect more from the codebtor if the stay were lifted than the creditor would collect under the debtor's plan. If the debtor or codebtor fails to object, however, the court must grant relief to the creditor within twenty days after the creditor's request was filed. Section 1301(d) represents a significant improvement because it provides relief from the stay which properly recognizes creditor interests, but it does not reduce the protection for Chapter 13 debtors and codebtors that Congress deemed appropriate.

B. The Debtor's Repayment Plan

In Chapter 13 cases, the most significant document is the debtor's repayment plan. The plan contains the debtor's proposal to creditors for the repayment of outstanding claims. Notwithstanding the great significance of the plan, the Bankruptcy Code allows the debtor substantial flexibility to determine the contents of the plan. Section 1322 of the Code states only that the debtor's plan must provide for the submission of assets sufficient to fund the plan, the full payment of priority claims, identical treatment for all claims within a particular class, and repayment within three years unless the court specifically approves a longer period. Aside from these mandatory requirements, the Code permits the debtor to include a virtually unlimited number of other provisions relating to the treatment of claims.

219. Section 1301(c)(2) (1982) states that relief from the codebtor stay should be granted only "to the extent that . . . the plan filed by the debtor proposes not to pay such claim." 11 U.S.C. § 1301(c)(2) (1982) (emphasis added).

220. See generally W. Drake & J. Morris, supra note 180, at §§ 9.01-.12 (discussion of required and permissible provisions of Chapter 13 plans).


224. Id. § 1322(a)(3).


226. Section 1322(b) contains nine categories of provisions which a Chapter 13 plan may include. 11 U.S.C.A. § 1322(b)(1)-(9) (West 1979 & Supp. 1985). Section 1322(b)(10) also allows the debtor to "include any other appropriate provision not inconsistent with [the Bankruptcy Code]." 11 U.S.C. § 1322(b)(10) (1982). The only limitation on the permissive...
1. Classification of Claims

Although the Code requires identical treatment of all claims within a particular class, the debtor need not classify claims in any particular manner. The only requirement is that the debtor "may not discriminate unfairly against any class so designated" if the debtor chooses to classify claims. If a Chapter 13 debtor does choose to classify claims, each claim within each class must receive identical treatment, and the classification of unsecured claims must not result in unfair discrimination against any designated class.

The Bankruptcy Code also suggests that Chapter 13 debtors should classify claims in the manner recognized for Chapter 11 cases in Code section 1122. Section 1122(a) permits a debtor to "place a claim . . . in a particular class only if such claim . . . is substantially similar to the other claims . . . of such class." Because section 1322(a)(3) already provides that all claims within the same class must receive identical treatment, section 1122(a) does not affect a debtor's classification decisions significantly. Section 1122(b), however, permits the debtor to designate "a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience." This section recognizes that the full payment of small claims often is more economically feasible and administratively convenient than the full payment of other larger claims with the same legal status. Because

provisions of Chapter 13 plans is that they cannot conflict directly with other Code provisions. Id.

228. See id. § 1322(b)(1) (providing that the debtor "may" classify claims).
229. Id.
230. Id. § 1322(a)(3). But see In re Sellers, 33 Bankr. 854, 858-59 (Bankr. D. Colo. 1983) (while noting that creditors in same class must receive identical treatment, the court deemed payment of $1 to each creditor to be permissible even if not pro rata because any "unequal" treatment was de minimis).
232. See id. (referring to 11 U.S.C. § 1122 (1982)).
the administrative benefits of a small claims classification are appreciable, the cross-reference to section 1122 in section 1322(b)(1) most likely was directed at the "administrative convenience classification" provision of section 1122. Section 1322(b)(1) apparently still authorizes additional classes of claims, subject to the requirement that the debtor must not discriminate unfairly against any other class.237

The unfair discrimination requirement has caused some courts to limit the designation of classes to the "administrative convenience classification" of section 1122(b).238 Most courts, however, have held that debtors may classify claims for purposes other than administrative convenience.239 Courts that have permitted other classifications, however, have not thrown open the doors to any classification which suits the debtor's fancy. Instead, these courts have enforced the provision concerning unfair discrimination by limiting the debtor's capacity to prefer certain claims over others through classification systems in which some creditors are paid more than others.240

Most classification controversies involve attempts to treat "special" unsecured claims more favorably than other unsecured claims. These "special" claims have involved debts to physicians,241 debts to suppliers,242 and, most frequently, debts guaranteed by

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238. In re Iacovoni, 2 Bankr. 256, 260 (Bankr. D. Utah 1980). The court held that any separate classification of claims occupying the same legal status results in unfair discrimination per se, with the sole exception of the administrative convenience classification. Id. at 260-61.
240. One court, however, has held that the separation into different classifications of claims occupying the same legal status is not objectionable even if one class is paid a much greater percentage of its claims than another class, as long as the creditors in each class receive at least what they would have received in a Chapter 7 proceeding. In re Sutherland, 3 Bankr. 420, 422 (Bankr. W.D. Ark. 1980).
242. E.g., AMFAC Distrib. Corp. v. Wolff, 22 Bankr. 510 (Bankr. 9th Cir. 1982).
relatives or co-workers of the debtor. Courts have permitted these special classifications only if the debtor could show a special postbankruptcy need for continuing the relationship with the particular creditor. Courts have demonstrated this need in cases involving physicians and suppliers, but they have encountered greater difficulty in attempting to show adverse ramifications from failures to pay claims guaranteed by relatives or friends.

Congress specifically addressed this problem in the Bankruptcy Amendments Act. The Act amended section 1322(b)(1) to provide that a debtor's plan "may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims." The new section, however, did not delete the requirement that any separate classification of claims must not unfairly discriminate against any particular class. The debtor may classify codebtor claims in a manner which provides different treatment, but the classification must not result in unfair discrimination against other classes. The specific recognition that codebtor claims may be placed in a separate class, however, strongly suggests that Congress intended to permit Chapter 13 debtors to pay creditors with claims guaranteed by other individuals more than they pay to other creditors, without having those payments struck down as "unfairly discriminatory." As a result, the courts probably will interpret the amendment in this manner and will consider the new provision a reaction to earlier decisions that prohibited more favorable treatment of codebtor claims in Chapter 13 plans.


