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Changing Definitions of Fresh Start in U.S. Bankruptcy Law

ABSTRACT. Consumer bankruptcy law in the United States has been distinguished by its commitment to the fresh start concept, enabling the debtor to discharge indebtedness and begin a new economic life. In this paper recent developments respecting four important limitations on the scope of the fresh start are examined. The four limitations are: (1) the debtor must give up non-exempt property; (2) in some parts of the country debtors are effectively required to complete 3 to 5 year debt repayment plans (called Chapter 13 plans) before receiving a discharge; (3) certain debts are "excepted" from discharge; and (4) many rights of secured creditors in collateral are preserved despite discharge.

The author concludes that, with respect to the first three limitations, debtor's rights have been restricted over the past 15 years approximately. In the conclusion possible reasons for these restrictions in scope of the debtor's fresh start are discussed. The author discusses the tremendous increase in consumer bankruptcy filing rates in the United States but concludes that the best evidence indicates that increased filings are not a good reason to restrict the scope of the fresh start. He suggests that one important factor for increasing limitations on the fresh start has been a reduced political commitment to values that historically have justified the granting of a discharge to consumer debtors.

U.S. consumer bankruptcy law is nearly unique in the world in its commitment to the "fresh start." The "fresh start" idea, embodied in Chapter 7 of the Bankruptcy Code and an essential feature of bankruptcy law since its inception in the United States, is summarized by the metaphor of a curtain falling on a debtor's affairs at filing. All the debtor's property and debts existing at filing are dealt with in the bankruptcy proceeding. Except to the extent it is exempt, the debtor's property is used to pay creditors. Debts not paid in this way are "discharged," meaning that the creditors cannot look to property subsequently acquired by the debtor for repayment of debt. The debtor begins his/her financial life with a clean slate, or "fresh start."

A debtor's fresh start has always been subject to important limitations. In this paper I detail these limitations, with an emphasis on how they have changed since the enactment of the Bankruptcy Code in 1978.[1] To the extent I have been able to obtain the data, I describe the "law in action" as well as the "law on the books." In consumer

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bankruptcy law, as virtually all areas of consumer law, there is a considerable gap between the two. My discussion of limitations on a debtor's fresh start is divided into four sections: exemptions, "forced Chapter 13's," exceptions from discharge, and security interests.

I will conclude that the limitations on a debtor's fresh start are substantial and have been expanding. I will offer some reflections on why U.S. consumer bankruptcy law may be taking new directions.

EXEMPTIONS

Exemptions are not so much a limitation on fresh start but part of its definition. The idea of fresh start is not just that the debtor emerge from bankruptcy without debt, but also with sufficient assets to be able to function as a productive member of society. For example, a reasonable amount of household furnishings and clothes are necessities in civil life and normally exempt; retention of these assets permits the debtor to begin his/her new economic life without debt incurred to acquire them.

Before enactment of the 1978 Code, debtors' exemptions in bankruptcy were determined by the law of the state in which the debtor was domiciled. State laws varied greatly in the amount of exemptions they allowed debtors, with some states granting very limited exemptions. In the 1978 Code Congress adopted federal exemptions in bankruptcy in response to concerns that exemptions in some states were so limited that it detracted from the debtor's fresh start (National Commission on the Reform of Bankruptcy Laws, 1973, pt. I, p. 171). Debtors are allowed to choose between federal and state exemptions, so that debtors from states with exemptions that are more generous than the federal exemptions do not lose the benefit of their more generous state exemptions by filing bankruptcy. However, Congress also allowed states to enact special legislation providing that its domiciliaries could only select state exemptions.[2] This provision, known as the "opt out" provision, responded to the concerns of creditors from low exemption states that the availability of higher exemptions would unduly encourage debtors facing collection pressure to file bankruptcy. Over the next few years 39 jurisdictions exercised this "opt out" option (Collier, 1996, Vol. 3, pp. 513–522). For the most part the jurisdictions that have not opted out have generous state exemptions, leading

many of their domiciliaries filing bankruptcy to select state exemptions. As a result, the introduction of federal exemptions in bankruptcy by the 1978 Code has not greatly altered the exemptions available to debtors. The exemptions of the vast majority of consumer debtors in bankruptcy are still determined by state law, and in many cases those exemptions are not very generous.

Most state exemption laws, as well as the federal exemptions in bankruptcy, define exemptions by categorizing assets and allowing debtors to select assets in those categories as exempt up to specified values. For example, household furnishings, motor vehicles, and tools of the trade, up to designated values, might be declared exempt. With this type of "specified assets" exemption statute, the total value of a debtor's exemptions is a function of what categories of assets he/she owns upon filing. Shares of stock are rarely exempt in such jurisdictions, for example. Real estate used as a primary residence normally is exempt, up to a specified value in excess of any secured claims.

