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DENIAL OF DISCHARGE FOR SUBSTANTIAL ABUSE: REFINING—NOT CHANGING—BANKRUPTCY LAW

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INTRODUCTION

THE Bankruptcy Code[1] (the "Code") provides a variety of benefits to individual debtors. Perhaps the key advantage conferred upon an individual at the culmination of a bankruptcy case is the "fresh start" that derives from the discharge of debts. The Code does not, however, contemplate that a fresh start is appropriate under all circumstances. For example, 11 U.S.C. § 707(b) authorizes a bankruptcy court to deny a Chapter 7 discharge to one whose debts are primarily consumer in nature and who substantially abuses the provisions of the Chapter.[2]

Since the passage of § 707(b) in 1984,[3] the absence of a statutory directive and the gloom of unclear legislative history[4] have caused the courts to express disagreement over the meaning of "substantial abuse." Some courts have found that a debtor who would earn sufficient income after the bankruptcy to pay all or a substantial portion of his creditors was abusing the Code—this is the "excess income" test.[5] Other courts have maintained that additional circumstances, such as unconscionable spending habits or the commission of fraud, are required in addition to excess income—this is the "totality of the circumstances" test.[6] This Article proposes that courts ostensibly applying the totality of the circumstances test have not, in fact, required additional circumstances to dismiss a Chapter 7 case. Despite rhetoric to the contrary, the preponderance of cases shows that the courts routinely apply only an excess income test. Amendments to the Code are now being proposed to specifically provide that the ex-

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1. 11 U.S.C. §§ 101-1330 (1994).

2. *See id.* § 707(b).

3. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, tit. III, §§ 312, 475, 98 Stat. 333, 355, 381.

4. "When the final version of the Bankruptcy Amendments and Federal Judgeship Act of 1984 was released, however, there were no official Judiciary Committee reports. This lack of an official record creates problems in determining legislative intent." Robert B. Vandiver, Jr., *Bankruptcy—A Review of Recent Court Decisions Applying Section 707(b) of the Bankruptcy Code to Chapter 7 Proceedings*, 22 Mem. St. U. L. Rev. 549, 563 (1992) (footnote omitted).

5. *See infra* Part V.B.1.

6. *See infra* Part V.B.2.

cess income test is sufficient.[7] This Article suggests that such amendments do not actually change the Code, but rather clarify the standard that the courts already apply to § 707(b) cases.

Part I of this Article outlines the form and function of the discharge and corresponding fresh start in bankruptcy proceedings. Parts II and III trace their historical development and examine their current status in today's Code. Part IV considers the division of assets upon declaration of bankruptcy and identifies the traditional policy rationales that underlie this scheme. Part V turns to the discretionary denial of discharge authorized by the Code, comparing the theories that courts have proposed for determining whether discharge is appropriate with their actual practices evidenced by the case law. Part VI then evaluates current legislation that attempts to resolve this inconsistency in favor of the excess income test. This Article concludes that such legislation adopts the substance of the reported cases, though not their actual language.

I. The Concept of the Discharge and Fresh Start

A. *Benefits for the Debtor*

The Code contains a cornucopia of benefits for those involved in its application. It relieves debtors (who used to be called bankrupts)[8] from the pressures exerted by unpaid creditors[9] and enables them to keep certain assets free from the claims of those creditors.[10] It enables creditors to receive various measures of recovery[11]—perhaps even full recovery. It protects the rights of secured creditors.[12] It puts certain unsecured creditors in preferred positions where assets are insufficient[13] and ensures that not all creditors who had previously advanced to the head of the line in order to levy on the debtors' assets will get the benefit of their pre-bankruptcy behavior.[14]

The Code's principal benefit for the debtor is the discharge from unpaid obligations and a corresponding fresh start. The Code sets up several procedures (to which I will return from time to time) that prescribe methods for applying a debtor's assets to his obligations and for expunging the remainder of those obligations.[15]

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7. *See infra* Part VI.B.
8. Aside from its title, the Code barely uses the word "bankrupt." This was part of the consumer-related changes made in the 1978 revision. The debtor was presented as a good guy—an idea better conveyed through the word "debtor" than the pejorative "bankrupt."
9. *See* 11 U.S.C. § 362 (1994).
10. *See id.* § 522.
11. *See id.* § 726(a).
12. *See id.* § 506(a).
13. *See id.* § 507.
14. *See id.* § 547.
15. The Code addresses the concept of discharge in various sections. *See id.* §§ 727(a), 1141(d), 1328.