244. E.g., AMFAC Distrib. Corp. v. Wolff, 22 Bankr. 510, 512 (Bankr. 9th Cir. 1982).


246. See AMFAC Distrib. Corp. v. Wolff, 22 Bankr. 510, 512 (Bankr. 9th Cir. 1982).


249. See id.

250. Id.

251. See supra note 247.
2. Executory Contracts and Leases

Another congressional alteration of section 1322(b) affected the debtor's ability to accept or reject executory contracts and leases. Previously, section 1322(b)(7) allowed the debtor to "provide for the assumption or rejection of any executory contract or unexpired lease of the debtor not previously rejected under section 365 of [the Code]." Courts interpreted this provision as giving Chapter 13 debtors full discretion to assume or reject executory contracts and leases without becoming subject to the restrictive provisions of section 365. Without these restrictions, debtors could assume or reject executory contracts for their own benefit or for the benefit of a creditor or a third party and could use this unrestricted power to override other Code provisions. For example, a Chapter 13 debtor theoretically could assume an executory contract that committed a third party to lend money to the debtor. Section 365(c)(2) might have prevented the debtor from assuming the contract, but Chapter 13 debtors did not face that restriction because the courts had held section 365 inapplicable to Chapter 13 debtors.

Congress responded to this problem by amending section 1322(b)(7) to provide explicitly that any assumption, rejection, or assignment of an executory contract or unexpired lease under a Chapter 13 plan is subject to the provisions of section 365. This change is appropriate because it brings the treatment of executory contracts and unexpired leases in Chapter 13 cases in line with the


253. Benevides v. Alexander, 670 F.2d 885, 888 (9th Cir. 1982).


256. Benevides v. Alexander, 670 F.2d 885, 888 (9th Cir. 1982); see supra note 253 and accompanying text. The courts could have limited a Chapter 13 debtor's ability to assume or reject executory contracts and unexpired leases on other grounds. For example, the courts could have denied confirmation of a debtor's plan if they found that assumption of a particular executory contract would have jeopardized the feasibility of the plan. See 11 U.S.C.A. § 1325(a)(6) (West 1979 & Supp. 1985). The inapplicability of section 365, however, severely restricted the courts' ability to control assumption and rejection of executory contracts and leases.

treatment of these issues in Chapter 11 proceedings. Although section 365 is not perfect, it provides detailed guidelines for the assumption or rejection of executory contracts and unexpired leases—guidelines which Congress determined to be appropriate in bankruptcy proceedings. These guidelines should apply equally to Chapter 7, Chapter 11, and Chapter 13 proceedings.

3. Timing and the Chapter 13 Plan

a. Initiation of Payments Under the Plan

The debtor must file a Chapter 13 plan either with the petition that initiates the case, or within fifteen days after the petition is filed. The court may extend the deadline if the debtor shows good cause for the delay. Most debtors file a plan very shortly after the case commences. The original version of the Code, however, did not provide any explicit deadline by which the debtor was required to commence payments under the plan once it was filed.

The Bankruptcy Amendments Act provided a deadline in Code section 1326. Under the new section, the debtor must "commence making the payments proposed by a plan within thirty days after the plan is filed." The court under the amendment can allow debtors to refrain from initiating payment until later, but the new section does not provide guidelines for the court to follow when it makes this decision. The amended section, however, does appear to anticipate timely payment in the absence of unusual circumstances. A court faced with a plan that proposes to commence payments after the thirty day period has passed, therefore, should consider carefully whether to accept the proposal. For example, if a Chapter 13 plan proposes to pay debts from the proceeds of a real
estate sale, a court generally should not require the debtor to begin making payments until the debtor liquidates the real estate and the funds are available for distribution, even if the thirty day deadline has passed. On the other hand, if a debtor simply prefers to delay the first payment until an order is entered confirming the plan, a court generally should not permit a moratorium.

Code section 1326(a)(2) protects the debtor when the trustee receives payments before the court confirms the Chapter 13 plan. Under this subsection, the trustee must hold any payments until the court either confirms or denies the plan. If the court confirms the plan, the trustee must distribute the funds under the terms of the plan. If the court does not confirm the debtor's plan, however, and the debtor does not propose another plan which the court confirms, two options are available: the court could convert the case to a Chapter 7 proceeding, or it could dismiss the proceeding on the motion of the debtor or another party in interest. If the court dismisses the case, section 1326(a)(2) directs the trustee to return the funds to the debtor after deducting unpaid administrative expenses. Unfortunately, the appropriate treatment of the funds is unclear if the court converts the case to a Chapter 7 proceeding.

268. Id.
269. Id.
270. 11 U.S.C.A. § 1307(c)(5) (West Supp. 1985). The debtor also has the right to convert the case to Chapter 7 at any time. 11 U.S.C. § 1307(a)(8)(A) (1982). Alternatively, the court could convert the case to Chapter 11, 11 U.S.C. § 1307(d) (1982), although the court probably would not do so because Chapter 11, like Chapter 13, also would require the court to confirm a plan submitted by the debtor or another party in interest. See 11 U.S.C.A. § 1129 (West 1979 & Supp. 1985) (requirements for confirmation of Chapter 11 plan); id. § 1121 (parties eligible to file Chapter 11 plan).
271. 11 U.S.C.A. § 1307(c)(5) (West Supp. 1985). The debtor also has a right to dismissal upon request unless the case previously was converted from Chapter 7 or Chapter 11 to Chapter 13. Id. § 1307(b).
272. Id. § 1326(a)(2) (referring to 11 U.S.C.A. § 503(b) (West 1979 & Supp. 1985), which governs claims for administrative expenses). This approach is consistent with section 349(b)(3) of the Code, which provides that dismissal of a bankruptcy case "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case." 11 U.S.C. § 349(b)(3) (1982); see, e.g., In re Groves, 27 Bankr. 866, 867-68 (Bankr. D. Kan. 1983).
b. Treatment of Funds After Conversion to Chapter 7

Conversion of a case from Chapter 13 to Chapter 7 "does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief,"273 except with respect to a limited number of specifically enumerated items.274 None of these exceptions apply to the determination of what constitutes property of the debtor's estate under either Chapter 13 or other parts of the Code.275 In Chapter 13 cases, section 1306(a)(2) specifically includes in the estate "earnings from services performed by the debtor after the commencement of the case."276 Outside Chapter 13, however, section 541(a)(6) provides that a debtor's earnings from services rendered after the commencement of the case are not property of the estate.277 Because neither the definition of "commencement of the case" nor the provisions governing property of the estate are affected by a conversion from Chapter 13 to Chapter 7, and because section 541(a)(6) applies once the case is taken out of Chapter 13, the debtor's postpetition earnings do not appear to be property of the estate after a conversion to Chapter 7.