A widespread practice known as exemptions planning has ameliorated discrimination between debtors in the value of exemptions available to them because they own different kinds of assets. Commonly acting on the advice of counsel, prior to filing bankruptcy a debtor disposes of non-exempt assets and reinvests the proceeds in assets in exempt categories, in order to maximize the property retained as exempt after bankruptcy. There are several appellate cases denying exempt status to assets acquired through exemptions planning and/or imposing other sanctions on the debtor.[3] Despite the prominence of the courts making these pronouncements, exemptions planning is prevalent and debtors rarely face sanctions as a result. Many attorneys specializing in representing consumer debtors regard it as malpractice not to counsel a client respecting exemptions planning. The practice of exemptions planning enhances the fresh start of many debtors, of course, and is probably increasing in frequency as the consumer bankruptcy debtors' bar grows in size and becomes more sophisticated.

Exempt property, both in and out of bankruptcy, is subject to the claims of creditors with a security interest in the exempt property. A secured creditor's personal claim against a debtor is avoided by a discharge in bankruptcy, but its claim to the collateral upon nonpayment of the debt is unaffected. Consequently, the property retained by a debtor after bankruptcy discharge is importantly determined by

the rights of a secured creditor in bankruptcy, a topic I discuss extensively in a later section.

One aspect of the rights of secured creditors, applicable only to secured claims in exempt property, will be discussed here. A new provision adopted by the 1978 Code invalidates security interests that impair an exemption if they are non-possessory, non-purchase money security interests in designated categories of assets, including household furnishings, personal jewelry, professional books, tools of the trade, and professional health aids.[4] This innovative provision was adopted in response to evidence that debtors sometimes granted security interests in such collateral without appreciating the consequences.[5] Creditors holding a security interest in all of a debtor's household furnishings and/or professional tools could repossess so much collateral that a debtor was unable to obtain anything approximating a fresh start in bankruptcy. The provision has been effective in inhibiting the commercial practice of taking broad, non-purchase money security interests in assets protected by this provision (Whitford, 1985, pp. 985–992).

The Bankruptcy Code contains one important "hidden exemption." In *Patterson v. Shumate*, a 1992 decision of the United States Supreme Court,[6] a Bankruptcy Code provision intended for quite a different purpose was interpreted to exclude the beneficial interests in most employee pensions from the assets that a debtor must give up upon filing bankruptcy. States cannot "opt out" of this "hidden exemption" because the Supreme Court's interpretation is not based on the exemptions section of the Code. The *Patterson* decision has vastly enhanced the fresh start of debtors with pension rights of substantial value – in my judgment far beyond what is reasonable in many cases. In the *Patterson* case itself, the employee pension rights retained by the debtor were valued at $250,000.

FORCED CHAPTER 13'S

The fresh start idea is embodied in Chapter 7 of the Bankruptcy Code. Chapter 13 provides consumer debtors another means for dealing with overindebtedness. Debtors propose a "plan" pursuant to which they make monthly payments from disposable income for three to five years to a fund used to pay creditors in the amounts and order provided in the plan. If the plan is satisfactorily completed,

the debtor will then be discharged from unsecured debts remaining unpaid.

There are good reasons for some debtors to prefer Chapter 13 to Chapter 7. If a debtor has nonexempt property that he/she prefers to retain, Chapter 13 can provide a better remedy than a Chapter 7 proceeding, even after exemptions planning. Chapter 13 can also be a better way for a debtor to deal with creditor claims that are "excepted" from a Chapter 7 discharge or that are secured, as will be more fully discussed in later sections of this paper. Furthermore, some debtors for reputational or ethical reasons will prefer to pay debts and Chapter 13 provides a viable way to do that.[7]

The Bankruptcy Code provides that Chapter 13 is an option only the debtor can select.[8] Nevertheless, some debtors are effectively forced to choose Chapter 13 because their financial situation makes some form of bankruptcy relief very desirable, and Chapter 7 is not available to them. Creditors have long fought for a provision in the Code preventing debtors from choosing Chapter 7 if they could afford to pay a substantial portion of their claims through Chapter 13. These efforts culminated in 1984, when a compromise provision was adopted authorizing a court to dismiss a Chapter 7 proceeding "if the granting of relief would be a substantial abuse of the provisions of this chapter."[9] There is a substantial divergence in interpretation of this section. In some jurisdictions if the debtor can make substantial payments to unsecured creditors through a Chapter 13 plan (i.e., out of anticipated future income), filing a Chapter 7 proceeding is considered a "substantial abuse." In such jurisdictions a consumer debtor needing some kind of relief is effectively required to file a Chapter 13 proceeding. In other jurisdictions the substantial abuse provision is almost never applied (Wells et al., 1991).

The percentage of total consumer bankruptcy proceedings filed in Chapter 13 varies dramatically among judicial districts, from as low as 2–3% (the Dakotas, Vermont, N.D. of Iowa) to as high as 75–80% (W.D. of Tennessee, M.D. of North Carolina).[10] Some of this variation is accounted for by differing interpretations of the "substantial abuse" provision, but there is another more important cause of this variation. In many judicial districts there exists a "local legal culture" that either favors or disfavors Chapter 13 for consumer debtors. Debtor attorneys in such districts tend to adapt to the local culture by "steering" their clients into the favored Chapter, without fully informing their clients of the advantages of the alternative

proceeding (Braucher, 1993; Sullivan, Warren, & Westbrook, 1997, in this issue).

