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Consumer Proposals in the Bankruptcy Reform Act of 1998: H.R. 3150, 105th Congress, 2d Session (1998)

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ABSTRACT

The House Judiciary Committee reported the Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong., 2nd Sess. (1998) favorably with an amendment in the nature of a substitute on May 18, 1998 by a vote of 18 to 10.

H.R. 3150 would require certain debtors to pledge future wages or income towards debt repayment under a chapter 13 consumer reorganization rather than having the option of liquidating under chapter 7. Hence, it introduces the concept of “mandatory reorganization” into a bankruptcy system that has been premised on *voluntary* debtor reorganization as an alternative to liquidation to obtain a bankruptcy discharge of indebtedness.

This report considers the legislative history of the current consumer scheme. It examines current consumer bankruptcy practice and surveys the consumer proposals set forth in Title I of H.R. 3150, with an emphasis on the likely impact of the bill on family support obligations.

The report will be updated as legislative action warrants.

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Summary

Shortly before the close of the 1st Session of the 105th Congress, two bills — H.R. 2500 and S. 1301 — were introduced that would dramatically change the manner in which consumer bankruptcies are administered under the U.S. Bankruptcy Code, 11 U.S.C. § 101 *et seq.* On February 3, 1998, a successor bill to H.R. 2500 was introduced — H.R. 3150. This bill is far broader in scope and addresses many aspects of bankruptcy practice in addition to consumer reform. The House Judiciary Committee reported H.R. 3150 favorably with an amendment in the nature of a substitute on May 18, 1998 by a vote of 18 to 10.

Although the Senate and House bills differ significantly, they are referred to as being intended to effect “needs based” bankruptcy, *i.e.*, a consumer bankruptcy system that differentiates among debtors and, by application of external jurisdictional standards or through case-by-case scrutiny, ensures that unsecured creditors receive a higher distribution than they might otherwise.

To achieve this goal, H.R. 3150 would require certain debtors to pledge future wages or income towards debt repayment under a chapter 13 consumer reorganization rather than having the option of liquidating under chapter 7. Hence, it introduces the concept of “mandatory reorganization” into a bankruptcy system that has been premised on *voluntary* debtor reorganization as an alternative to liquidation to obtain a bankruptcy discharge of indebtedness.

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Introduction

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Although the Senate and House bills differ significantly, they are referred to as being intended to effect “needs based” bankruptcy, *i.e.*, a consumer bankruptcy system that differentiates among debtors and, by application of external jurisdictional standards or through case-by-case scrutiny, ensures that unsecured creditors receive a higher distribution than they might otherwise.

To achieve this goal, H.R. 3150 would require certain debtors to pledge future wages or income towards debt repayment under a chapter 13 consumer reorganization rather than having the option of liquidating under chapter 7. Hence, it introduces the concept of “mandatory reorganization” into a bankruptcy system that has been premised on *voluntary* debtor reorganization as an alternative to liquidation to obtain a bankruptcy discharge of indebtedness.

This report considers the legislative history of the current consumer bankruptcy scheme. It examines current consumer bankruptcy practice and surveys the consumer proposals set forth in Title I of H.R. 3150, with an emphasis on the likely impact of the bill on family support obligations.

¹ H.R. 2500, 105th Cong., 1st Session (1997), the “Responsible Borrower Protection Bankruptcy Act.” (Introduced September 18, 1997 by Representatives McCollum and Boucher.)

² S. 1301, 105th Cong., 1st Session (1997). (Introduced October 21, 1997 by Senators Grassley and Durbin.)

³ H.R. 3150, 105th Cong., 2nd Session (1998). (Introduced by Representatives Gekas, McCollum, Boucher and Moran.)

⁴ See, H.R. Rep. 540, 105th Congress, 2nd Session (1998).

Background⁵

Current consumer bankruptcy practice. The current bankruptcy Code was enacted in 1978.⁶ It replaced and repealed in its entirety the pre-existing Bankruptcy Act of 1898.⁷ In 1970, when Congress perceived the need to modernize the bankruptcy laws, it created a Commission on the Bankruptcy Laws of the United States to study and recommend changes in the law. The Commission filed its final report with the Congress on July 30, 1973.⁸ In 1994, Congress created another commission, the National Bankruptcy Review Commission (NBRC), to study and report recommendations for legislative change. The NBRC issued its report on October 20, 1997.⁹ In a lengthy report of approximately 1300 pages, the Commission adopted as many as 172 recommendations dealing with, *inter alia*, consumer bankruptcy, business bankruptcy, municipal bankruptcy — as well as bankruptcy jurisdiction, procedure, and administration.

However, in the case of consumer bankruptcy reform, the Commissioners were generally not in agreement.¹⁰

Chapter 7. Consumer debtors usually avail themselves of one of two operative chapters of the U.S. Bankruptcy Code.¹¹ Chapter 7 of the Code governs liquidation of the debtor’s estate and is often referred to as “straight bankruptcy.” Under the supervision of a standing trustee, the debtor’s assets are liquidated, *i.e.*, reduced to cash, and the proceeds are distributed to creditors in accordance with the procedures mandated. At the conclusion, the debtor receives a “discharge,” which operates as a permanent injunction against any attempt by a creditor to collect discharged debts.

Chapter 13. Chapter 13 has a jurisdictional threshold for filing. It is limited to an individual (and spouse) with regular income whose aggregate unsecured and secured debts are less than \$250,000 and \$750,000 respectively. 11 U.S.C. § 109.

⁵ The following discussion of background and current bankruptcy practice is adapted from CRS Rep. 98-276, “Consumer Bankruptcy Reform: Proposals Before the 105th Congress” by Robin Jeweler (March 20, 1998).

⁶ The Bankruptcy Reform Act of 1978, P.L. 95-598, 92 Stat. 2549 (November 6, 1978).

⁷ 30 Stat. 544 (July 1, 1898).

⁸ Report of the Commission on Bankruptcy Laws, H.R. Doc. No. 137, Parts I and II, 93rd Cong., 1st Sess. (1973).

⁹ “Bankruptcy: The Next Twenty Years,” National Bankruptcy Review Commission Final Report (Government Printing Office, October 20, 1997). The report is accessible on the Internet: <<http://www.access.gpo.gov/NBRC>>.

¹⁰ See, “Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners,” *id.*

¹¹ For a more detailed explanation of bankruptcy procedure, see CRS Rep. 97-1057A, “A Bankruptcy Primer: Liquidation and Reorganization Under the U.S. Bankruptcy Code,” by Robin Jeweler.

Chapter 13 contemplates a more expedited and streamlined procedure for individual (*i.e.*, consumer) reorganization than that provided for under chapter 11, which is designed to accommodate business reorganization.¹² In contrast to chapter 11, a chapter 13 reorganization always requires the participation of a standing trustee. It does not establish creditor committees, nor do creditors vote to accept or reject a plan of reorganization, although they are given the opportunity to accept certain provisions and interpose objections. Only the debtor may propose the reorganization plan, which must be completed within a specified three to five year time frame. A debtor receives a discharge of indebtedness not upon confirmation, but upon completion of all payments under the plan.

Plans are generally required to be completed within three years of the first payment under the reorganization plan, unless the debtor requests and the court approves a modification to extend it for up to, but no longer than five years. 11 U.S.C. § 1329.

Distinctive features of the U.S. Bankruptcy Code

Many features of bankruptcy administration under the modern Code lead to disparities in the financial outcome of debtors who undergo reorganization. However, many of these statutory features have considered, deliberate policy and political explanations for their genesis. We examine several which are relevant to consumer bankruptcy filings.

The function of exclusions and exemptions in bankruptcy. The U.S. Bankruptcy Code, by design, is *not* an equalizer of wealth among all bankruptcy debtors. Each bankruptcy is highly fact specific; but as a general proposition, a debtor who enters bankruptcy with more wealth is likely to emerge from bankruptcy with more assets intact. Any disparity in the outcome among consumer bankruptcy debtors is, in large part, a function of the bankruptcy system of exclusions and exemptions.

A legal treatise observes that “[few people would voluntarily take any legal action which meant the surrender of so much of their possessions as to leave them destitute and virtually helpless.”¹³ Hence, when an individual debtor’s assets are liquidated, the law permits him or her to retain a certain minimum of money and property necessary to realize a “fresh start.” When a debtor files in bankruptcy, a bankruptcy “estate” is created. In some cases, the law permits the debtor to *exclude* property from the estate altogether; in others, property is included in the estate, but is *exempted* from the reach of creditors.

¹² Although chapter 11 is clearly designed to facilitate business, *i.e.*, corporate reorganization, an individual consumer debtor not engaged in business is permitted to file. *Toibb v. Radloff*, 501 U.S. 157 (1991). The 1994 Bankruptcy Reform Act amendments significantly raised the permissible debt levels for filing under chapter 13. Hence, many individuals who could not file under chapter 13 and of necessity filed to reorganize under chapter 11, may now avail themselves of chapter 13.

¹³ 2 Cowans Bankr. Law and Practice § 8.1 (6th Ed. 1994).

Although it would be within Congress' authority to establish a uniform set of bankruptcy exemptions which would be binding upon the states by virtue of the Supremacy Clause, the Code does not do so.¹⁴ Despite recommendations from the 1970 Bankruptcy Commission advising Congress to adopt a uniform system of national bankruptcy exemptions,¹⁵ Congress declined to do so. Congress permits not just that the debtor make an election between federal and state created exemptions, but permits the states to deny debtors the use of — or “opt out” from — federal exemptions.¹⁶ Consequently, even though there is a significant variance between the states in the generosity of their exemptions, more than half have enacted laws that deny debtors the use of federal exemptions.¹⁷

When the debtor's state of domicile has *not* enacted legislation which precludes a debtor from electing federal exemptions, the following are available:¹⁸

- the debtor's aggregate interest, not to exceed \$15,000, in real or personal property that the debtor uses as a residence, or in a burial plot for the debtor or a dependent;
- the debtor's interest, not to exceed \$2,400, in a motor vehicle;
- the debtor's interest, not to exceed \$400, in any one item or \$8,000 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held for personal or family use of the debtor;
- the debtor's aggregate interest, not to exceed \$1000, in jewelry held primarily for the personal use of the debtor;
- the debtor's aggregate interest in any property, not to exceed \$800, plus up to \$7,500 of any unused amount of the exemption for housing above;
- the debtor's aggregate interest, not to exceed \$1,500, in any implement, professional books, or tools of the trade of the debtor;

¹⁴ The U.S. Constitution expressly delegates to the Congress the power “To establish ... uniform Laws on the subject of Bankruptcies throughout the United States.” Article I, section 8, clause 4.