Notwithstanding this statutory directive, some courts have held that funds held by a trustee in a case which was converted from Chapter 13 to Chapter 7 before a plan was confirmed are property of the Chapter 7 estate.278 These courts have relied on section 348 and its directive that a conversion "does not effect a change in the date of . . . the commencement of the case."279 They reason that once the case has been commenced, section 1306 operates to bring postpetition earnings of the debtor into the property of the estate, and section 348 does not operate to reverse that action. The shortcoming of this approach, however, is that it does not distinguish

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274. See id. § 348(b)-(c).
275. See id. (enumeration does not include sections 1306 or 541).
276. Id. § 1306(a)(2).
277. 11 U.S.C.A. § 541(a)(6) (West Supp. 1985); see also In re Fitzsimmons, 725 F.2d 1208, 1210-11 (9th Cir. 1984) (an individual's postpetition earnings are excluded from bankruptcy estates under section 541(a)(6) of the Code, except in Chapter 13 cases).
between an estate in Chapter 13 and an estate in Chapter 7. After conversion, the former Chapter 13 case no longer exists. Instead, a Chapter 7 proceeding effectively commences when the Chapter 13 petition is filed. Because section 1306 has no application to a Chapter 7 case, section 541 should determine what constitutes property of the bankruptcy estate. Under section 541, a debtor's postpetition earnings are not included in the bankruptcy estate.\(^1\)

If the court confirms the debtor's Chapter 13 plan before the case is converted to Chapter 7, however, the treatment of property held by the trustee after conversion would be different because confirmation of the debtor's Chapter 13 plan "bind[s] the debtor and each creditor." As a result, the Chapter 13 trustee must distribute the funds to the creditors pursuant to the terms of the confirmed plan. Conversion does not affect the trustee's obligation.\(^2\) After conversion, the Chapter 13 trustee cannot turn the funds over to the Chapter 7 trustee or return the funds to the debtor as exempt property because these alternatives were not included in the confirmed Chapter 13 plan.\(^3\) If additional postconversion earnings inadvertently are paid to the former Chapter 13 trustee, however, the trustee must return these funds to the debtor because they do not constitute property of the Chapter 7 estate.\(^4\)

By filing a Chapter 13 plan, the debtor effectively asserts a willingness to repay creditors from future income only according to the terms of the plan. If the court does not confirm the plan and the debtor converts the case to Chapter 7, the debtor effectively asserts an unwillingness to allow creditors any recovery from the debtor's future income. A court which held in such a case that funds paid to the Chapter 13 trustee before conversion were property of the Chapter 7 estate would override the debtor's choice. The definition of "property of the estate" set out in section 541 of

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\(^{3}\) See 11 U.S.C. §§ 348(a), 1327(a) (1982).

\(^{4}\) But cf. Bankr. Rule 1019(5), 11 U.S.C.A. (West 1984) (directing the Chapter 13 trustee to turn over all property of the estate to the Chapter 7 trustee). Arguably, however, the estate referred to in Rule 1019(5) is the Chapter 7 estate, and it would not include postbankruptcy earnings held by the Chapter 13 trustee.

\(^{5}\) See In re Richardson, 20 Bankr. 490, 492 (Bankr. W.D.N.Y. 1982).
the Code, and the concept of a fresh start which the definition embodies, are inconsistent with such an action. Instead, the Code's provisions and policies demand that a Chapter 13 trustee who holds funds representing a debtor's postpetition earnings must return these funds to the debtor if the debtor converts the case to Chapter 7 before the court confirms the Chapter 13 plan.285

The new thirty day deadline for commencement of payments under a Chapter 13 plan could increase the number of cases which present questions concerning the treatment of postbankruptcy earnings after conversion to Chapter 7. The number of potential problems is increased further by the new requirement that Chapter 13 trustees "ensure that the debtor commences making timely payments under Section 1326."286 If the court does not confirm the plan, the debtor has an absolute right to convert the case to Chapter 7.287 As a result, the number of cases in which a Chapter 13 trustee holds a debtor's funds although no plan has been confirmed and the case has been converted to Chapter 7 may increase significantly.

4. Confirmation of the Debtor's Plan

Section 1325 of the Bankruptcy Code governs confirmation of the debtor's plan.288 The bankruptcy court must confirm any Chapter 13 plan that meets all the requirements of section 1325(a).289 Before the Bankruptcy Amendments Act, these requirements were: (1) compliance with the provisions of Chapter 13 and other applicable Code provisions,290 (2) proposal of the plan in

good faith, 291 (3) a showing that the plan is in the creditors' best interests, 292 (4) proper treatment of secured claims, 293 and (5) feasibility. 294 In addition, the original version of section 1325 required the debtor to pay all necessary fees and charges before the court confirmed the plan. 295

The Bankruptcy Amendments Act did not change the requirements for confirmation that were listed in section 1325(a). Congress added a new subsection (b) to section 1325, however, which significantly altered the requirements for confirmation. 296 Under the new subsection, the court may not confirm a debtor's plan if an unsecured creditor or the trustee objects to it unless "the value of the property to be distributed under the plan on account of [the claims of objecting creditors] is not less than the amount of such claim[s], or [unless] the plan provides that all of the debtor's projected disposable income [for the next three years] will be applied to make payments under the plan." 297