When a consumer debtor is forced or steered into Chapter 13 when he/she would be financially better off in Chapter 7, it is at a minimum a delay of his/her fresh start. If creditors are paid in Chapter 13 who would not be paid in Chapter 7, it is also a curtailment or limitation of his/her potential fresh start. The extent of the delay and curtailment of the fresh start varies between judicial districts because of the great variation in the nature of Chapter 13 plans. Though it is reasonable to assume that the average total income of debtors filing bankruptcy is relatively constant in different regions around the country, the average projected payouts to unsecured creditors in Chapter 13 plans varies considerably between regions (Whitford, 1994, p. 411). Furthermore, the rate at which Chapter 13 plans are not completed as confirmed, and then either dismissed or converted to a Chapter 7 proceeding, also varies greatly around the country (Whitford, 1994, p. 411, Table 2, col. 4). A debtor can convert a Chapter 13 proceeding to Chapter 7 "at any time,"[11] but because of differences in local legal culture and the quality of lawyering by debtor attorneys, frequently failed Chapter 13's are simply dismissed and debtor receives no discharge. When a Chapter 13 plan is terminated and converted to Chapter 7 relatively soon after confirmation, unsecured creditors are likely to receive relatively little payment through the Chapter 13 plan, and the debtor's fresh start, while delayed, is not significantly curtailed.

In sum, a debtor's fresh start is delayed and often curtailed when Chapter 13 plans result from steering a debtor into Chapter 13 even though Chapter 7 is more economically advantageous to the debtor. The extent of inappropriate steering into Chapter 13 varies dramatically among different parts of the country. It is very substantial in some parts of the country and non-existent in others. Since 1980 there has been a gradual increase in the percentage of consumer bankruptcy filings that are in Chapter 13, from 24% to 31%.[12] Chapter 13 filings often result from considerations of debtor self-interest, however. I cannot determine whether the increase in the percentage of Chapter 13 filings results from an increase in inappropriate steering into Chapter 13 or from another change in circumstance making Chapter 13 more frequently in the debtor's self-interest. Most likely, both factors have contributed to the Chapter 13 increase.

EXCEPTIONS TO DISCHARGE

Even if a debtor receives a bankruptcy discharge,[13] not all debts are discharged. Secured creditor claims in the collateral survive discharge, a topic to be discussed in the next section. And a number of specific unsecured debts are specifically "excepted" from discharge. These exceptions exist in both Chapters 7 and 13, though the exceptions are different in each Chapter.

The specific exceptions from a Chapter 7 discharge have varied over time. Since enactment of the 1978 Code, however, there has been a marked trend towards increased exceptions, resulting from both legislative changes and judicial reinterpretations of existing statutory language. Only the major post-1978 changes in the positive law of exceptions are detailed here.[14]

One of the most important exceptions to a Chapter 7 discharge covers liabilities for property, services or credit obtained by "false pretenses, a false representation, or actual fraud."[15] Neither historically nor in the 1978 Code did this provision expressly protect credit card companies from opportunistic debtors who incur charges in contemplation of a bankruptcy discharge, providing the debtor made no misrepresentations in the original application for a credit card.[16] Credit card issuers now routinely argue nonetheless that credit card charges are excepted from discharge if they are incurred with an intent not to repay them and/or without the reasonable ability to do so. The issuers' legal theory is that charges so incurred result from an "implied false representation" that the debtor both intends and has the reasonable ability to repay them. The credit card companies have won a number of important court victories sustaining this legal theory (Frackowiak, 1995).

Overdue and future support obligations to a spouse, former spouse, or child, evidenced by a divorce or marital separation agreement or judgment, have historically been non-dischargeable in bankruptcy.[17] In 1981 Congress added assigned obligations to the exception, when the assignment was required in exchange for receipt of certain government payments.[18] In 1984 the exception was again expanded to include support awards in favor of out-of-wedlock children and all assignments to government agencies.[19] The result of the 1981 and 1984 amendments has been to make virtually all child support arrears non-dischargeable; rarely are such arrears assigned to anybody other than a government agency.

Educational loans insured or guaranteed by a governmental unit have long been excepted from a Chapter 7 discharge if they first became payable within the five years preceding the bankruptcy filing, unless the court finds that excepting the loans from discharge would impose an undue hardship on the debtor.[20] In 1990, the five year period was extended to seven years, and the exception was applied to some debts arising from other than loan transactions.[21] In recent years court precedents have established that courts take a very stringent stance in applying the undue hardship limitation to this exception.[22]

In 1984 Congress added to the list of exceptions judgments establishing liability arising from the debtor's operation of a motor vehicle while intoxicated.[23] In 1990 this new exception was broadened by eliminating the requirement that the liability be reduced to judgment, but contracted slightly by limiting the exception to liabilities for injury to the person or for death.[24]

Under the 1978 Code all Chapter 7 exceptions from discharge other than support obligations were made inapplicable to a Chapter 13 discharge resulting from a satisfactory completion of a confirmed plan.[25] Known colloquially as the "superdischarge," Congress' purpose was to create an incentive for debtors to select Chapter 13. Only in that way could a debtor receive a discharge for obligations arising from a false financial statement in writing, willful and malicious torts, educational loans that had first become payable within five years, and the like (Whitford, 1989, pp. 96–97).