¹⁵ Report of the Commission on Bankruptcy Laws, *supra* at 170-173.

¹⁶ The opt-out program for exemptions was one of many compromises between the Senate, which advocated retaining exemptions under state law, and the House, which enacted a bill premised on federal exemptions. See, Kenneth N. Klee, Legislative History of the Bankruptcy Reform Act of 1978, in Annual Survey of Bankruptcy Law 21 (Callaghan & Co. 1979).

¹⁷ 2 Cowans, *supra* at § 8.2.

¹⁸ Pursuant to amendments effected by the 1994 Reform Act, monetary amounts for exemptions will be adjusted automatically at three-year intervals to reflect the change in the Consumer Price Index. 11 U.S.C. § 104(b).

- any unmaturred life insurance contract owned by the debtor;
- the debtor's aggregate interest, not to exceed \$8,000, in any accrued dividend under, or loan value of, any unmaturred life insurance contract under which the insured is the debtor;
- professionally prescribed health aids;
- the debtor's right to receive social security benefits, unemployment compensation, public assistance benefits, veterans' benefits, disability, illness or unemployment benefits, alimony and support to the extent reasonably necessary;
- benefits under certain pension, profit sharing, stock bonuses, annuity or similar plan or contract, to the extent necessary for the support of the debtor;
- the debtor's right to receive property traceable to an award under a crime victim's reparation law; a payment on account of a wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor; a personal injury award not exceeding \$15,000 for actual compensation (not including pain and suffering); and, payment in compensation for loss of future earnings, to the extent reasonably necessary for support.

In states where federal elections are not permitted, the debtor is limited to his exemptions under applicable state law and nonbankruptcy federal statutes. The amount and value of state law exemptions varies enormously. Among the best-known are those states with homestead exemptions of unlimited monetary value.¹⁹ Media attention is frequently given to wealthy debtors who establish prebankruptcy residency in a state with a generous homestead exemption.²⁰ Thus, when Bowie Kuhn and Harvey Meyerson established homesteads in Florida for \$1 million and \$1.75 million respectively, observers pointed to the ease with which debtors abuse the bankruptcy laws. But these anecdotal illustrations of "abuse" are the result of a deliberate congressional decision to permit states to limit their residents to state law exemptions, and of the deliberate statutory policy of various states to permit, for whatever reason, residents to avail themselves of an unlimited homestead exemption.

Another area which leads to great disparity in the treatment of consumer debtors is the disposition of pension funds. In some instances, a debtor's pension funds may

¹⁹ Homestead exemptions in Florida, Iowa, Kansas, South Dakota, and Texas are of unlimited monetary value.

²⁰ See, e.g., Tim Nickens, *Limiting Debtor Luxury*, THE HERALD, March 30, 1994 at 3A features five individuals who relocated to Florida to purchase homes in excess of one million dollars to benefit from the state homestead exemption prior to filing in bankruptcy: Bowie Kuhn, Harvey Meyerson, Paul Bilzerian, Marvin Warner, and Martin Siegel. See also, Kirstin Downey, *Antonelli's Lifestyle Survives Bankruptcy*, THE WASHINGTON POST, December 14, 1991 at A1.

be completely excluded from the bankruptcy estate;²¹ in others, they may be exemptible under either the Code's exemptions²² or state law. The net result of the complex interaction of these laws is that a debtor's pension assets — often substantial — may be *excluded*, or some or all of the pensions funds may be *exempted*, from the bankruptcy estate available to satisfy creditor claims. When assets are excluded from the estate, they are not administered by the bankruptcy court. When they are exempted, they are beyond creditors' reach. Thus, the fact that debtors emerge from bankruptcy with various amounts of assets intact, though often perceived to be an "abuse" of the law, is often a result of the law's application.

H.R. 3150 addresses these major variants in the manner in which debtors emerge from bankruptcy. It caps the permissible amount of a homestead exemption under state law at \$100,000 (except for family farmers).²³ It also clarifies current law, and continues the practice of permitting the exemption of substantially all of a debtor's pension assets, so long as they are tax exempt under §§ 401, 403, 408, 414, 457 or 501(a) of the Internal Revenue Code of 1986.²⁴

Voluntary vs. mandatory reorganization. Although a debtor may be forced into chapters 7 or 11 involuntarily by creditors,²⁵ that is rarely the case. The vast majority of all bankruptcy cases are filed voluntarily by the debtor. Chapter 13 may *only* be entered voluntarily by the debtor.

Chapter 13 was expressly designed to have built-in incentives to encourage debtor filing as an alternative to liquidation under chapter 7. Among those features are the "superdischarge", *i.e.*, the possibility of paying down and ultimately discharging some types of debt that may not be discharged under chapter 7, and the ability to save the debtor's home by permitting him to cure arrearages in a home mortgage where defaults may have occurred and foreclosure proceedings commenced.

Creditors are benefitted by the "best interests of the creditor" confirmation standard, *i.e.*, the requirement that creditors receive more under the debtor's proposed reorganization plan than they would if the debtor were liquidated under chapter 7. Indeed, creditors generally receive greater repayment when the debtor pledges post-petition income to debt repayment, than is the case under chapter 7 where only pre-petition assets are dedicated to pre-petition debt satisfaction. That is why creditors have long sought "mandatory" consumer reorganization.

The "fresh start" policy implicit in bankruptcy law. Chapter XIII wage earner reorganization was formally introduced into the Bankruptcy Act of 1898 by 1938

²¹ 11 U.S.C. § 541(c)(2). See also, *Patterson v. Shumate*, 504 U.S. 753 (1992).

²² 11 U.S.C. § 522(d)(10)(E).

²³ H.R. 3150, § 182.

²⁴ *Id.*, § 119.

²⁵ 11 U.S.C. § 303.

amendments effected by the Chandler Act.²⁶ In 1934, however, the U.S. Supreme Court, in *Local Loan Co. v. Hunt*,²⁷ had occasion to consider the question whether a bankruptcy debtor's assignment of (future) wages under state law created a lien that was nondischargeable under the federal bankruptcy law. Creditors argued that their claim for future wages created a security interest — a statutory lien — that could not be discharged in bankruptcy. The Court held that an assignment of future wages did *not* create a nondischargeable lien in bankruptcy:

One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.' ...

When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much if not more than it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emancipated debtor, would be of little value to the wage-earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy. Confining our determination to the case in hand, and leaving prospective liens upon other forms of acquisitions to be dealt with as they may arise, we reject the Illinois decisions as to the effect of an assignment of wages earned after bankruptcy as being destructive of the purpose and spirit of the Bankruptcy Act.²⁸

Both the 1970 and the 1994 Bankruptcy Commissions considered and rejected the notion of requiring consumer debtors to devote future income to debt satisfaction as a condition of obtaining relief in bankruptcy.

1973 Report of the Commission on Bankruptcy Laws. The Commission which helped lay the foundation for the current Code considered proposals for limiting the bankruptcy relief available to wage earners. The Commission noted that the frequency of utilization of wage earner reorganization, chapter XIII under the Bankruptcy Act of 1898, reflected local legal "culture," that is, the familiarity of the local bar with and the propensity of attorneys to encourage debtors to file under

²⁶ 52 Stat. 840 (June 22, 1938).

²⁷ 292 U.S. 234 (1934)

²⁸ *Id.*, 244. Citations omitted.

chapter XIII.²⁹ In some districts, debtors were advised by attorneys more knowledgeable in implementing reorganization as to its viability, and were encouraged by the court and creditors to reorganize; in others, wage earner reorganization was an unfamiliar, and therefore, nonpreferred procedure.

Nonetheless, the Commission specifically considered and rejected the notion of *requiring* wage earner reorganization:

In communities where Chapter XIII is used extensively, the Commission is informed that referees are not only hospitable, but counsel and the credit community generally encourage, if indeed they do not insist, that wage-earner debtors in financial distress petition for relief under Chapter XIII. ...In any event, proposals have been made to Congress from time to time that a debtor able to obtain relief under Chapter XIII should be denied relief in straight bankruptcy, and the Commission has received communications expressing support for a change in the Bankruptcy Act to this effect.

After Congressional hearings in 1967, however, the House Judiciary Committee determined that it should not recommend the enactment of this proposed change in the provisions of the Bankruptcy Act applicable to wage earners. The proposal was opposed by the Judicial Conference of the United States, the National Bankruptcy Conference, the Association of the Bar of the City of New York, and spokesmen for labor unions. The measure was supported by the American Bar Association, the American Bankers Association, the Chamber of Commerce of the United States, CUNA International, Inc. the National Federation of Independent Business, and the American Industrial Bankers Association.