The impetus for the change in confirmation standards for Chapter 13 plans presumably was the number of zero or nominal payment Chapter 13 plans which debtors had proposed. Many courts had confirmed Chapter 13 plans in which the debtors offered to pay either nothing or only a very small percentage of their claims, although other courts had withheld confirmation, holding that these plans violated the "good faith" requirement of section 1325(a)(3). 298 Courts which relied on the good faith requirement to withhold confirmation of zero or nominal payment plans could do so only if they construed the requirement in a quantitative as well

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291. Id. § 1325(a)(3).
292. See id. § 1325(a)(4).
293. See id. § 1325(a)(5).
294. Id. § 1325(a)(6).
295. Id. § 1325(a)(2).
297. Id.
as qualitative manner.\textsuperscript{299} The confusion created by the disparate treatment of the good faith requirement was resolved only after extensive appellate consideration.\textsuperscript{300} These opinions did not prohibit the confirmation of nominal payment Chapter 13 plans, but they did make confirmation more difficult.\textsuperscript{301} The evolution of the good faith standard had controlled the zero and nominal payment plan problem to a great extent. The new subsection which Congress added in 1984, however, nearly will eliminate the problem.\textsuperscript{302}

Under the new subsection, a bankruptcy court may not confirm a nominal or zero payment plan in the face of a creditor objection unless the debtor's disposable income is too low to provide more than a nominal amount to pay creditors during the following three years.\textsuperscript{303} The new subsection imposes little risk on a creditor who files an objection to confirmation of a Chapter 13 plan. If the court overrules the objection and confirms the plan, the creditor will receive no less than what the debtor originally proposed. On the other hand, if the court agrees that the debtor can pay more, the court must deny confirmation until the debtor increases the size of the proposed payments. If a creditor holds even the slightest suspicion that the debtor could pay more under the Chapter 13 plan, therefore, the creditor has every incentive to object to confirmation.

A creditor's objection to a Chapter 13 plan is not totally without risk because the debtor could react to a denial of confirmation by

\textsuperscript{299} E.g., In re Iacovoni, 2 Bankr. 256 (Bankr. D. Utah 1980).
\textsuperscript{300} See In re Hines, 723 F.2d 333 (3d Cir. 1983); Flygare v. Boulden, 709 F.2d 1344 (10th Cir. 1983); Johnson v. Vanguard Holding Corp., 708 F.2d 865 (2d Cir. 1983); Kitchens v. Georgia R.R. Bank & Trust Co., 702 F.2d 885 (11th Cir. 1983); United States v. Eustus, 695 F.2d 311 (8th Cir. 1982); Deans v. O'Donnell, 692 F.2d 968 (4th Cir. 1982); Barnes v. Whale, 699 F.2d 193 (D.C. Cir. 1982); Goeb v. Heid, 675 F.2d 1386 (9th Cir. 1982); Ravenot v. Rimgale, 669 F.2d 426 (7th Cir. 1982).
\textsuperscript{301} The courts in Kitchens v. Georgia R. R. Bank & Trust Co., 702 F.2d 885, 888, and United States v. Eustus, 695 F.2d 311, 317, cited In re Bellgraph, 4 Bankr. 421 (Bankr. W.D.N.Y. 1980), as an example of a confirmable nominal payment plan. In Bellgraph, the debtor was a 56-year-old widow and mother of seven who sought Chapter 13 relief to save her home from foreclosure. The court noted that the nominal payments proposed by the debtor constituted not just her "best efforts," as some courts had suggested were necessary for confirmation, but in fact represented a "super effort." The courts in Kitchens, and Eustus, however, did not indicate whether less strenuous efforts would permit confirmation of nominal payment plans.
\textsuperscript{302} 11 U.S.C.A. § 1325(b) (West Supp. 1985).
\textsuperscript{303} See id. § 1325(b)(1)(B).
seeking dismissal of the case\textsuperscript{304} or a conversion to Chapter 7 proceedings.\textsuperscript{305} Because the Code contains protections for creditors in these situations, however, neither alternative is particularly attractive to the debtor or devastating to the creditor. If the debtor seeks dismissal, the Code reinstates the creditor's state law collection rights.\textsuperscript{306} If the debtor seeks conversion, the court might not permit the debtor to proceed under Chapter 7,\textsuperscript{307} and even if the court did allow conversion, the creditor could collect from the sale and distribution of assets under that chapter. Also, a debtor who originally chose to file under Chapter 13 because he owned significant nonexempt property would not be tempted to seek conversion. In other circumstances, such as when a debtor owned very little nonexempt property but had substantial expected future income, the court likely would not allow the debtor to proceed under Chapter 7, leaving only the Chapter 13 alternative.\textsuperscript{308} Considering all the factors, a creditor is likely to refrain from objecting to a proposed Chapter 13 plan only if the debtor is proposing payments that meet the specific requirements of section 1325(b).\textsuperscript{309}

In effect, the new requirements of section 1325(b) have been added to the six enumerated requirements in section 1325(a) as proper grounds for objection to confirmation of a Chapter 13 plan. Congress further confirmed this conclusion by amending section 1325(a) to provide explicitly that confirmation of a debtor's plan also is subject to the creditors' and trustee's right to object to confirmation under section 1325(b).\textsuperscript{310} A court, therefore, may not confirm the debtor's plan unless it meets the new requirements of section 1325(b)—not even if the debtor proposes the plan in good

\textsuperscript{304} 11 U.S.C.A. § 1307(b) (West Supp. 1985).
\textsuperscript{305} 11 U.S.C. § 1307(a) (1982).
\textsuperscript{306} Id. § 349(b). For an interesting discussion of the interplay between the bankruptcy system and the state law collection system, see LoPucki, A General Theory of the Dynamics of the State Remedies/Bankruptcy System, 1982 Wis. L. Rev. 311.
\textsuperscript{307} The court could find that the debtor's actions constituted a "substantial abuse" of the provisions of Chapter 7. 11 U.S.C.A. § 707(b) (West Supp. 1985); see supra notes 24-31 and accompanying text.
\textsuperscript{308} See supra notes 24-31, 307 and accompanying text.
\textsuperscript{309} 11 U.S.C.A. § 1325(b) (West Supp. 1985); see supra note 297 and accompanying text.
\textsuperscript{310} The new section 1325(a) provides explicitly that the court must confirm a plan if it meets the six enumerated requirements "[e]xcept as provided in subsection (b)." 11 U.S.C.A. § 1325(a) (West Supp. 1985).
faith, meets the best interest of creditors test, and otherwise complies with section 1325(a). Consequently, section 1325(b) and the concepts of full payment of claims and application of disposable income on which it relies will become central to the confirmation decisions of bankruptcy courts. Because of their importance, this Article now examines these requirements in greater detail.