Since 1978, there have been two curtailments of the "superdischarge." First, Congress has created additional exceptions to the Chapter 13 discharge. Now, in addition to support obligations (which have been expanded as described above), educational loans, drunk driving torts, and criminal fines and restitution awards made as part of a criminal proceeding are excepted from a Chapter 13 discharge to the same extent they are excepted from a Chapter 7 discharge.[26] Second, there are now a number of judicial decisions refusing to confirm a Chapter 13 plan (as not proposed in "good faith") where the debtor has only one substantial debt which is dischargeable in Chapter 13 but not in Chapter 7.[27]

Although empirical information about the number of exceptions actually claimed by creditors is largely unavailable, I believe the number is increasing. This is largely because of the increasing frequency with which credit card issuers assert exceptions under the implied fraud theory described above. Often, without filing a formal

claim of exception attorneys for credit card issuers contact a debtor's attorney and seek a reaffirmation, perhaps offering to continue the credit card with modest limits in return. The request will be accompanied with at least an implied threat to claim a formal exception if a reaffirmation is not obtained. A reaffirmation is a new promise of the debtor to repay a debt that would otherwise be discharged, and is enforceable when specified procedures are satisfied.[28]

SECURITY INTERESTS

One type of creditor claim that has never been subject to bankruptcy discharge is a secured creditor's interest in the collateral. It has always been a fundamental conception of bankruptcy that whereas a debtor's personal liability to a secured creditor is subject to discharge, the secured creditor retains a right in the collateral, even if the collateral would otherwise be exempt. Because secured claims constitute the majority of a typical consumer bankrupt's indebtedness (Sullivan, Warren, & Westbrook, 1989, p. 64, Table 4.1)[29] and exempt property is often the collateral, this principle represents the single most important limitation on fresh start policy. Either the debtor loses the collateral to the secured creditor or the secured creditor must be compensated in some other way for its nondischargeable claim in the collateral.

Analysis of secured claims in bankruptcy must begin by distinguishing oversecured and undersecured claims. An oversecured claim is one where the value of the collateral exceeds the indebtedness. In such circumstances the creditor will be fully paid despite the discharge, either by the debtor or as a result of foreclosure and sale of the collateral. Undersecured claims, however, are "bifurcated" in bankruptcy, with the creditor treated as having two claims: an "allowed secured claim" in an amount equal to the value of the collateral, and an "allowed unsecured claim" for the balance (i.e., the deficiency).[30] The creditor's unsecured claim is subject to discharge. The undersecured creditor's claim in the collateral (i.e., the allowed secured claim) is dealt with differently in Chapters 7 and 13, and these differences have important practical implications for the debtor and the scope of his/her fresh start.

In a Chapter 7 proceeding the undersecured creditor is entitled to relief from the automatic stay so that it can repossess the collateral.[31]

The only way the debtor can avoid repossession without obtaining the agreement of the secured creditor is to redeem the collateral from the security interest. This can be done pursuant to state law, as it could have been done before bankruptcy, but that normally requires payment of the full amount owing, including the unsecured amount (or deficiency).[32] The Code allows the debtor to redeem the collateral from the security interest by paying only the value of the collateral, if it is "tangible personal property intended primarily for personal, family or household use."[33] Where a debtor does redeem collateral upon payment of only collateral value rather than the full amount owing, the act is commonly characterized as "stripping the lien."

There are practical limitations on the debtor's ability to strip a lien by paying only collateral value in Chapter 7. The secured creditor can insist on payment in lump sum; there is no statutory right to pay in installments. If the collateral has substantial value – if it is a reasonably new motor vehicle, for example – most debtors cannot raise this amount. If he/she cannot, the creditor is entitled to repossess, and it is normal for the secured creditor to do so unless the debtor agrees to pay the full amount owing (i.e., including the deficiency) in installment payments over time. An agreement by the debtor to pay any amount over time made after filing bankruptcy, called a reaffirmation, is legally enforceable despite the discharge, providing it meets certain procedural prerequisites.[34]

While lien stripping is difficult in Chapter 7, it is more feasible in Chapter 13. In Chapter 13 a court will confirm a plan over a undersecured creditor's objection providing the payments proposed on account of the allowed secured claim equal the value of the collateral plus a reasonable rate of interest for the period of the proposed payments.[35] In addition the plan must propose to distribute on account of creditor's unsecured claim (the deficiency) whatever payment is proposed to be distributed to general unsecured creditors. Providing the plan is completed as confirmed, whatever portion of the unsecured claim is not paid is discharged and the lien on the collateral is terminated. In effect the debtor has released the collateral from the lien on payment of less than the full amount owing at filing (i.e., stripped the lien). Even more importantly, since a considerable majority of Chapter 13 plans are not completed as confirmed, if the debtor completes payments on the secured claim before converting to Chapter 7, the undersecured creditor's claim in the Chapter 7 proceeding is

treated as fully unsecured (Lundin, 1993, §8.20). Again the debtor has released the lien on the collateral without paying the full amount owing at filing, and in this instance without even paying as much as proposed in the confirmed Chapter 13 plan.