The arguments against the proposal included objections made to the difficulties of achieving any nationally uniform standard of application by referees throughout the country, as evidenced by the divergence of their viewpoints regarding the virtues of Chapter XIII. Another view expressed by opponents was that fulfillment of a debtor's commitment made pursuant to a Chapter XIII plan requires not merely a debtor's consent but a positive determination by him and his family to live within the constraints imposed by the plan during its entire term and a will to persevere with the plan to the end. Imposition of a Chapter XIII plan on an unwilling debtor, it was said, would be almost bound to encourage the debtor to change employment and, if necessary, to move to another area to escape the importuning calls and correspondence of his creditors. Likewise, those petitioning debtors turned away by the court on the ground that they failed to show that relief would not be obtainable under Chapter XIII would be motivated to change jobs and locations to get away from creditors who would threaten garnishment and other means of collecting debts. In states where wage garnishment is an unavailable remedy of creditors, the impact of the proposed legislation would have been minimal. A final argument made in opposition to the proposed legislation was that business debtors are not subject to any limitation on the availability of straight bankruptcy relief, including discharge from debts, and it was pointed out that, quite apart from bankruptcy, business debtors are able to incorporate and to limit their liability to their investments in corporate assets. To force unwilling wage earners to devote their future earnings to payment of past debts smacked to

²⁹ Report of the Commission on Bankruptcy Laws, *supra* at 157.

some of debt peonage, particularly when business debtors could not be subjected to the same kind of regimen under the Bankruptcy Act.

The Commission has considered the arguments made for conditioning the availability of bankruptcy relief, including discharge, on a showing by the debtor that he cannot obtain adequate relief from his condition of financial distress by proposing a plan for payment of his debts out of his future earnings. The Commission has concluded that forced participation by a debtor in a plan requiring contributions out of future income has so little prospect for success that it should not be adopted as a feature of the bankruptcy system.³⁰

Arguably, the Commission's concerns about national uniform standards for implementation of reorganization are outdated, although current studies continue to suggest that application of consumer bankruptcy law varies regionally.³¹ However, its concerns with respect to debtor commitment in a mandatory reorganization, the result of debtor insolvency absent reorganization, and of a perceived inequity between consumer and business debtors, remain relevant.

1997 Report of the National Bankruptcy Review Commission. Twenty years of experience with the U.S. Bankruptcy Code did not lead the NBRC to significantly alter the judgement expressed in the 1973 Commission Report. The NBRC considered proposals from the credit industry advocating some sort of debtor-by-debtor scrutiny before permitting debtors to file for chapter 7.³² The NBRC, by a 5-4 vote, reaffirmed maintenance of the status quo.³³

Some witnesses concluded that using a means test to establish Chapter 7 eligibility would fall hardest on families already financially pressed past the breaking point, with little provable benefit. Others expressed their concern that with a completion rate of only 32% for *voluntary* Chapter 13 plans today, forcing unwilling debtors into Chapter 13 would only burden the system, decreasing both the overall repayment to creditors and the successful rehabilitation of debtors. ...In a time of increasing strain on judicial resources, questions also have arisen about the number of judges, clerks, and other staff needed to administer a means test to hundreds of thousands of debtors annually. The credit industry has sought means testing consistently for at least 30 years, but Congress has consistently refused to change the basic structure of the consumer bankruptcy laws.

³⁰ Id. at 158-159. Footnotes omitted. Cited with approval by the House Judiciary Committee in the legislative history of the 1978 Bankruptcy Reform Act. H.R. Rep. 595, 95th Congress, 1st Session 120-121 (1977).

³¹ See, e.g., Jay Westbrook, *Local Legal Culture and the Fear of Abuse*, 6 AM.BANKR.INST.L.R. 25 (1998)

³² NBRC Final Report, *supra* at 89. ("The consumer bankruptcy debates never lacked a discussion of whether debtors are receiving 'more relief than they need,' although the cost and implementation of a 'means testing' system were not developed in specific detail. These features are now detailed in the 'means test' legislation recently proposed in H.R. 2500.")

³³ None of the four dissenting commissioners appears to specifically advocate "means testing" as a consumer bankruptcy reform. They do, however, "disagree most strongly with the [Commission] Framework proposals that . . .discourage Chapter 13 repayment plans and encourage Chapter 7 liquidations[.]" Dissent, *supra* at 3.

There is no dispute on one point: bankruptcy should be used only by the needy and not by others. The bankruptcy laws should *never* invite abuse. When Congress charged the Commission with its duties, it cautioned that there was no evidence that the bankruptcy system needed radical reform. It characterized the system as ‘generally satisfactory,’ and directed the Commission to review, improve and update the Code ‘in ways which do not disturb the fundamental tenets and balance of current law.’ The Commission conducted an intensive review of consumer bankruptcy that resulted in a full set of recommendations, but the proposals contemplate no change in the basic structure of consumer bankruptcy. Access to Chapter 7 and to Chapter 13, the central feature of the consumer bankruptcy system for nearly 60 years, should be preserved.³⁴

In summary, the two Bankruptcy Commissions charged with considering the prospect of mandatory consumer reorganization cited the following reasons in support of their rejection of the concept:

- difficulty of compliance by unwilling/unable debtors. Subjecting those, for whatever reasons, least able to manage finances to an extremely strict long-term future budget is likely to fail;
- current low success rate for voluntary reorganization;
- difficulty of creditor collection where debtors avoid bankruptcy relief to evade mandatory reorganization;
- no comparable business requirement;
- increased implementation costs.

In the past, Congress has also considered and rejected the idea.³⁵

Consumer Reform Under H.R. 3150

Background: A Major Shift in Bankruptcy Policy. Because of its complex, technical nature, study and review of the of the U.S. Bankruptcy Code has previously been delegated to specially designated Commissions, discussed *supra*. As late as 1994, however, Congress expressed general satisfaction with the operation of the bankruptcy laws. In the legislative history to the Bankruptcy Reform Act of 1994, Congress wrote:

[The National Bankruptcy Review] Commission should be aware that Congress is generally satisfied with the basic framework established in the current

³⁴ Id. at 90-91. Footnotes omitted; emphasis in original.

³⁵ See, e.g., *Oversight Hearing on Personal Bankruptcy Before the House Judiciary Subcomm. on Monopolies and Commercial Law*, 97th Congress, 2d Session (1982); “*Bankruptcy Reform Act of 1978 (Future Earnings), Part 2*,” *Hearings Before the Senate Judiciary Subcomm. on Courts*, 97th Congress, 1st Session (1981); *Hearing on H.R. 1057 and H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Congress, 1st Session (1967).

Bankruptcy Code. Therefore, the work of the Commission should be based upon reviewing, improving, and updating the Code in ways that do not disturb the fundamental tenets and balance of current law.³⁶

The intervening years and the massive increase in consumer bankruptcy filings have apparently led the Congress to reevaluate its “satisfaction” with current law. The approach to consumer bankruptcy in H.R. 3150 generally disregards the recommendations of the 1994 Commission. It revises the fundamental tenets and balance of current law in a variety of ways, for example: it weakens the comprehensiveness of the automatic stay; it substantially enlarges classes of nondischargeable debt to include commercial debt, and thereby minimizes the historically vaunted “fresh start”; it increases adversarial litigation permitted before the bankruptcy court; and, it permits debtors to donate up to 15% of gross annual income to qualified religious and charitable organizations, prior to and during the course of a reorganization. The legally sanctioned increases in litigation, that is, administrative expenses, and extent of permissible charitable donations diminish the current policy of maximizing the debtor’s bankruptcy estate available to pay creditors.

Also, in the expressed desire to protect family support obligations, discussed *infra*, the bill establishes postbankruptcy “priorities” applicable to state law. This is historically significant because bankruptcy has been a self-contained process under federal law. Application of federally created “priorities” to the vast array of state judicial and administrative proceedings applying state domestic and commercial law is without precedent in modern bankruptcy practice. It is likely to pose a unique challenge to the parties and tribunals that attempt to enforce it.

The new policy goals are articulated in committee report language accompanying H.R. 3150 which evidences congressional desire to inject “personal responsibility” and “integrity” into bankruptcy practice by recalibrating the balance of debtor/creditor relations:

The purpose of H.R. 3150 is to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and by ensuring that it is fair for both debtors and creditors.

...

The consumer bankruptcy reforms ... are implemented through a self-evaluating income/expense screening mechanism, the establishment of new eligibility standards for bankruptcy relief, the imposition of additional financial disclosure requirements for consumer debtors, and augmented responsibilities for those charged with administering consumer bankruptcy cases. In addition, H.R. 3150 institutes a panoply of consumer bankruptcy reforms designed to increase the protections afforded to debtors and creditors.³⁷

To the extent that H.R. 3150 presents a dramatic departure from sixty years of consumer bankruptcy practice, it is difficult to predict its ultimate impact. Congress clearly contemplates that if its provisions are implemented, “the rate of repayment to

³⁶ H.R. Rep. 835, 103rd Congress, 2nd Session 59 (1994).

³⁷ H.R. Rep. 105-540, *supra* at 71.

creditors will increase while the number of bankruptcy filings will decrease.”³⁸ These expectations, however, are based upon predictions derived from economic modeling, not historic experience. The scope of revision coupled with its uncertain impact on the postbankruptcy debtor’s ability to reestablish financial viability has led the Clinton Administration to oppose the bill.³⁹

Subtitle A — “Needs based” bankruptcy. This bill would effect “means testing” by requiring debtors who seek to file under chapter 7 to satisfy complicated financial formulas intended to weigh the debtor’s debt against his income. If a debtor is ineligible to file under chapter 7, he would be required either to file under chapter 13, or to refrain from filing. This is the basic principle behind “needs based” bankruptcy, *i.e.*, only those who meet criteria establishing “need” to file under chapter 7 will be permitted to do so.

The bill would amend that section of the U.S. Bankruptcy Code, 11 U.S.C. § 109, which defines who may be a debtor under the various chapters, by providing that a debtor (which includes an individual and spouse) may *not* file under chapter 7 if the debtor has “income available to pay creditors as determined under” the new statutory standards.