a. Discounting Debtor Payments

Section 1325(b)(1)(A) provides that the court must withhold confirmation of the plan unless “the value of the property to be distributed under the plan on account of [the objecting creditor’s] claim is not less than the amount of such claim.”311 Although this provision appears straightforward, it is subject to many possible interpretations. One of the most important interpretational problems concerns the effect the discount value of money should have when the court compares the value of the property to be distributed against the value of the creditor’s “allowed unsecured claim.”312

Usually a court will not have to add unmatured interest to the value of a creditor’s claim.313 Creditors are entitled to interest only if the debtor is not considered insolvent because the value of the nonexempt portion of the bankruptcy estate exceeds the value of all claims.314 In the vast majority of cases, the debtor is insolvent and is not required under Chapter 13 to pay interest on unsecured claims. The court may have trouble determining the value of the property to be distributed, however, because it must compare the value of the property to the value of the claim “as of the effective date of the plan”315 to determine whether it can confirm the plan. For example, if the plan proposes installment payments, it must provide an appropriate discount rate so the present value of the

311. Id. § 1325(b)(1)(A).
property to be distributed will equal or exceed the value of the claim.\(^{316}\)

Although the exact meaning of "the effective date of the plan" may be disputed,\(^{317}\) the phrase undeniably requires the court to determine the present value of the property described in section 1325.\(^{318}\) In simple mathematical terms, ten monthly payments of $10 each will not pay a $100 claim in full for the purposes of section 1325(b)(1)(A) because the present value of the payments does not equal $100.\(^{319}\) To judge whether a proposed plan complies with the statute, therefore, the court must face the issue of how to determine the appropriate discount rate for these payments. This determination involves considerations similar to those used to decide whether the debtor's plan meets the best interest of creditors test of section 1325(a)(4).\(^{320}\)

The courts have failed to reach a consensus concerning what discount rate is most appropriate. Many courts simply have made conclusory determinations in particular cases that the proposed discount rate either was or was not sufficient to satisfy the best interests of creditors test.\(^{321}\) The cases in which courts have adopted a specific discount rate have not produced a leading candidate for general application to either the best interest of creditors test or the present value of payments test.\(^{322}\) Regardless of

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317. The Bankruptcy Code does not define "the effective date of the plan." Ken Klee, one of the staff attorneys who helped draft the Bankruptcy Code, has suggested that the effective date of a plan is the day after the order confirming the plan becomes final. Klee, All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code, 53 Am. BANKR. L.J. 133, 137 n.24 (1979).

318. See In re Martin, 17 Bankr. 924, 926 (N.D. Ill. 1982).

319. See 5 COLLIER ON BANKRUPTCY (MB) ¶ 1325.01-36, -37 (15th ed. 1985).


321. See, e.g., In re Worthen, 24 Bankr. 532, 533 (Bankr. S.D. Ohio 1982) (court did not consider any particular interest rate, but noted that a solvent debtor's plan would not meet best interest of creditors test if it proposed to pay claims in full over five years without any interest on the unpaid balance); General Fin. Co. v. Powell, 2 Bankr. 314, 315 (Bankr. E.D. Va. 1980) (court did not consider any particular interest rate, but noted that unsecured creditors would receive nothing in a Chapter 7 case, so any payment to them under Chapter 13 would meet the best interest of creditors test).

322. See, e.g., In re Wilheim, 29 Bankr. 912, 913 (Bankr. D.N.J. 1983) (courts used a 12% discount rate, apparently based on the statutory judgment rate in effect when the debtor filed the petition); In re Jewell, 25 Bankr. 44, 46 (Bankr. D. Kan. 1982) (court found the 52-
which discount rate a court chooses, however, it should apply the same standard to both the best interest test and the present value of payments test.

b. Determining a Consumer Debtor’s Disposable Income

If the debtor is unable to pay unsecured claims in full, section 1325(b)(1)(B) still allows the court to confirm the debtor’s plan if the plan “provides that all of the debtor’s projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.” To apply this section, the court must determine “the debtor’s projected disposable income” for the next three years. If the debtor’s plan proposes to apply all of this disposable income to plan payments, the court cannot deny confirmation as long as the plan meets the other requirements of section 1325(a).

The Bankruptcy Amendments Act defines “disposable income” as “income which is received by the debtor and which is not reasonably necessary to be expended—(A) for the maintenance or support of the debtor or a dependent of the debtor; or (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation and operation of such business.” The primary issue associated with this definition arises when the court attempts to determine what amount of income is “reasonably necessary” to support the debtor and the debtor’s dependents. The court generally can ascertain the debtor’s gross income from reliable sources other than the debtor.

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week Treasury Bill rate to be an appropriate interest rate, based on its use by financial institutions to set the rate on all-savers’ certificates); In re Williams, 3 Bankr. 728, 732 (Bankr. N.D. Ill. 1980) (court used the statutory rate of interest on judgments and suggested that it would be an appropriate interest rate for all unsecured claims).

324. Id. § 1325(b)(2).
325. The debtor’s employer can be ordered to pay some or all of the debtor’s income to the Chapter 13 trustee, and therefore probably could be required to disclose information on the debtor’s income. See 11 U.S.C.A. § 1325(c) (West Supp. 1985). The debtor’s income tax returns also should give acceptable information concerning the debtor’s previous income. Creditors could obtain this information using available discovery procedures, and subsequently could make the information available to the court. See infra note 329. The court also could rely on the debtor’s own Chapter 13 Statement, which will contain the debtor’s
Independent verification of the debtor's expenses, however, is not always possible, which forces the court to rely primarily on the list of expenses contained in the debtor's Chapter 13 statement. As a result, the debtor often can establish the categories and the amounts of his own expenses, and he may be able to divert the attention of the court and other parties from some potentially questionable expenses. The debtor cannot slip all questionable expenses through the process without contest, but if an expense is challenged he at least has made the first "offer" in the negotiations, which may affect the final determination significantly.