There is an important exception to this use of Chapter 13 to strip a lien. A Chapter 13 plan may not strip the lien held by a secured creditor whose only collateral is real property that is the debtor's primary residence.[36] The plan may delay foreclosure on real property to permit the debtor to cure arrearages within a reasonable time, however.[37] This right can be important because in Chapter 7 a secured creditor can often insist upon foreclosure of a home mortgage if there are arrearages.

Courts sometimes prohibit election of Chapter 13 for the primary purpose of discharging a claim excepted from Chapter 7 discharge. A similar issue has not even been raised when Chapter 13 is selected for the primary purpose of stripping a lien on an undersecured claim or curing arrearages on a home mortgage; indeed these are the most common reasons for a debtor to decide that a Chapter 13 proceeding is more advantageous than Chapter 7. The ability to deal with secured creditors so advantageously in Chapter 13 is an innovation with the adoption of the 1978 Code. Congress' apparent intent was to provide an incentive to file Chapter 13, which it has certainly done. Why it is secured creditors who should in effect be "taxed" in order to gain whatever public benefits exist from election of Chapter 13 is not clear (Whitford, 1989).

The extent to which Chapter 13 enhances a debtor's fresh start by facilitating lien stripping depends on a number of decisions in formulating and confirming a Chapter 13 plan that are customarily taken in significantly different ways in different parts of the country. One decision concerns what constitutes a debtor's "best efforts." To confirm a Chapter 13 plan, a debtor must commit "all . . . projected disposable income to be received in [a] three year period . . . to make payments under the plan."[38] There is considerable variance around the country in the amounts that debtors are allowed to reserve for anticipated living expenses in calculating projected disposable income. Moreover, whereas in some districts debtors are informally pressured to propose a five year plan unless he/she proposes to pay unsecured creditors in full in less time, in other districts it is routine to confirm three year plans proposing to pay unsecured creditors

10% of their claims, or even less (Braucher, 1993, p. 532). These decisions affect how much of an undersecured creditor's deficiency claim will be paid in Chapter 13.

Other important decisions concern the secured part of an undersecured creditor's claim. To be confirmed, a plan must pay the creditor, on account of the secured claim, the value of the collateral plus reasonable interest.[39] But the standards for valuing collateral, or determining a reasonable interest rate, are not provided in the Code. There is now a split among the federal circuit courts of appeal about whether wholesale or retail markets should provide the baseline for valuing collateral, with a majority of the circuits favoring a retail value standard.[40] There has also been appellate litigation concerning the interest rate standard. The tendency has been to use an interest rate prevailing in the market in which the particular loan was incurred, e.g., the car loan market (Pawlowic, 1995, pp. 175–178). But more than 50% of the confirmed Chapter 13 plans are not successfully completed, and the creditor is rarely awarded an interest rate reflecting the extreme riskiness of what is in effect a compelled loan to the Chapter 13 debtor.

In summary, the rights of secured creditors are a crucial determinant of the scope of a debtor's fresh start in consumer bankruptcy. The 1978 Code potentially expanded a debtor's fresh start by facilitating stripping of the undersecured creditor's deficiency claim from the lien. However, lien stripping in Chapter 7 is normally not practical with respect to motor vehicle debt, and it is not even legally available with respect to home mortgages. Motor vehicle and home mortgage credit constitute the vast majority of secured debt in consumer bankruptcy. In Chapter 13 the potential exists to strip motor vehicle debt. How important a practice this is depends on a series of low visibility decisions made by the courts and debtors' lawyers, respecting what percentage of unsecured claims are paid in Chapter 13, how collateral is valued, and how reasonable interest rates are set.

CONCLUSIONS

U.S. bankruptcy law has been special in its commitment to the idea of a fresh start for consumer debtors, but the fresh start has always been subject to important limitations. In this paper I have outlined the principal limitations, emphasizing changes since 1978. For the most part the limitations have increased. The fresh start has become

less fresh; "stale start" may now be a more fitting metaphor. Particularly important in this regard have been: (a) the decision of a majority of states to opt out of federal exemptions in bankruptcy; (b) the increasing unavailability of Chapter 7 to debtors in some parts of the country; and (c) expansion of the exceptions to discharge.

What accounts for these increased limitations on the fresh start? I believe they suggest a lessened public commitment to the core values that have historically justified a fresh start in consumer bankruptcy. Society's interest in increased production is the most common policy justification for the fresh start; a worker overburdened with debt has a reduced incentive to engage in productive work, and an enhanced incentive to consume leisure, since he/she must share the rewards of enterprise with creditors (Jackson, 1985, pp. 1420–1424). A second justification for the fresh start is as a kind of social insurance against financial exigency, in which debtors as a class, through higher interest charges, provide the means for granting a discharge to the most needy among them (Warren & Westbrook, 1996, pp. 440–442). The justification for this social insurance is that much indebtedness results not from blameworthy acts by the debtor but from unfortunate occurrences. A very large percentage of bankruptcies follow temporary unemployment (Sullivan, Warren, & Westbrook, 1994, pp. 130–131), and large medical debts seem to be the principal cause of some other bankruptcies (Sullivan et al., 1989, p. 168). The United States has fewer social guarantees against interruption of income, and less publicly supported social medical care for the less fortunate, than most industrialized countries. Hence the need for the limited protection provided by the availability of a discharge in bankruptcy.