“Income available to pay creditors” means (1) a current monthly income of not less than the highest national median family income for a family of equal size; (2) projected monthly net income greater than \$50; and, (3) projected monthly net income sufficient to repay 20 percent or more of unsecured non-priority claims⁴⁰ during a five-year, as opposed to the currently presumptive three year, repayment plan.⁴¹ The terms are further defined as specified below.⁴²

³⁸ *Id.*

³⁹ See, *Clinton Administration Opposes HR 3150* at <www.abiworld.org/legis/legisnews>.

⁴⁰ See 11 U.S.C. § 507 which classifies priority claims.

⁴¹ H.R. 3150, § 101(4) would add a new subsection 11 U.S.C. § 109(h) to the Code.

⁴² New subsection 109(h) would further provide that:

(2) Projected monthly net income shall be sufficient [to repay 20 percent of unsecured nonpriority claims] ... if, when multiplied by 60 months, it equals or exceeds 20 percent of the total amount scheduled as payable to unsecured nonpriority creditors.

(3) ‘Projected monthly net income’ means current monthly total income less—

(A) the expense allowances under the applicable National Standards, Local Standards and Other Necessary Expenses allowance (excluding payments for debts) for the debtor, the debtor’s dependents, and, in a joint case, the debtor’s spouse if not otherwise a dependent, in the area in which the debtor resides as determined under the Internal Revenue Service financial analysis for expenses in effect as of the date of the order for relief;

(B) the average monthly payment on account of secured creditors, which shall be calculated as the total of all amounts scheduled as contractually payable to secured creditors in each month of the 60 months following the date of

(continued...)

“Adequate income” and “extraordinary circumstances”. The bill requires a chapter 13 debtor to commit adequate income to a reorganization plan that pays unsecured creditors. In essence, this means that during the course of the five year reorganization,⁴³ if the trustee or an unsecured creditor objects to the debtor’s proposed reorganization plan, then “the total amount of monthly net income received by the debtor shall be paid to unsecured nonpriority creditors under the plan[.]”⁴⁴

One of the major distinctions between current law and the bill is the application of economic and statistical formulae to determine such basic factors as who may file under chapter 7 versus 13, and what will be deemed “disposable income.” Instead of determining what is “disposable income” on a debtor-by-debtor basis, all debtors will be expected to live on budgets based on IRS calculations for living expenses.

Currently, the formulation of the reorganization plan provides far more discretion and leeway to a debtor — though the plan is always subject to scrutiny by a trustee and the court to protect unsecured creditors. Further, under current law, when an unsecured debtor objects to a proposed reorganization, the debtor may be required to provide all of his projected disposable income for a three year period to payment under the plan. However, there is greater flexibility in the present definition

⁴²(...continued)

the petition by the debtor, or, in a joint case, by the debtor and the debtor’s spouse combined, and dividing that total by 60 months; and

(C) the average monthly payment on account of priority creditors, which shall be calculated as the total amount of debts entitled to priority, reasonably estimated by the debtor as of the date of the petition, and dividing that total by 60 months.

⁴³ The presumptive term of a chapter 13 plan for a debtor whose income is not less than the highest national median income would be five years, unless the court approves a seven year plan “for cause;” if the debtor’s income is less than the highest national median income, the repayment period would be three years, with an extension to five years “for cause.” See, § 409 of H.R. 3150.

⁴⁴ H.R. 3150, § 102(1). Disposable, that is, “monthly net income” is defined as:

... the amount determined by taking the current monthly total income of the debtor less — (A) the expense allowances under the applicable National Standards, Local Standards and Other Necessary Expenses allowance (excluding payments for debts) for the debtor, the debtor’s dependents, and, in a joint case, the debtor’s spouse if not otherwise a dependent, in the area in which the debtor resides as determined under the Internal Revenue Service financial analysis for expenses in effect as of the date it is being determined; (B) the average monthly payment on account of secured creditors, which shall be calculated as of the date of the determination as the total of all amounts then remaining to be paid on account of secured claims pursuant to the plan less any of such amounts to be paid from sources other than the debtor’s income, divided by the total months remaining of the plan; and (C) the average monthly payment on account of priority creditors, which shall be calculated as the total of all amounts then remaining to be paid on account of priority claims pursuant to the plan less any of such amounts to be paid from sources other than the debtor’s income, divided by the total months remaining of the plan.

of “disposable income,” which means “income which is received by the debtor and which is not reasonably necessary to be expended ... for the maintenance or support of the debtor or a dependent of the debtor.”⁴⁵ The court and the trustee, not creditors, however, are the primary overseers of the debtor’s proposed expenses.

The bill contemplates an intensive five to seven-year program of debt repayment overseen by the bankruptcy court — the debtor will make payments of “projected monthly net income” according to externally derived payment criteria, and will be required to pass on any additional income to unsecured creditors over the course of the five years. The trustee will be required to investigate and verify the debtor’s projected monthly net income over the course of the plan’s duration, and file annual reports with the court (with copies to creditors.)

The debtor will be permitted to modify the plan annually to allow additional expenses if “extraordinary circumstances” so warrant. “Extraordinary circumstances” are not defined in the bill. So the matter may be subject to litigation as parties with sufficient resources seek to clarify what the term encompasses.⁴⁶ Parties who cannot afford to litigate such matters with their creditors, as can be expected of many bankruptcy debtors, may be subject to a variety of pressures to reaffirm debt or seek a dismissal or conversion.⁴⁷ To the extent that the debtor forfeits any right to disposable income for a period of five years, it may be difficult to negotiate unforeseen expenses.

The actual process for establishing extraordinary circumstances and modifying the plan is arguably cumbersome. Basically, the debtor files a report with the court which explains and itemizes income which has been lost in the preceding six months, and itemizes replacement income which has been secured or is *expected*; itemizes each additional expense; gives a detailed description of why the debtor requires the additional expense; and, provides a sworn statement by the debtor and his attorney verifying the information.

⁴⁵ 11 U.S.C. § 1325(b)(2). See, *In re Presley*, 201 B.R. 570 (Bankr.N.D.Fla. 1996) (Under the disposable income test for chapter 13 confirmation, courts must determine on a case-by-case basis, whether debtor’s listed monthly expenditures, individually and as a whole, are reasonably necessary for maintenance or support of the debtor.)

⁴⁶ For example, would orthodontics for a debtor’s children be considered an “extraordinary circumstance”? Would the debtor have to litigate the question of whether braces served a structural rather than cosmetic purpose? Tutoring for a child’s learning disability? Replacement of household appliances, or an automobile? Currently, expenses which are “reasonably necessary for maintenance and support” are subject to the court’s review, but the term “extraordinary” presumably will establish a far stricter standard.

⁴⁷ The legislative history to the 1978 Code demonstrates many instances of concern about disparities between debtors and creditors with respect to access to resources to fund litigation. Writing about an exception to discharge, the House Judiciary Committee wrote, “The threat of litigation over this exception to discharge [11 U.S.C. § 523(a)(2)] and its attendant costs are often enough to induce the debtor to settle for a reduced sum, in order to avoid the costs of litigation. Thus, creditors with marginal cases are usually able to have at least part of their claim excepted from discharge (or reaffirmed), even though the merits of the case are weak.” H.R. Rep. 95-595 at 130.

A debtor will have one window of opportunity to modify the plan within 45 days before each anniversary of confirmation.⁴⁸ In order to do so, the debtor must file a statement of “extraordinary circumstances” with the court and the trustee. The bill is silent on adjustments that may require attention outside of the anniversary of confirmation. If neither the trustee nor creditors object, the debtor’s statement of necessary modification may take effect. If objections are interposed, there will be a hearing before the court to rule on the proposed modification. The debtor will have the legal burden of proving “extraordinary circumstances.” The court may award a reasonable attorney’s fee to the prevailing party if the nonprevailing party was “not substantially justified.” Further, the debtor must state, “under penalties of perjury,” the “amount of monthly net income, which may be as adjusted under section 111 ... and the amount of monthly net income which will be paid per month to unsecured non-priority creditors under the plan.”⁴⁹

The bill would also expand the debtor’s duty to file specified information with the bankruptcy court.⁵⁰ Filing documentation would include three years of prior tax returns; copies of all payment advices received within 60 days of filing; a statement of the amount of projected monthly net income, itemized to show how calculated; and, statements disclosing any “reasonably anticipated” increase in income or expenditures for the next 12 months. Failure to file all the information required would result in a mandatory, automatic case dismissal without the need for a court order.⁵¹

Finally, needs-based bankruptcy is promoted by elaborate requirements that prospective debtors “make a good faith attempt to create a debt repayment plan outside the judicial system for bankruptcy law” through credit counseling.⁵² Debtors will presumably learn about this requirement when they contemplate a bankruptcy filing. Many expenses that a debtor incurs during the 90-day mandatory prebankruptcy counseling period are likely to constitute nondischargeable debts under other sections of the bill. This requirement exemplifies a new bankruptcy policy direction which channels debt collection activities to venues other than U.S. bankruptcy court.

Subtitle B — Adequate protection for consumers. Under current law, a bankruptcy court clerk is obligated to provide a consumer debtor written notice which indicates each chapter under which the individual may proceed.⁵³

- *Financial management training.* H.R. 3150 would direct the Executive Office for the United States Trustees (EOUST) to develop a financial management training curriculum to educate individual debtors on how to better manage

⁴⁸ New § 111(b), added by § 102 of H.R. 3150.

⁴⁹ The legal implications of subjecting debtors to prosecution for perjury based upon the *expectation* of income and payout is not considered in this report.

⁵⁰ H.R. 3150, § 406.

⁵¹ *Id.*, § 407.

⁵² *Id.*, § 104.

⁵³ 11 U.S.C. § 342(b).

their finances.⁵⁴ The program would be implemented in three judicial districts on a pilot basis. Subsequently, the EOUST would evaluate the effectiveness of the program compared to those carried out by the credit industry, by standing trustees, and by consumer counselling groups.