Some other controls do exist on the debtor's ability to assert the value of claimed expenses. For example, creditors and trustees may question the debtor directly concerning claimed expenses at the hearing on confirmation of the plan. Also, items such as the debtor's checking account records or other documentation of prebankruptcy living expenses are discoverable and can be used to check the debtor's assertions concerning expenses. The effort assertions concerning current and future income. See Official Bankr. Form 10, 11 U.S.C.A. (West 1984); Bankr. Rule 1007(b), 11 U.S.C.A. (West 1984) (requiring all Chapter 13 debtors to file Form 10).


327. An American Bar Association subcommittee noted a similar problem in many Chapter 13 repayment proposals, caused by the absence of definitive standards for minimum repayments of debts. The subcommittee noted that the debtor's ability to set the repayment level is particularly significant because of the litigation-oriented approach of the Code to resolving disputes. It has been noted that the economics of consumer bankruptcies are such that consumer creditors simply cannot afford to litigate these issues in typical cases. In other words, the absence of standards provides a great benefit to the person who applies the standard in the first instance (the debtor), and a significant handicap to the party that must litigate to change it (the creditor). When such litigation is not feasible, the absence of a definitive standard is tantamount to letting the debtor set the standard and to making that standard nonreviewable. In other words, it is essential that any standard be sufficiently definite so that it provides a clear guide to what the law requires, and so that case by case litigation is not necessary for the standard to be applied fairly. ABA Report, supra note 165, at 258-59.

328. See, e.g., In re Strong, 26 Bankr. 814, 817 (Bankr. N.D. Ind. 1983) (creditor objected to debtor's claimed expenses for medical and dental care, transportation, haircuts, and housing).

329. Objections to confirmation are "contested matters" which are governed by Bankruptcy Rule 9014. Bankr. Rule 3020(b)(1), 11 U.S.C.A. (West 1984). Rule 9014 provides...
and expense required to challenge a debtor’s assertions of expenses, however, may be prohibitive.

Even if the trustee or a creditor obtains evidence which contradicts the debtor’s assertions, discrepancies in the amounts alone will not always convince the court to withhold confirmation of the debtor’s plan. Evaluating the credibility of the debtor’s stated expenses is only the first step in the bankruptcy court’s determination of whether to confirm a debtor’s proposed plan notwithstanding the objection of the trustee or a creditor. The court also must make a qualitative judgment concerning whether the expenses which the debtor expects to incur are “reasonably necessary . . . for the maintenance or support of the debtor or a dependent of the debtor.”

Neither the Bankruptcy Code nor the legislative history of the Bankruptcy Amendments Act provides any significant guidance to the bankruptcy courts concerning the reasonableness issue. Courts which must determine the reasonableness of a Chapter 13 debtor’s projected expenses, however, can look for guidance in cases which construe several of the categories of exempt property in section 522(d) of the Code, because these exemptions also are limited to amounts “reasonably necessary for the support of the debtor and any dependent of the debtor.” Courts which have considered the debtor’s reasonable needs for the purposes of section 522(d) generally have suggested that the debtor’s prebankruptcy lifestyle does

that Bankruptcy Rule 7034 applies in contested matters. Id. Rule 9014. Rule 7034, in turn, adopts FED. R. CIV. P. 34. Id. Rule 7034. Under FED. R. CIV. P. 34, creditors or the trustee can require a debtor to produce documentary evidence of claimed expenses. A debtor’s checking account records presumably would be documentary evidence covered by the rule, and generally would provide an accurate and relatively complete picture of a debtor’s living expenses.

330. The court, however, could deny confirmation to a debtor who misrepresented expenses by holding that the plan was not “proposed in good faith.” 11 U.S.C. § 1325(a)(3) (1982); see Kitchens v. Georgia R.R. Bank & Trust Co., 702 F.2d 885, 889 (11th Cir. 1983); United States v. Eustus, 695 F.2d 311, 317 (8th Cir. 1982); Barnes v. Whelan, 689 F.2d 193, 197-98 (D.C. Cir. 1982).


332. 11 U.S.C. § 522(d)(10)(E), (11)(B), (11)(C), (11)(E) (1982). In a number of decisions, for example, courts have considered what amount is “reasonably necessary” for the purposes of the exemption in section 522(d)(10)(E), which attaches, inter alia, to payments from pension and profit sharing plans. See, e.g., In re Miller, 33 Bankr. 549 (Bankr. D. Minn. 1983); In re Kochell, 31 Bankr. 139 (Bankr. W.D. Wis. 1983); Warren v. Taff, 10 Bankr. 101 (Bankr. D. Conn. 1981).
not limit the court’s postbankruptcy determination of reasonableness. These courts have emphasized that exempt property should be sufficient only to “sustain basic needs, not related to [a debtor’s] former status in society or the lifestyle to which he is accustomed.”

Although the determination of reasonableness in many of the exemption cases involved circumstances which raised significantly different issues than would be raised by an objection to a Chapter 13 debtor’s claimed expenses, the same general approach also seems appropriate for the determination of a debtor’s reasonably necessary living expenses under a Chapter 13 plan. The court should not permit a debtor to maintain the extravagant lifestyle which may have led to the need for bankruptcy relief in the first place.

The expenses most likely to be scrutinized closely under section 1325(b)(1)(B) are the debtor’s nonhousing expenses. Before the Bankruptcy Amendments Act, some bankruptcy courts already closely scrutinized these expenses by applying the good faith requirement of section 1325(a)(3). The debtor’s housing expenses may present less opportunity for debtor manipulation, but they also may present other more difficult problems. In most cases, a monthly rental or mortgage payment is the largest single expenditure in the debtor’s budget. If other directly related expenses are included, such as utility costs and taxes, the expense grows even larger. If the debtor resides in large or lavish quarters, the court might feel compelled by section 1325(b)(1)(B) to withhold confirmation of the debtor’s plan until the debtor moves to less expensive quarters.