It is necessary to canvass other possible reasons for increased limitations on the fresh start before assigning sole responsibility to a reduced commitment to the values associated with the fresh start. Over the same post-1978 period covered in this paper individual bankruptcy filings have roughly doubled in the United States.[41] As those filing rates soar, the total amount of debt discharged in consumer bankruptcy increases. If one assumes that creditors would have been able to collect some of the discharged debt in the absence of bankruptcy, then creditor costs have increased as a result of the increase in bankruptcy, which in turn has most likely led to an increase in the cost of credit to debtors.[42] Most commentators would not be concerned, however, that because of any increase in the price of credit, the amount of consumer credit outstanding is less than is desirable. Since 1980

revolving consumer debt in the United States (mostly credit card debt) has increased nearly 600%.[43]

A more serious public policy concern related to the tremendous increase in bankruptcy filings concerns the probability that increased debtor opportunism in bankruptcy (what I will call abusive filings) has accompanied the increase in filing. There are two principal categories of debtor opportunism in consumer bankruptcy. First, cases can be filed when an immediate fresh start is not needed, because the debtor could repay some or all of his/her obligations without undue hardship. Second, even if an immediate fresh start is needed, debtors can recklessly incur debt, not out of need, in the months before filing. As these uses of bankruptcy become more common, reforms restricting the availability and scope of discharge could be justified as a way of combatting and deterring abusive filings. Because the extra creditor costs resulting from debtor opportunism are largely passed on to debtors who do not file bankruptcy, reform can be justified as in the interest of the debtor class as a whole.

The best available evidence suggests that the percentage of bankruptcy cases filed by persons who could repay some or all of their debts without undue hardship has not been increasing, and perhaps is decreasing. The study found that the median income of consumer bankruptcy filers had dropped, both absolutely and in relation to income of the population generally, between 1981 and 1991 (Sullivan et al., 1994, p. 130). Even if the percent of this kind of filing abuse has declined, however, the absolute dollar losses to creditors from abusive filings may have increased, since the total number of filings have increased so dramatically. The justification for reform would be particularly strong if reforms could be targeted just at abusive filings, without impacting debtors for whom a fresh start is most justified. However, most of the restrictions on the fresh start discussed above impact "deserving" debtors. Forced Chapter 13s would seem to be attempt to separate out abusive debtors for denial of a fresh start. Although this may happen in some jurisdictions, once again the best available evidence suggests that in most jurisdictions there is no difference in the extent of indebtedness or projected future income of Chapter 13 and Chapter 7 debtors (Sullivan et al., 1994, pp. 140–146). Hence even if forced 13s do reduce the losses from abusive filings, it may be difficult to justify them because they apparently also deny an immediate fresh start to a number of debtors needing it.

Another form of debtor opportunism is incurring unnecessary debts in anticipation of an otherwise justifiable Chapter 7 filing. One important new limitation on the fresh start – the "implied fraud" doctrine promoted by the credit card companies to except from discharge debts incurred when the debtor has no reasonable prospect of repayment – seems specially targeted at this type of abuse. Recent evidence suggests that the extent of credit card debt held by consumers who have no reasonable prospect of repayment is growing rapidly (Personal bankruptcies, 1996) and much of it may be incurred in anticipation of a bankruptcy filing. The doctrine being developed is not limited, however, to debts incurred for unnecessary goods or services in anticipation of a bankruptcy filing. It is often easiest to show that there was no reasonable prospect of repayment of credit card debt when it was incurred to obtain necessities by a low income debtor whose incentive to be productive will be most compromised by excepting substantial debt from discharge. This suggests, at a minimum, that efforts to deter pre-filing debtor opportunism are compromising achievement of the basic objectives in providing debtors a fresh start.

Though increased filings do not seem to justify the increasing limitations on the fresh start as a matter of public policy, it may be worthwhile for particular creditors to seek ways to reduce the additional losses caused by the additional filings. It is usually assumed that in general creditors pass on or avoid additional bankruptcy costs by raising interest costs, and by restricting credit to the marginally creditworthy who present the greatest risk of default. However, if particular creditor groups succeed in getting only their debts excepted from discharge, it can provide that group a competitive advantage over other creditor groups. If the benefited creditors collect a significant portion of the debts excepted from discharge, they will have lower costs than creditors whose obligations are discharged in bankruptcy. Significantly, particular creditor groups, especially the credit card issuers, have been very aggressive in lobbying[44] and litigating[45] to establish some of the most significant restrictions on the fresh start. Perhaps their efforts account for many of the increased limitations on the fresh start.