Detailed, substantive disclosure statements for a “debt relief counselling agency” are established.⁵⁵ A new section of the Code, 11 U.S.C. § 527 entitled “Debtor’s bill of rights” would prescribe detailed requirements for advertising by debt relief counselling agencies and proscribed practices.⁵⁶ Enforcement mechanisms are also established.⁵⁷

Further, the Congress encourages the states to develop personal finance curricula for use in elementary and secondary schools.⁵⁸

- *Charitable donations.* 11 U.S.C. § 548, entitled “Fraudulent transfers and obligations,” is designed to prevent a debtor from depleting the resources available to creditors through gratuitous transfers of property prior to filing. Although some prebankruptcy transfers, such as religious tithing by an insolvent individual prior to filing in bankruptcy, may not involve actual “fraudulent” intent, courts had found that they harmed the interests of creditors in general, and have allowed a bankruptcy trustee to seek return of the contribution from the donee for inclusion in the bankruptcy estate to be distributed to creditors.

H.R. 3150 would amend the Code to provide that donations of up to 15% or more of a debtor’s annual gross income made in the year prior to filing in bankruptcy cannot be canceled — or “avoided.”⁵⁹ It would permit a chapter 13 debtor to contribute a comparable amount during the course of a chapter 13 reorganization, thus minimizing the income available to satisfy creditor claims.

Although there is judicial precedent which both permits and prohibits the transfers at issue,⁶⁰ several free-standing bills have been introduced to amend

⁵⁴ H.R. 3150, § 112.

⁵⁵ Id. § 114 requires that specific information about bankruptcy and the role of attorneys, bankruptcy petition preparers and debt relief counselling agencies be disclosed.

⁵⁶ Id., § 115,

⁵⁷ Id., § 116.

⁵⁸ Id., § 117.

⁵⁹ Id. § 118.

⁶⁰ See, *Christians v. Crystal Evangelical Free Church (In re Young)*, ___F.3d___, 1998 WL 166642 (8th Cir. 1998)(permitting pre-chapter 7 bankruptcy tithing of 10% of debtors’ annual income. In *Boerne v. Flores*, 117 S. Ct. 2157 (1997) the U.S. Supreme Court held that the Religious Freedom Restoration Act (RFRA) was unconstitutional as applied to state law. The Eighth Circuit held that RFRA is constitutional as applied to federal law, specifically, the

the Code to permit donations by insolvent bankruptcy debtors to charitable and religious organizations.⁶¹

Subtitle C — Adequate protection for secured lenders. Subtitle C of H.R. 3150 would amend many provisions of the Code to enhance the position of secured creditors throughout the course of the bankruptcy proceedings. These include:

- *Discouraging bad faith repeat filings; stopping abusive conversions from chapter 13.*⁶² The bill would amend the automatic stay provision of the Code, 11 U.S.C. § 362, to provide that the stay may or may not apply with respect to specific creditors if a debtor had a previous case pending within the previous year. The court will have to determine whether previous cases were filed in “good faith”; whether the previous case was dismissed by the court “without substantial excuse (but mere inadvertence or negligence shall not be substantial excuse unless the dismissal was caused by the negligence of the debtor’s attorney);” and, whether there has been a substantial change in the financial or personal affairs of the debtor since the previous dismissal. In certain instances, the court would be permitted to grant an *in rem* order in connection with the stay.⁶³ When a debtor converts from chapter 13 to another chapter (presumably 7), secured creditors would be entitled to their full contract, *i.e.*, nonbankruptcy, claim amount, not an amount reduced by a court valuation or determination made in connection with allowing a secured claim.⁶⁴
- *Definition of “household goods”.*⁶⁵ The bill would amend the Code to provide a uniform definition of “household goods” patterned after the Federal Trade Commission’s Credit Practices Rules.⁶⁶ This amendment is intended to end litigation over what items qualify for the federal exemption for household goods. To the extent that the proposed definition of household goods is somewhat narrower than some courts have interpreted it to be, it will work a hardship on the debtor having to avail himself of the exemption. For example, the new definition specifies that “household goods” *excludes* “electronic entertainment equipment other than one television and one radio.” Some would argue that used consumer televisions, tape players, nintendo players, etc. are irreplaceable to a debtor but of minimal resale value, hence of negligible value to the creditors on whose behalf they would be seized. Some have also argued that a narrow definition of household goods benefits home finance companies who routinely take blanket liens on a customer’s personalty

⁶⁰(...continued)

U.S. Bankruptcy Code.)

⁶¹ See, H.R. 2604, 105th Congress, 1st Sess. (1997); H.R. 2611, 105th Congress, 1st Sess. (1997); and, S. 1244, 105th Congress, 1st Sess. (1997).

⁶² *Id.*, § 121.

⁶³ *Cf.*, Recommendation of the NBRC, 1.5.6 *In Rem Orders*, *supra* note 8 at 8.

⁶⁴ H.R. 3150, §127.

⁶⁵ *Id.*, §122.

⁶⁶ 16 C.F.R. § 444.1(i) (1997).

to secure loans; debtors would be under increased pressure to reaffirm otherwise dischargeable debts in order to retain more of their household chattels.

- *Debtor retention of secured property; relief from the automatic stay.*⁶⁷ There is a split among the courts regarding the effect of a debtor's failure to reaffirm a debt when the debtor retains the collateral and stays current on all payments.⁶⁸ The debtor's retention of the property without a reaffirmation while maintaining payment is referred to as a "ride-through." The bill would amend the Code to clarify that a debtor is required to formally reaffirm a debt or redeem the collateral in compliance with Code requirements. Failure by the debtor to do so would result in a creditor being permitted to pursue the collateral outside of bankruptcy. Comparable provisions with respect to the assumption of an unexpired lease of the debtor would apply. In the case of certain individual filings, a request for relief from the automatic stay will be self-executing after 60 days unless the court issues a final decision before then, or finds compelling circumstances warranting an extension of time.
- *Restraining abusive purchases on secured credit; fair valuation of collateral.* 11 U.S.C. § 506 currently provides that a secured claim is secured up to the value of the collateral, and unsecured for any amount over the collateral's value. The bill would amend this section to provide that in individual bankruptcies under chapter 7, 11, 12, or 13, when a debtor purchases secured personal property within 6 months of filing bankruptcy, the amount of the secured claim must reflect the contract value of the claim (including unpaid interest and charges), not the market value of the collateral.⁶⁹ Valuation of consumer property claims under § 506 would be valued at "the price a retail merchant would charge for the property of that kind," overruling *Associates Commercial Corp. v. Rash*.⁷⁰
- *Protection of holders of claims secured by debtor's principal residence.* The Code currently provides that a chapter 13 debtor's reorganization may *not* modify the secured interest of a mortgage holder on the debtor's home. 11 U.S.C. § 1322(b)(2). The bill would extend protection of the mortgage holder to prevent the debtor from modifying debts secured by "incidental" property,

⁶⁷ H.R. 3150, §§ 123, 124.

⁶⁸ Cases which have permitted ride-through include *Capital Communications Federal Credit Union v. Boodrow*, 126 F.3d 43 (2nd Cir. 1997), *cert. denied*, 118 S. Ct. 1055 (1998); *In re Belanger*, 962 F.2d 345 (4th Cir. 1992); *Lowry Federal Credit Union v. West*, 882 F.2d 1543 (10th Cir. 1989). *Contra*, *In re Johnson*, 89 F.3d 249 (5th Cir. 1996), *In re Taylor*, 3 F.3d 1512 (11th Cir. 1993); *In re Edwards*, 901 F.2d 1383 (7th Cir. 1990); *In re Bell*, 700 F.2d 1053 (6th Cir. 1983).

⁶⁹ H.R. 3150, § 128

⁷⁰ 117 S. Ct. 1879 (1997) (holding that under 11 U.S.C. § 506(a) the value of property retained by the debtor is "the cost the debtor would incur to obtain a like asset for the same proposed use" or the replacement value.)

which is defined to include window treatments, carpets, appliances, etc.⁷¹ It would also permit exceptions to the automatic stay for postponements or continuations of prepetition actions by the creditor to foreclose or sell the until a prepetition mortgage default is fully cured.

Subtitle D — Adequate protections for unsecured lenders. Subtitle D of the bill would amend the Code to alter the relationship between high priority and nondischargeable debt, and makes several provisions to enhance the position of credit card lenders. These provisions include:

- ***Debts incurred to pay nondischargeable debts.*** The bill would amend the Code to make debts which are nondischargeable under § 523 high priority unsecured claims as well.⁷² The provision also establishes priorities among the priorities.⁷³ High priority unsecured claims, defined in § 507, get favored, *i.e.*, high priority, distribution from the debtor’s bankruptcy estate. High priority claims, with the exception of child support and alimony, are not necessarily the same as nondischargeable claims. Nondischargeable claims may be pursued by a creditor against the debtor from assets received after he is out of bankruptcy. Entitling creditors of nondischargeable claims to high priority status as well will minimize the debtor’s estate available for distribution to those creditors whose claims will be discharged, and permit holders of nondischargeable claims to collect from estate and nonestate assets. Tracing the end-use of credit card charges and the expenditure of cash advances is without precedent in bankruptcy practice.⁷⁴

⁷¹ H.R. 3150, § 130.

⁷² H.R. 3150, §141. “Under the Bankruptcy Code, certain unsecured debts are not discharged... .To avoid the obvious consequences of [nondischargeability under § 523(a)], debtors can borrow money to pay these nondischargeable debts and then seek to discharge the debt incurred for the money borrowed. For example, a debtor, under current law, can obtain a cash advance with a credit card and use those funds to pay an outstanding obligation for child support, which would have not been discharged.” H.R. Rep. 105-540, *supra* at 108-109.

⁷³ “Under section 141, a general unsecured claim incurred by a debtor to pay a tax or child support obligation is entitled to priority of payment after payment of higher order priority claims in Section 507(a)(10), as amended by this provision. Claims within the tenth category of priority are paid according to their respective priority. This ensures that higher priority claims, such as child support claims, will be paid in full, before estate assets can be used to pay those obligations accorded a lower priority under section 507 of the Bankruptcy Code.” H.R. Rep. 105-540, *supra*.