335. For example, in many exemption cases the court was considering the appropriate amount of an exemption for a debtor’s pension or profit sharing plan. See supra note 332. In such cases, courts may consider the debtor’s age and life expectancy to determine whether the debtor can replenish the pension fund in the future. See, e.g., In re Clark, 18 Bankr. 824, 826-28 (Bankr. E.D. Tenn. 1982). This issue would not be relevant to the determination of reasonable expenses under Chapter 13.

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The court should temper its decision regarding the reasonable amount of the debtor's living expenses, however, by considering other factors which may support the continuation of living expenses that ordinarily would be considered excessive. For example, if the debtor had to sell a residence in a tight real estate market, he probably would lose a significant amount of equity in the home.337 Also, the debtor's moving costs could outweigh the savings realized by reduced monthly rental or mortgage payments. The debtor also may have a legitimate interest in staying in a particular location to obtain noneconomic benefits such as a superior school system. When considering the reasonableness of a debtor's projected housing costs, therefore, bankruptcy courts should consider not only the gross reduction in living expenses, but also the potential loss of equity, moving expenses, and noneconomic costs which any move would entail.

c. Determining a Business Debtor's Disposable Income

Bankruptcy courts may encounter difficulty in determining projected disposable income not only for consumer debtors, but for business debtors as well. The Code defines a business debtor's disposable income as the amount in excess of that reasonably "necessary for the continuation, preservation and operation of [the debtor's] business."338 Because this definition is stated disjunctively from the definition of a nonbusiness debtor's disposable income,339 a court could conclude that a business debtor's disposable

337. The sale of a residence at less than fair market value may work against creditors' best interests as well as the debtor's. Chapter 13 debtors must pay unsecured creditors at least the present value of the nonexempt portion of their residences. See 11 U.S.C. § 1325(a)(4) (1982). Any reduction in a debtor's equity could reduce the amount available to pay creditors.

338. 11 U.S.C.A. § 1325(b)(2)(B) (West Supp. 1985). This definition applies "if the debtor is engaged in business," which, according to another applicable section of Chapter 13, means that the debtor "is self-employed and incurs trade credit in the production of income from such employment." 11 U.S.C. § 1304(a) (1982).

income should be determined solely from the debtor's business expenses. Under Chapter 13, however, business debtors are individuals who incur personal living expenses. The courts, therefore, should consider not only whether a business debtor's salary is a reasonably necessary expense of the business, but also whether the debtor's personal living expenses are excessive. Failure to scrutinize a business debtor's personal living expenses could produce anomalous results. For example, an annual salary of $100,000 might be a reasonably necessary expenditure for the debtor's business which legitimately should operate to reduce the debtor's business income, but the debtor should not be able to use that salary for unnecessary personal expenses such as extended vacations or substantial purchases of lottery tickets.

Another interpretational problem associated with the disposable business income provision is that it permits debtors to deduct only “expenditures necessary for the continuation, preservation, and operation of [a] business” from disposable income. If a court read the definition strictly, it might disallow expenditures for expansion of a debtor's existing business. Even under this interpretation, however, a debtor facing this situation could seek approval of expansion plans through alternate Code provisions such as the section which permits debtors to use estate property other than in the ordinary course of business after notice and a hearing. Using this provision, the debtor could obtain approval for expansion plans after notice to creditors and a hearing on the issue even if the court does not consider expansion expenses necessary for the “operation” of the business. The court's determination concerning the use of the funds outside the ordinary course of the debtor's business would be binding on creditors and the trustee, and would reduce the debtor's disposable income for section 1325 purposes.

342. Id. § 1325(b)(2)(A); see supra notes 323-37 and accompanying text.
343. Id. § 1325(b)(2)(B).
344. See id. § 363(b)(1) (providing that a trustee, “after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate”). A Chapter 13 debtor is authorized to exercise this power by 11 U.S.C. § 1303 (1982) (giving a Chapter 13 debtor “the rights and powers of a trustee under [section] 363(b)”).
345. Even if a creditor objected to the proposed use or sale of the property, appealed an adverse bankruptcy court ruling, and got the ruling reversed, the reversal probably would be
Because business cases under Chapter 13 are relatively rare, early decisions which construe the new Chapter 13 provisions governing business debtors' disposable income could set more significant precedents than counterpart decisions in the nonbusiness area. Courts faced with a lack of bankruptcy precedent could look to nonbankruptcy decisions concerning the business judgment rule to determine the reasonableness of business expenses in Chapter 13 cases. Alternatively, the courts could develop reasonableness standards unique to bankruptcy. In any event, fewer opportunities will arise for other courts to challenge the approaches set out in early decisions, and development in this area will be slow.

5. Modification of the Debtor's Plan

Congress also included a provision in the Bankruptcy Amendments Act that will permit creditors to propose modifications to confirmed Chapter 13 plans. Although an order of confirmation binds creditors to the provisions of the plan, the trustee or the holder of an allowed unsecured claim may propose modifications to the plan once it has been confirmed. These modifications may of little use to the creditor unless any action on the bankruptcy court order was stayed pending the appeal. Section 363(m) of the Code provides that "reversal or modification of [the bankruptcy court's order under section 363(b)] does not affect the validity of a sale or lease under [bankruptcy court] authorization to an entity that purchased or leased such property in good faith." 11 U.S.C. § 363(m) (1982).

346. Of the 102,201 debtor-initiated Chapter 13 cases filed in the twelve month period that ended June 30, 1983, only 7746 were filed by individuals engaged in business. See supra note 202.