I do not believe that creditor efforts would have been successful in establishing so many additional limitations on the fresh start, however, unless there was a lessened public commitment to the values underlying the fresh start. The United States has never been a fully

developed welfare state by European standards, but in the same period covered in this paper there has been a concerted, and partly successful, effort to cut back some of the welfare programs established in the New Deal and Great Society eras. It would be consistent with these other changes in U.S. social welfare policies to suppose a lessened commitment to consumer bankruptcy as a social insurance program. Consumer bankruptcy has never been a program that shifted significant amounts of income between classes, however. The costs to creditors of consumer bankruptcy are passed on to other debtors of the creditors bearing the losses, and on the whole creditors deal with debtors from the same social class. The distributional effects of other contractions of the social welfare net for the lower middle class may have significant inter-class distributional effects. Reduced job security, resulting from weakened unionism and trade agreements that facilitate transfer of production, may help managerial classes preserve their social position and increase investor profits. Reduced governmental spending on medicare (health care for the elderly) and public education may reduce tax burdens falling disproportionately on social classes that are better off than the primary beneficiaries of those programs. The shrinking fresh start, however, is less likely to redistribute income inter-class. Consequently, the politics of redistribution is not a fully adequate account for what seems to be a reduced political commitment to the fresh start.

It is even harder, at first glance, to imagine reduced public commitment to the goal of creating increased incentives to work for the overburdened debtor. This is the other policy usually cited as supporting the provision of a fresh start. Public rhetoric in America today is full of statements about the importance of work. Nonetheless there is a growing permanent underclass in America. Consumer bankruptcy has never been a remedy sought by the very poor. With the possible exception of child support arrears, they normally do not have enough debt to make discharge important or worth the cost of a bankruptcy proceeding. There is also clear evidence of a declining material position of the middle classes in America. Debtors from these classes have historically provided the great bulk of filers in consumer bankruptcy (Sullivan et al., 1989, pp. 89–91). The declining position of this social class no doubt partly accounts for the increase in bankruptcy filing rates, as working class consumers turn to more consumer debt than they can comfortably repay in an effort to maintain a lifestyle which they can no longer afford. The declining position is some-

times associated with the effects of globalization. American capital is no longer so dependent on its workforce, either for production or consumption. Public rhetoric notwithstanding, perhaps there is also less concern with providing this class with appropriate incentives to become productive, and hence the lessened commitment to the values underlying the fresh start.

NOTES

[1] There was an extensive revision of American bankruptcy law in 1978 (effective in 1979). The statute then enacted is referred to as the "Bankruptcy Code," and is cited herein as such. Prior to 1978, the bankruptcy law was known as the "Bankruptcy Act."

[2] Bankruptcy Code §522(b)(1).

[3] E.g., Norwest Bank Nebraska v. Tveten, 848 F.2d 871 (8th Cir. 1988).

[4] Bankruptcy Code §522(f)(1)(B).

[5] H.R.Rep. No. 595, 95th Cong., 2d Sess. 127 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6088.

[6] 504 U.S. 753 (1992).

[7] For a more complete discussion of the reasons why a debtor may prefer Chapter 13 to Chapter 7, see Whitford (1989, pp. 94–104).

[8] Bankruptcy Code §303(a).

[9] Bankruptcy Code §707(b). For an account of the enactment of this legislation, see Huls et al. (1994, pp. 129–131).

[10] I published these data for the years 1990, 1991, and 1993, by judicial district, in Whitford (1994, pp. 407–408). Similar data are reported in a companion article in this issue (Sullivan, Warren, & Westbrook, 1997, Tables A1 and A2).

[11] Bankruptcy Code §1307(a).

[12] Data from Administrative Office of the United States Courts, Federal Judicial Workload Statistics, Table F-2.

[13] A Chapter 7 debtor can be denied a discharge for a number of reasons, such as engaging in a pre-filing fraudulent conveyance; Bankruptcy Code §727(a). Denials of general discharge are quite rare in Chapter 7 consumer bankruptcy cases, however, so I will not discuss this topic.

[14] Important exceptions to discharge that are not discussed subsequently, because there has been no substantial change in their definition since 1978, include most taxes, fraud while acting in a fiduciary capacity, and willful and malicious torts; Bankruptcy Code §§523(a)(2), (4) and (6).

[15] Bankruptcy Code §523(a)(2)(A)&(B).

[16] Leading precedent at the time of the adoption of the 1978 Code supported the position that only misrepresentation on the credit card application would justify an exception from discharge under §523(a)(2). *See* First Nat'l Bank of Mobile v. Roddenberry, 701 F.2d 927 (11th Cir. 1983).

[17] Bankruptcy Code §523(a)(5).

[18] Omnibus Budget Reconciliation Act of 1981, Pub.L.No. 97-35, 95 Stat. 357, Title XXIII, §2334(b). The most important government payment was under the Aid to Families of Dependent Children (AFDC) program, the largest "welfare" program for the unemployed.