⁷⁴ In 1994, the Code was amended to make debts incurred to “pay a tax to the United States” nondischargeable if the underlying tax was nondischargeable. Hence, use of a credit card to make certain federal tax payments *would* make that credit card claim nondischargeable. However, examining all credit card charges and cash advances to determine their end-use has not been legally required, perhaps due to the foreseeable difficulties of documentation.

- *Nondischargeability of credit card debt.*⁷⁵ The bill would amend the Code to make credit card debt nondischargeable under chapters 7 and 13 when the debtor used a credit card “without a reasonable expectation or ability to repay.” The use of a financial statement to obtain credit that is nondischargeable because the debtor made it “with an intent to deceive” will become nondischargeable if made by the debtor “without taking reasonable steps to ensure the accuracy of the statement.” Debts are currently nondischargeable when incurred within 60 days before bankruptcy for the purchase of “luxury” goods aggregating more than \$1000; this category of nondischargeability would be broadened to cover “consumer debts” incurred within 90 days of bankruptcy.
- *Debts for alimony, maintenance, and support.* The current exception to discharge for debts owed to state agencies for child support would be expanded to include nondischargeability for accrued interest on the underlying debt; such obligations would also be nondischargeable under chapter 13.⁷⁶ The automatic stay would not apply to government actions to withhold income pursuant to the child support provisions of § 466(b) of the Social Security Act, or withholding or suspending a driver, professional, or occupational license as punishment for nonpayment of child support. All of the reorganization chapters — 11, 12, and 13 — would be amended to provide that a debtor could not receive plan confirmation, or a discharge, unless the debtor was current on all postpetition family support. Nondischargeability of property settlements would also be expanded.⁷⁷
- *Protection of child support and alimony payments after the discharge.*⁷⁸ This provision would add a new statute, 11 U.S.C. § 529, which is intended to protect child support and alimony payments after discharge. It would preempt all state constitutions and laws which would confer a different priority on nondischargeable child support as against other nondischargeable debts. States, however, do not generally have any laws establishing priorities among nondischargeable debts under the U.S. Bankruptcy Code. Hence, it is unclear who would assert this “priority” — the debtor as defendant being sued for other nondischargeable debts such as nondischargeable credit card debt; or, would the spouse seeking nondischarged child support have to intervene in commercial litigation between the debtor as defendant and the commercial creditor as plaintiff? This provision is discussed in greater detail, *infra*.
- *Fees arising from certain ownership interests.* The 1994 Bankruptcy Reform Act made certain postpetition condominium fees nondischargeable when a debtor continued to occupy the property. 11 U.S.C. § 523(a)(16). The bill

⁷⁵ Id., §§ 142, 143, 145.

⁷⁶ Id., § 146.

⁷⁷ Id., § 147.

⁷⁸ Id., § 150.

would expand nondischargeability for all condominium, cooperative and homeowners' association fees.⁷⁹

Subtitle E — Adequate protection for lessors. Subtitle E confers a variety of financial protections and enhancements to the position of a lessor of personal property to a debtor lessee in chapters 7 or 13. These benefits are generally in the nature of requiring a prompt assumption of a lease for personalty by the debtor; liberal relief from the automatic stay for creditors; and greater cash payments for use of the property during the reorganization. Residential landlords would not be bound by the automatic stay to prevent or delay eviction proceedings when the lease has expired.⁸⁰

Implications of Needs Based Bankruptcy

A less discretionary, more stringent Bankruptcy Code. Despite its length and complexity, the U.S. Bankruptcy Code achieves, to some extent, an expeditious and streamlined procedure for dealing with consumer bankruptcy. A significant percentage of debtors who file under chapter 7 have little to no assets, and their cases are referred to as “no asset chapter 7’s.”⁸¹ Their cases can proceed with minimal professional involvement.

The proposed jurisdictional filing requirements in H.R. 3150 would likely necessitate that debtors obtain more individually tailored, sophisticated professional assistance — legal and financial — to determine what debtor filing options are. This would include preliminary calculations regarding the debtor’s income in relationship to the national median income and the debtor’s projected monthly net income in relationship to the percentage of unsecured debt.

Those debtors who are required to file under chapter 13 will experience five years of intensive judicial and professional financial review. Clearly, this new level of bankruptcy case management will involve higher costs. Whether those most in need of bankruptcy relief will be able to afford and receive the necessary assistance is an open question. Another unresolved issue is whether attorneys and financial service providers will be able to provide the services in a newly labor-intensive bankruptcy system. The challenge will be to provide services in a cost-effective manner that satisfies legal requirements but does not increase the public’s perception that professional fees often consume too much of the debtor’s estate. The newly complex filing requirements could make the Bankruptcy Code rival the Tax Code in the complexity of its application. Indeed, a “bankruptcy filing industry” like the “tax preparation” industry may evolve to service consumer needs.

⁷⁹ Id., § 149.

⁸⁰ Id., §§ 161 - 163.

⁸¹ “Chapter 7 cases account for nearly 70% of all bankruptcy filings. Approximately 95% of these chapter 7 cases are terminated as ‘no asset’ cases[.]” Ed Flynn, *Bankruptcy Statistical Update for 1996* in *The 1997 Bankruptcy Yearbook & Almanac* 39 (New Generation Research, Inc. 1997).

Increased costs of bankruptcy. H.R. 3150 would inject numerous opportunities for adversarial hearings in the course of a consumer bankruptcy as debtors and creditors wrangle over the application of statutory terms such as “extraordinary circumstances” and “reasonable expectation of repayment.” Historically, the mere threat of litigation by creditors against an insolvent debtor “unleveled” the playing field. The cessation of costly legal proceedings is a prime factor for bankruptcy’s automatic stay — which is designed to preserve and maximize the bankruptcy estate for all creditors. Therefore, it is reasonable to anticipate that in some instances, debtors who cannot afford creditor-initiated adversarial litigation will acquiesce in reaffirmation agreements, unreasonable repayment schedules, or just opt out of the bankruptcy system. In other instances, frequent adversarial litigation will deplete the debtor’s assets available for repayment to all unsecured creditors.

Many of the NBRC’S recommendations are intended to streamline and expedite both business and consumer bankruptcies by minimizing their time and expense. Some aspects of the consumer reform proposals may have the effect of transforming consumer bankruptcies into potentially litigation-intensive proceedings.

Implementation costs. The increased responsibilities of the bankruptcy courts with respect to credit counseling, investigatory and verification responsibilities, and auditing will add substantially to the costs of the U.S. bankruptcy court system. It is not clear whether the present fee system would support the revised system.

Mandatory reorganization. The merits of requiring debtors to reorganize as opposed to liquidate their assets have been considered and rejected by the Congress and two bankruptcy commissions. Arguably, those who resort to bankruptcy, in addition to suffering from unanticipated adversity — sickness, loss of employment, etc. — may not be the population most adept at financial planning and management. Are these debtors likely to succeed at five to seven years of tightly budgeted, intensively monitored living, when they are required to do so involuntarily? What would be the practical consequences of fewer bankruptcy filings and fewer successful consumer reorganizations if the actual rate of consumer insolvency remains steady or grows?

The meaning of increased consumer filings. The reforms of “need based” bankruptcy appear to be designed to stem the steadily-increasing tide of consumer bankruptcies.⁸² There also appears to be an assumption that bankruptcy filings are bad — for creditors specifically, and for the economy in general. But alternative scenarios are possible. A fast and expeditious consumer bankruptcy process may, on some levels, inject certainty into debtor/creditor relations. If insolvent debtors refrain from bankruptcy, will creditors actually receive a greater return on indebtedness? Do the high transaction costs of piecemeal debt collection outweigh whatever advantages fall to creditors when people are insolvent outside of bankruptcy? Bankruptcy process is intended to ensure fairness and maximize returns among competing creditors, not simply to rehabilitate debtors. Will *all* creditors, including small business creditors, capture more or less as a consequence of needs based bankruptcy? Will small

⁸² See CRS Rep. 97-637E, “One Million Personal Bankruptcies in 1996: Economic Implications and Policy Options,” by Mark Jickling.

creditors with limited legal resources be outmatched by larger creditors with greater resources?

The nexus between the growth of consumer credit and consumer bankruptcy was a development that commanded the attention of the 1970 Bankruptcy Commission and the Congress prior to enactment of the Bankruptcy Reform Act of 1978. The question was asked then, as it is now — does easy credit lead to overextended debtors? The legislative history of the Code paints a picture of consumer credit and increased filings that is analogous to contemporary concerns.⁸³ If there is a relationship, will erecting obstacles to bankruptcy relief absent tightened standards for consumer lending facilitate or impede commerce?⁸⁴

⁸³ Discussing consumer debt in 1977, H. Rept. 95-595 at 116, the House Judiciary Committee made the following observations:

Since World War II, the incidence of consumer credit has grown enormously. Consumer finance has become a major industry, and more and more goods have been sold on credit, such as on revolving charge plans. As we have become a consumer society, we have also become a credit society. The Bankruptcy Commission documented the tremendous rise in the amount of credit outstanding for personal, family, or household purposes, and it is not necessary to reiterate those data here.

The result of the increase in consumer credit has been a corresponding increase in the number of consumers who have overburdened themselves with debt. Often, these consumers are able to keep up with their obligations in normal times, but have saved very little for emergencies or unexpected events. When a family member takes seriously ill or when the breadwinner is laid off from his job, a financial crisis ensues....