348. 11 U.S.C.A. § 1329(a) (West Supp. 1985). Only the debtor may propose a plan. 11 U.S.C. § 1321 (1982); see, e.g., In re Fluharty, 23 Bankr. 426, 428 (Bankr. N.D. Ohio 1982); In re Waldrep, 20 Bankr. 248, 250 n.2 (Bankr. W.D. Tex. 1982); In re Frost, 19 Bankr. 804, 809 (Bankr. D. Kan. 1982). Debtors also are the only individuals entitled to seek any preconfirmation modifications of a plan. 11 U.S.C. § 1323 (1982). Creditors may be able to force the debtor to modify a plan before confirmation through objections based on noncompliance with the requirements of section 1325. 11 U.S.C.A. § 1325 (West 1979 & Supp. 1985); see supra notes 288-347 and accompanying text. If the debtor's plan is not objectionable under section 1325, however, creditors have no power to propose modifications to the plan before it is confirmed. See 11 U.S.C. § 1323 (1982); In re Fluharty, 23 Bankr. 426, 429 (Bankr. N.D. Ohio 1982).


entail increases in the amount to be paid on particular claims or reductions in the time period for payments under the plan.\textsuperscript{351}

This amendment to the postconfirmation modification provision logically follows from the notion that debtors can be forced to apply all of their disposable income to the Chapter 13 plan for a stated period.\textsuperscript{362} If a debtor's postconfirmation income is greater than expected or expenses are less than expected, actual disposable income will exceed projected disposable income, and the confirmed plan would not require the debtor to apply all disposable income to plan payments. In such instances, creditors should be able to seek modifications of the original plan to reflect the debtor's actual financial status.

The primary difficulty faced by the trustee and creditors who may seek modifications under the new provision involves obtaining information concerning the debtor's postpetition income and expenses.\textsuperscript{363} The Code only requires the debtor to file a proposed budget at the beginning of the proceedings\textsuperscript{364} and to file a supplemental statement if the debtor acquires or becomes entitled to acquire certain narrowly defined types of property within 180 days after filing the petition.\textsuperscript{365} The debtor need not report increases in income, reductions in expenses, or even the good fortune of winning a state lottery.\textsuperscript{366} Given these obstacles, creditors and trustees

\textsuperscript{351} See id. Creditors also could propose decreases in the amount of the debtor's payments or extension of the repayment period, but such creditor action is unlikely.

\textsuperscript{362} See id. § 1325(b)(1) (requiring for confirmation that the debtor either pay unsecured claims in full or apply all disposable income to fund the plan). The amendment strongly suggests that Congress did not intend Chapter 13 debtors to retain any portion of their disposable income during the term of the proceedings unless creditors are paid in full. See generally supra notes 288-347 and accompanying text (describing requirements for confirmation of a Chapter 13 plan).

\textsuperscript{352} See supra notes 325-29 and accompanying text.

\textsuperscript{353} See supra notes 325-29 and accompanying text.


\textsuperscript{356} Bankruptcy Rule 1007(h) requires only that the debtor report the receipt of inheritances, bequests, and devises, life insurance proceeds, death benefits, or property settlements obtained within 180 days after the petition was filed. Id. The lack of any disclosure requirement for other types of property, however, does not indicate necessarily that such property does not belong in the bankruptcy estate. Cf. In re Miller, 16 Bankr. 790, 791 (Bankr. D. Md. 1982) (debtor won a lottery before he filed the bankruptcy petition; court held that prize was property of the estate even though a portion of it was to be received in the future).
can ascertain postconfirmation changes in a debtor’s disposable income only if they act to obtain the proper information. One way creditors and trustees can act is to request that the order confirming the plan include a provision that requires the debtor to report income and expenses periodically to the court or the trustee. This method would ensure that the court would have the information needed to determine whether postconfirmation modification would be appropriate.\textsuperscript{357} Nonetheless, the costs of commencing an action to modify a confirmed plan probably will deter modification proposals unless the debtor’s disposable income has changed significantly.

IX. Conclusion

The Bankruptcy Amendments Act significantly changed many substantive aspects of consumer bankruptcy law. The changes largely reflect the consumer credit industry’s efforts to persuade Congress that the Bankruptcy Reform Act of 1978 went too far in protecting the interest of debtors at the expense of creditors.\textsuperscript{358} Notwithstanding opposing testimony and commentary,\textsuperscript{359} Congress adopted many of the consumer credit industry’s proposals, and in some instances granted even greater protection to creditor interests than the credit industry itself sought.\textsuperscript{360}

The comments of several Congressmen on the floors of the House and Senate indicated a strong belief that the perceived pro-debtor orientation of the Bankruptcy Reform Act of 1978 was responsible in significant part for the increased bankruptcy filings in

\textsuperscript{357} The severe sanctions available to courts if debtors supply false information probably would guarantee compliance with such an order. If a debtor did supply false information, the court could revoke confirmation of the debtor's plan, see 11 U.S.C. § 1330(a) (1982), or revoke the debtor's discharge, see 11 U.S.C.A. § 1328(e) (West Supp. 1985). The court also could order dismissal of the case or force conversion to Chapter 7 by holding that the false information supplied by the debtor constituted a "material default by the debtor with respect to a term of a confirmed plan." 11 U.S.C.A. § 1307(b)(6) (West Supp. 1985).


\textsuperscript{359} See, e.g., Hearings, Part I, supra note 7, at 185-99 (testimony and statement of Professor King); Limiting Access, supra note 11, at 1103-38; Schuchman & Rhorer, supra note 31.

\textsuperscript{360} See, e.g., supra note 128.
1980 and thereafter. The claimed empirical support for this position has been discredited, however, both by academicians and by the General Accounting Office. As a result, the Bankruptcy Amendments Act may have been based on an overstatement of the problems under the 1978 Code, and significant inadequacies and injustices may occur when the amended Code provisions are applied.

Congress could commission further study of consumer bankruptcy filings to detect whatever increase or decrease in consumer bankruptcy filings may occur, to gather empirical data on the effectiveness of each substantive Code change, and to identify further refinements which may be needed. Congress, however, is unlikely to be interested in consumer bankruptcy issues so soon after the extensive reforms of 1978 and 1984. Because Congress most likely will not make additional significant changes soon, interested individuals should be aware of the weaknesses of the new Code changes and the alleged empirical support and should plan their actions accordingly.

362. See supra note 30 and accompanying text.
363. See supra note 31 and accompanying text.