[19] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L.No. 98-353, Title III §454(b), 98 Stat. 376 (1984).
[20] Bankruptcy Code §523(a)(8). The 1978 Code expanded the historic provision slightly by including all loans from non-profit institutions of higher learning, whether or not guaranteed by a government agency. In the United States, loans guaranteed by the federal government (most educational loans) do not first become payable until after the student has left school.
[21] Crime Control Act of 1990, Pub.L.No. 101-647. See Dunham & Buch (1992).
[22] E.g., Cheesman v. Tennessee Student Assistance Corp. (In re Cheesman), 25 F.2d 356 (6th Cir., 1994).
[23] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L.No. 98-353, Title III §371, 98 Stat. 364 (1984).
[24] Criminal Victims Protection Act of 1990, Pub.L.No. 101-581, §2, 104 Stat. 2865 (1990).
[25] Bankruptcy Code §1328(a). It is possible to get a "hardship" discharge in Chapter 13 without completing a confirmed plan, but in that case all Chapter 7 exceptions to discharge apply; Bankruptcy Code §1328(b).
[26] Bankruptcy Code §1328(a)(2)&(3).
[27] E.g., In re LeMaire, 898 F.2d 1346 (8th Cir. 1990); In re Rasmussen, 888 F.2d 703 (10th Cir. 1989).
[28] Bankruptcy Code §§524(c)&(d).
[29] The most important forms of collateral are homes and cars (Sullivan, Warren, & Westbrook, 1989, p. 310, Table 17.4).
[30] Bankruptcy Code §506(a).
[31] Bankruptcy Code §362(d)(2).
[32] Uniform Commercial Code §9-506.
[33] Bankruptcy Code §722.
[34] Bankruptcy Code §524(c).
[35] Bankruptcy Code §1325(a)(5).
[36] Bankruptcy Code §1322(b)(2).
[37] Bankruptcy Code §1322(b)(5).
[38] Bankruptcy Code §1325(b).
[39] Bankruptcy Code §1325(a)(5)(B).
[40] In re Hoskins, 1996 WL 714104 (7th Cir., Dec. 12, 1996) (between wholesale and retail value); In re Rash, 90 F.3d 1036 (5th Cir.1996) (wholesale value for personalty), cert. granted 117 S.Ct.Rep. 758 (1997); In re Mitchell, 954 F.2d 557 (9th Cir., 1992) (wholesale value for personalty); In re Taffi, 68 F.3d 306 (9th Cir., 1995) (retail value for realty), rehearing en banc granted 86 F.3d 147 (9th Cir. 1996); In re Winthrop Old Farm Nurseries, 50 F.3d 72 (1st Cir. 1995) (retail value for realty); In re Trimble, 50 F.3d 530 (8th Cir. 1995) (retail value for personalty).
[41] Total individual filings in 1980, the first calendar year the new Bankruptcy Code was fully effective, were 471,330. In 1995 total individual filings were 926,601. In 1996 there will be a further increase in individual filings, which will exceed 1 million cases for the first time. The data used to make these calculations came from Administrative Office Of The United States Courts, Federal Judicial Workload Statistics, and McHugh (1995).
[42] When creditor costs increase, the creditor or creditors can (a) do nothing and accept lower profits, (b) withdraw funds from the consumer credit market and invest them elsewhere, and/or (c) raise interest rates to cover partially or wholly the increased costs. It is impossible to know which of these responses a creditor will take without detailed study of the business circumstances. But most analysts assume that the third alternative is the most common response. See generally Whitford (1979).

[43] The data for this calculation come from the Federal Reserve Bulletin, Table 1.55 (Consumer Installment Credit).

[44] Bankruptcy Code §707(b), the "substantial abuse" section, was enacted in 1984 after a determined attempt by revolving charge creditors to require debtors who could afford to pay a significant part of their debts from future income to file a Chapter 13 proceeding. This section has been influential in steering debtors into Chapter 13 in some parts of the country.

[45] For example, the litigation to establish that implied representations are made at the time of credit card use that the debtor has the reasonable ability to repay the charges, and when he/she does not, there is "implied fraud," excepted from discharge under Bankruptcy Code §523(a)(2)(A).

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ZUSAMMENFASSUNG

Änderungen in den Vorstellungen über einen völligen wirtschaftlichen Neubeginn im amerikanischen Insolvenzrecht. Das amerikanische Verbraucherinsolvenzrecht kennt als Besonderheit den völligen Neubeginn, der den Schuldner von seiner Schuldenlast befreit und ihm eine neue wirtschaftliche Existenz ermöglicht. Der Beitrag behandelt neuere Entwicklungen und stellt dabei vier wichtige Einschränkungen der Möglichkeiten eines solchen Neubeginns in den Mittelpunkt: (1) Der Schuldner muß seinen Besitz – soweit dieser hiervon nicht befreit ist – aufgeben; (2) in einigen U.S.-amerikanischen Staaten muß er vor der Schuldenbefreiung zunächst einen drei- bis fünfjährigen Rückzahlungsplan für seine Schulden erfüllt haben; (3) bestimmte Schulden können prinzipiell nicht erlassen werden; (4) zahlreiche Ansprüche abgesicherter Mitgläubiger sind von der Aufhebung der Schulden ausgenommen. Nach Meinung des Autors sind die Rechte des Schuldners in den letzten 15 Jahren vor allem wegen der ersten drei Einschränkungen beschnitten worden. Er diskutiert die enorme Zunahme der Insolvefälle bei Konsumenten, sieht in dieser Zunahme aber keine gute Begründung eines wirtschaftlichen Neuanfangs. Vielmehr führt er diese Einschränkung der Möglichkeiten auf eine abnehmende politische Verbindlichkeit solcher Wertvorstellungen zurück, die in der Vergangenheit die Gewährung einer Schuldenbefreiung rechtfertigt haben.

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