The vast majority of consumer financial crises are of these kinds. Aggressive advertising and sales techniques by the consumer credit industry, many of whose members rely more on quantity of loans than on the quality to make a profit, add to the problems young families encounter. When the crises finally erupt, the experience of the industry in collecting from overburdened debtors allows it an enormous advantage against the inexperienced and generally distraught consumer. Harsh collection practices heaped on top of already serious financial problems often result in ill health, family strain and divorce, and loss of jobs for many overextended consumer debtors. Bankruptcy often provides the only remedy. Thus, the number of bankruptcies has risen over 2,000 percent in the past 30 years. The rise has paralleled the rise in the amount of consumer credit outstanding.

(Footnotes omitted.)

The 1997 NBRC Report indicates that “[t]he common sense observations of the Congress in 1978 about the increase in consumer debt have been borne out by more statistical analyses since then.” Report, *supra* at 85.

⁸⁴ The NBRC Report recommends repealing the nondischargeability of student loans. Among the reasons cited is a demonstrated lack of correlation between legal nondischargeability and actual loan default: “[A]vailable evidence does not support the notion

(continued...)

Although debtor profiles are studied empirically, it is difficult to know exactly who is filing, and why.⁸⁵ Consumer credit lenders' oft-expressed concern that debtors engage in prebankruptcy binges of luxury spending are difficult to substantiate. Individuals use credit cards not just for vacations but for medical expenses, tax payments, school fees, groceries, even to start businesses; the end uses of cash withdrawals are difficult to trace.

As Congress reconsiders the merits of needs based bankruptcy, several underlying questions are likely to be considered. Will needs based bankruptcy increase the bankruptcy distribution to unsecured creditors, or will it simply discourage consumer reorganization? Some keys to the puzzle may lie in determining bankruptcy's role in a robust economy — is its relationship symbiotic to the expanding role of consumer credit, or a pathological manifestation of modern consumerism which needs to be greatly curtailed?

Impact on collection of family support obligations. One issue that has arisen repeatedly in connection with involuntary consumer reorganization is whether its enactment would have an adverse effect on the ability of domestic creditors to collect family support. Critics have suggested that enactment may have the unintended consequence of impeding payment of child and family support obligations.⁸⁶ These critics suggest that in some cases child support payments and credit card obligations would be “pitted against” each other.⁸⁷

This discussion examines the current status of child support payments under the Code in greater detail, with an emphasis on the relationship between “priority” and “nondischargeable” debts. These terms — though commonly used — are technical terms with a precise meaning under the U.S. Bankruptcy Code.

H.R. 3150 does not directly diminish the protections afforded child support and alimony under the U.S. Bankruptcy Code. However, consequences of its application may, in some circumstances, make it more difficult for domestic creditors to collect the child support and alimony payments they are owed.

⁸⁴(...continued)

that the bankruptcy system was systematically abused when student loans were more easily dischargeable. Furthermore, empirical evidence does not support the oft-cited allegation that changes in bankruptcy law entitlements — exemptions, dischargeability, or otherwise— affect the rate of filing for bankruptcy to obtain those benefits.” *Id.* at 213. Footnotes omitted.

⁸⁵ See, e.g., TERESA SULLIVAN, ELIZABETH WARREN & JAY WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA (1989). See also, the discussion of the rise in bankruptcy filings in the NBRC Report, *supra* at 82-87.

⁸⁶ See, e.g., Hillary Rodham Clinton, *Talking It Over: Bankruptcy shouldn't let parents off the hook*, THE WASHINGTON TIMES, May 7, 1998 at A2; Christie Dugas, *Critics say bankruptcy bills threaten child support*, USA TODAY, April 30, 1998 at 1A; Elizabeth Warren, *Bankrupt? Pay Your Child Support First*, NEW YORK TIMES, April 27, 1998 at A19.

⁸⁷ *Id.*

Child support payments under the current Bankruptcy Code. Chapter 7 of the Bankruptcy Code governs liquidation of a debtor’s assets; chapter 13 deals with consumer reorganization of combined secured and unsecured debts aggregating less than \$1,000,000. When a debtor files under chapter 7, he reduces all of his assets to cash and distributes the proceeds to creditors. The assets as of the date he files create the “bankruptcy estate.” In chapter 7, the debtor generally may keep income received after the date of filing, or “postpetition” income. In chapter 13, a debtor pledges disposable postpetition income to fund the reorganization plan for a period of three to five years.

Bankruptcy priority. Although the Code is designed to protect all creditors by attempting to ensure a fair distribution among them of the debtor’s assets, the law does prefer some unsecured creditors over others. These creditors hold “priority” unsecured claims. This is significant for two reasons:

- First, priority unsecured creditors receive payments on their claims before other creditors. They are paid out in the order in which they are listed under the statute, 11 U.S.C. § 507. This is an important protection because most debtors in bankruptcy do not have adequate assets to pay all of their creditors in full. While there is no guarantee that any given debtor will have enough to satisfy priority creditors, the law requires that they be paid from available assets in the order set down for distribution.
- Second, when a debtor reorganizes under chapter 13, the reorganization plan must ensure that creditors receive as much, and presumably, more than creditors would receive if the debtor liquidated under chapter 7. Thus, the reorganization plan must honor the Code’s priorities. This is referred to as “the best interests of the creditor” test. A bankruptcy court cannot confirm a chapter 13 plan unless it meets this test.

The Bankruptcy Reform Act of 1994 made widespread amendments raising the level of protection in bankruptcy accorded to alimony and support payments.⁸⁸ Prior to the child support and alimony amendments in 1994, the Code was silent on the priority status of these payments in reorganization. Even though they were nondischargeable — that is, the creditor may continue to attempt to collect them — there was conflicting case law and, arguably, confusion as to exactly how the payments were to be treated in chapter 13. There was also pre-1994 precedent that clearly had the effect of delaying collection of child support.⁸⁹

The 1994 amendments clarified that child support and alimony payments, in addition to being nondischargeable, are priority payments in bankruptcy.⁹⁰ Indeed, seventh priority — with no monetary limits — goes to allowed claims for debts to

⁸⁸ P.L. 94-394, § 304 (October 22, 1994). See 11 U.S.C. § § 362, 522, 523, and 547 governing automatic stays, exemptions, dischargeability, lien avoidance and other avoidable transactions.

⁸⁹ See, e.g., *In re Adams*, 12 B.R. 540 (Bankr.D.Utah 1981).

⁹⁰ 11 U.S.C. § 507(a)(7).

a spouse, former spouse, or child of the debtor, for alimony or support, in connection with a separation agreement, divorce decree, or property settlement.⁹¹

The effect of specifying that support payments are priority payments is of great significance, if for no other reason than it brings the issue of familial support into the bankruptcy forum and provides that it be paid. It clarifies that payments are to be made from the bankruptcy estate in both chapters 7 and 13.

Dischargeable debt. Historically, child support and alimony payments are *nondischargeable* debts.⁹² The goal of a debtor who files in bankruptcy is to receive a “discharge” of indebtedness. The discharge, which is a technical term, operates as a legal injunction. Any creditor who holds a debt that is discharged in bankruptcy is permanently prohibited, or enjoined, from attempting to collect the debt. The law, however, makes some types of debt — including child support — “nondischargeable.” As early as 1903, Congress declared debts for “maintenance or support of wife or child, or for seduction of an unmarried female” nondischargeable.⁹³ Under the current U.S. Bankruptcy Code, child support and alimony payments are nondischargeable.⁹⁴ Exempt property of the debtor, which is otherwise exempt from prepetition creditor claims, *may be used* to satisfy alimony and support claims.⁹⁵ As such, a spouse/creditor may pursue collection of such payments from any of the debtor’s assets, including property that is otherwise exempt in bankruptcy.

A bankruptcy case may be concluded in several ways. It may be closed or dismissed.⁹⁶ If a chapter 13 debtor successfully completes a reorganization plan, the

⁹¹ The majority of priorities in bankruptcy have monetary limits to effect the policy goal of maximizing the bankruptcy estate for distribution to all unsecured creditors. The first six bankruptcy priorities encompass administrative expenses; involuntary gap creditors; certain employee wages and benefits; certain claims of grain farmers and fishermen; and certain consumer claims for undelivered or unprovided goods or services.

⁹² 11 U.S.C. § 523(a)(5) and 1328(a)(2).

⁹³ 59 Stat. 797 (February 5, 1903).

⁹⁴ 11 U.S.C. § 523(a)(5).

⁹⁵ 11 U.S.C. § 522(c).

⁹⁶ Nondischargeability of debt is legally significant when a debtor files under chapter 7 and discharges those debts which he is permitted to write off; when he successfully performs a chapter 13 reorganization plan and receives a discharge of indebtedness for permitted debts; or, when the debtor does *not* successfully perform the reorganization plan but receives a “hardship” discharge under chapter 13. Despite the fact that a debtor does not complete all the payments provided for under the plan, the court may grant the debtor a discharge if: the debtor’s failure to complete payments is due to circumstances for which he should not justly be held accountable; the value of the property actually distributed under the plan is not less than the amount that would have been paid if the debtor’s estate had been liquidated under chapter 7; and modification of the plan is impracticable. A hardship discharge relieves the debtor from all unsecured debts provided for by the plan or disallowed by the court, but reinstates the nondischargeability of debts under § 523(a). Long term secured and unsecured debts which were not due until after the date on which final payment would have been due

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plan may be confirmed. Ordinarily, the debtor receives the discharge for debts which are permitted to be forgiven. Once a bankruptcy case is finished, *i.e.*, the debtor is “discharged,” creditors who hold *nondischargeable* debts *must collect them outside* of the U.S. Bankruptcy Code, under applicable state or federal nonbankruptcy law. Their claims will not be satisfied in a U.S. bankruptcy court. In bankruptcy, there are *no priorities for nondischargeable debt*. In other words, the U.S. Bankruptcy Code does not govern payment of nondischarged debts; it is up to each creditor, including a domestic relations creditor, to enforce his claim.

Child and Family Support under H.R. 3150. No provision in H.R. 3150 would repeal the current protection that child support receives under 11 U.S.C. § § 507 and 523.⁹⁷ Child support would retain its legally protected priority and nondischargeable status.⁹⁸ The bill would reenforce the legal status of these payments in some ways.⁹⁹ Indeed, in order to reorganize successfully, a chapter 13 debtor will have to fulfill priority child support arrearages, and maintain current payments.

Although child support protections would not be compromised under the bill, many other forms of unsecured indebtedness would be *elevated* in both priority and nondischargeable status. But, priority *only governs distribution of assets from the bankruptcy estate*, if there are any to distribute. Hence, the greater the amount of priority debt, the more wealth a debtor must have to satisfy a consumer reorganization.

Likewise, many other classes of previously dischargeable credit card debt would also become nondischargeable, setting up increased competition for the diminished assets of a postbankruptcy debtor. The competition for diminished assets arises because the U.S. Bankruptcy Code does *not* have a schedule for payment of nondischargeable debts when a debtor’s case is closed or dismissed.

⁹⁶(...continued)

under the plan are also nondischargeable. Hence, the “superdischarge” which might otherwise be available under chapter 13 is unavailable in connection with the nonperforming hardship discharge. 11 U.S.C. § 1328 (b) & (c).

⁹⁷ Sec. 147 of the bill, however, would amend 11 U.S.C. § 523(a)(5) to expand the categories of nondischargeable domestic debt to include property settlements and repeal current subsection 11 U.S.C. § 523(a)(15).

⁹⁸ Under the Code as amended by the bill, however, repayment of child support arrearages under chapter 13 would be paid out — or cured — over a much longer time period than is currently permitted.

⁹⁹ For example, it would amend chapter 13 to provide that no plan could be confirmed and no discharge granted unless the debtor was current on support payments due after the filing date; it would also provide that the automatic stay under § 362 does not apply to income withholding for child support or driver or professional license suspensions as punishment for overdue support under the Social Security Act, discussed *supra*.

For example, assume a debtor has no assets and files under chapter 7.¹⁰⁰ The debtor's estate does not have *any* assets to pay the priority debts under § 507. The debtor may nonetheless get a discharge for all of the claims against him *except* those which are nondischargeable under § 523(a). Child support is nondischargeable, so the child or spouse who is owed money may continue to attempt to collect it. Under H.R. 3150, however, many new categories of credit card debt will also be nondischargeable. In this fairly common scenario, child support payments and credit card obligations could be "pitted against" one another, as critics hypothesized. Both the domestic creditor and the commercial credit card creditor could pursue the debtor and attempt to collect from postpetition assets, but not in bankruptcy court.

Consistent with the concept of an indirect but negative impact on child support obligations as a result of increased competition for a debtor's limited assets, several observations may be relevant:

- Erosion of the debtor's estate. Increased litigation in bankruptcy will increase administrative costs and attorney fees. Administrative costs and attorneys fees are first priority expenses under § 507. To the extent that bankruptcy proceedings become more litigious, there will undoubtedly be less resources available and increased competition among lower priority creditors, including seventh priority support creditors, for the debtor's assets.
- Enlarged categories of nondischargeable debt. When categories of nondischargeable debt are enlarged, selected creditors may benefit, but the fresh start in bankruptcy is undermined. Hampering the debtor's rehabilitation by onerous nondischargeable debt was a prime concern of the Congress prior to enactment of the 1978 law.¹⁰¹
- Impact of failed reorganization. The bill would make it substantially more difficult for consumer debtors to successfully perform a chapter 13 reorganization. Those debtors who do will have successfully met support and other legally mandated obligations. Nevertheless, in view of the fact that only one-third of the voluntary reorganizations under current law presently succeed, it is reasonable to assume that fewer debtors will be able to successfully complete chapter 13 reorganization plans that require greater payments to more creditors over a longer time period. These debtors will be forced to liquidate, or to eschew bankruptcy completely. In the latter situation, postbankruptcy domestic creditors will be seeking payment of support obligations *without the protections* of the U.S. Bankruptcy Code.

¹⁰⁰ "Chapter 7 cases account for nearly 70% of all bankruptcy filings. Approximately 95% of these chapter 7 cases are terminated as 'no asset' cases[.]" Ed Flynn, *Bankruptcy Statistical Update for 1996* in *The 1997 Bankruptcy Yearbook & Almanac* 39 (New Generation Research, Inc. 1997).

¹⁰¹ "Perhaps the most important element of the fresh start for a consumer debtor after bankruptcy is discharge. ...However, there are several impediments under current law to the full effectiveness of the discharge, and debtors frequently come out of bankruptcy little better off than when they went in." H. Rept. 595, 95th Congress, 1st Sess. 128 (1977)(report of the House Committee on the Judiciary to accompany H.R. 8200.)

Protection of child support and alimony after the discharge. To address concerns about the collection of support obligations among the dependents of debtors whose estates are depleted by the stringent new requirements of amended chapter 13, H.R. 3150 would add a new section to the Code, 11 U.S.C. § 529, which is designed to confer a new, federal priority for child support which would preempt all state constitutions and laws to the contrary “providing a different priority.”¹⁰² The priority would not, however, “affect the priority of any consensual lien, mortgage, or security interest[.]”

Creating a postdischarge bankruptcy priority is without precedent in modern bankruptcy practice, so it is extremely difficult to predict how this mechanism would be implemented. The underlying philosophy of a federal bankruptcy law is the protection of all creditors by asserting jurisdiction over the debtor, *and all of his debts and assets*, in one judicial forum.¹⁰³ It was developed over the last century in response to the difficulties presented by state commercial law and jurisdictional impediments to debt collection efforts by any given creditor.

Debt collection, like bankruptcy, is highly fact-specific, and greatly dependent on underlying state commercial law principles. A creditor seeking to collect a debt owed from an individual under general principles of commercial law must address the following issues: Is the debt unsecured, that is, created by agreement (contract) or a legal obligation like court ordered support? Is the debt secured? If it is secured, what is the nature of the security interest and the property to which it attaches? Is it a consensual lien given voluntarily by the debtor? Or, is it created by operation of law, *i.e.*, a “statutory” lien? Or, is it a lien created by court order, *i.e.*, a “judicial” lien? To what assets of an individual does the lien attach? When was the lien created and perfected? There may be many security interests competing for any given asset of an individual. Does the state court have proper venue and jurisdiction over the debtor and/or his assets? Is the jurisdiction personal or *in rem*? What are the state procedures for levy, attachment, and execution of a judgment — which is the nonbankruptcy legal process for involuntarily reducing a debtor’s assets to cash to permit repayment?

Federal bankruptcy law was designed to cut through the enormous obstacles to debt collection under multijurisdictional state laws, and to streamline and expedite the process by which creditors realize whatever repayment they are likely to receive.¹⁰⁴ Inherent in the notion of priority is a gathering of assets among which priority may be asserted. Individual lawsuits for debt collection simply do not protect parties not privy to the action.

¹⁰² H.R. 3150, § 150.

¹⁰³ See, 1973 Report of the Commission on Bankruptcy, *supra* at 61-83, *Chapter 3: A Philosophical Basis for A Federal Bankruptcy Act*.

¹⁰⁴ “[T]here is a public interest in the proper administration of bankruptcy cases. ...In contrast to general civil litigation, where cases affect only two or a few parties at most, bankruptcy cases may affect hundreds of scattered and ill-represented creditors. In general civil litigation, a default by one party is relatively insignificant, and though judges do attempt to protect parties’ rights, they need not be active participants in the case for the protection of the public interest in seeing disputes fairly resolved.” H.R. Rept. 95-595, *supra* at 88.

What does this mean for the domestic creditor? There are many federal programs designed to protect the payment of child support.¹⁰⁵ Among the most important and successful of the federal-state cooperative support collection programs is wage withholding from noncustodial parents.¹⁰⁶ But wage withholding and garnishment, though also regulated under state and federal law, is only one component of debt collection. It is not applicable or appropriate in all instances. Other techniques for enforcing payments include the creation of property liens, seizure and sale of property, offset of unemployment compensation payments, and seizure of state and federal income tax returns. However, the most difficult child support orders to enforce involve interstate cases:

States are required to cooperate in interstate child support enforcement, but problems arise from the autonomy of local courts. Family law has traditionally been under the jurisdiction of State and local governments, and citizens fall under the jurisdiction of the courts where they live.¹⁰⁷

Federal-state cooperative child support collection activities are premised on the fact that domestic dependents are ill-equipped to compete with commercial creditors, but they are still far from being fully effective. Even when a spouse has the resources to fund aggressive collection litigation, the results under nonbankruptcy law are difficult to enforce and are often unsuccessful.¹⁰⁸

Under H.R. 3150, debtors may emerge from bankruptcy with a much broader array of nondischargeable debt, including many types of credit card debt. Property exempt from bankruptcy will be available to satisfy other creditors in addition to family support creditors. Although the Bankruptcy Code as amended by H.R. 3150 will establish a postdischarge priority for child support, it does not create a procedure to implement it.

¹⁰⁵ House Comm. on Ways and Means, 1996 Green Book, *Chapter 9. Child Support Enforcement Program*, WMCP 104-14, 104th Congress, 2nd Session 529-624 (1996). See also, CRS Rep. 97-363, *Child Support Enforcement Incentive Payments: Background and Administration's Recommendations* by Carmen Solomon-Fears (March 17, 1997).

¹⁰⁶ *Id.* at 549.

¹⁰⁷ *Id.* at 558.

¹⁰⁸ See, e.g., *Atkinson v. Kestell*, 954 F. Supp. 14 (D.D.C. 1997)(Former wife brought action against former husband to attach his wages or his severance benefits after a court of appeals affirmed denial of bankruptcy discharge for the former husband. The U.S. District Court held that: (1) the court lacked jurisdiction under the Bankruptcy Code since the debtor's case had been dismissed, and (2) no other statute conferred jurisdiction over an ex-spouse who was employed by the Inter-American Development Bank and resided in Jamaica.)