The award of a discharge frees the debtor from the continuing encumbrance of the obligation at issue.[16] He is able to enter into a "fresh start"—essentially a new chance to be a productive member of society, to shake off the yoke of obligations that cannot be paid, and, as the Constitution provides, to pursue (though perhaps never attain) happiness. Other Code sections fortify the concept of the discharge. For example, § 524 enjoins creditors from pursuing a discharged obligation in any way.[17] A discharge is more than an available defense to a potential claim; it orders the discharged creditor to "get lost."[18] In addition, the Code prohibits government units from discriminating against debtors solely because of the bankruptcy[19] and prohibits private employers from discriminating in areas of the employment.[20]

B. *Consumer and Business Discharges*

Both business entities and consumers[21] may obtain discharges and fresh starts under provision of the Code. Corporations and partnerships may not receive a discharge under the liquidation provisions of Chapter 7 because that chapter assumes these businesses will distribute all of their assets to their creditors and, consequently, cease to exist. Thus, a discharge is simply unnecessary for these businesses.[22] Corporations and partnerships may, however, receive discharges under the reorganization provisions of Chapter 11, because that Chapter is designed to enable businesses to free themselves from unsustainable debts and continue a productive existence.

C. *Availability to the Debtor*

This section focuses upon Chapters 7, 11, and 13 of the Code.[23] Discharges and fresh starts are available in all three.

16. Certain obligations are not discharged. *See, e.g.*, *id.* § 523 (describing exceptions to discharge, including: tax or custom duty, fraud while acting in a fiduciary capacity, etc.). The debtor remains subject to the terms of undischarged obligations after the bankruptcy.

17. *See id.* § 524.

18. Section 524(a)(3) provides in part that a discharge is "an injunction against . . . an act, to collect or recover . . . . " *Id.* § 524(a)(3).

19. *See id.* § 525(a).

20. *See id.* § 525(b).

21. Though "consumer" is not specifically defined by the Code, I will derive a generally accepted definition from "consumer debt": "debt incurred by an individual primarily for personal, family, or household purpose." *Id.* § 101(8). For purposes of this Article, a consumer means an individual, the bulk of whose expenses are for such a purpose. I recognize that, in a broader sense, any business is also a consumer. The "personal, family or household" requirement provides our distinction.

22. When this provision was adopted, Congress observed that the inability of corporations and partnerships to obtain a discharge in a dissolution case would "avoid trafficking in corporate shells." H.R. Rep. No. 95-595, at 384 (1977).

23. Because they are not relevant to the present argument, this Article omits reference to Chapters 9 (municipalities) and 12 (family farmers).

1. Chapter 7

Chapter 7 contemplates the liquidation of the debtor's assets. His property owned at the time of the petition (and certain property acquired later) is reduced by the exemptions given to individual debtors. The remainder is titled the estate[24] and distributed to those creditors who existed at the time of the petition (and some others who acquired creditor status later).[25] The remaining unpaid obligations are mostly discharged, and the debtor is free to enjoy a fresh start, unencumbered by creditors and unpaid debts. Certain debts, including specified tax claims and obligations to spouses and families, remain undischarged to reduce the pleasure of the fresh start.[26] The discharged debtor remains liable with respect to those obligations, and these unpaid creditors may take any action that they could have taken before the bankruptcy.

As previously noted, the Code presumes that corporations and partnerships cease to exist after they have disposed of all their assets. Discharges are therefore not available to them in Chapter 7.

2. Chapter 11[27]

Chapter 11 provides for the reorganization of debtors who, in new raiments, may continue their existences. Because Chapter 11 traditionally was used by commercial enterprises, there was once some doubt as to whether it was available to consumers. The Supreme Court resolved this question in *Toibb v. Radloff*.[28] The Court interpreted the words of 11 U.S.C. § 109 according to their plain meaning, acknowledging that "a person that may be a debtor under chapter 7 . . . may be a debtor under chapter 11."[29]

Despite *Toibb*, however, few consumers have sought relief under Chapter 11. The absence of consumer cases is most likely attributable to the complexity and expense of Chapter 11, which makes it inappropriate for consumer debtors. The debtor[30] must draft and submit a "plan" to the court describing how the debtor will work his way out of

24. *See* 11 U.S.C. § 541. Because of the exclusions granted to consumers, the nature of the property consumers typically bring into a bankruptcy case, and the consumers' ability to plan a bankruptcy in advance to their benefit, few assets will actually be surrendered to creditors in a consumer bankruptcy case. Richard I. Aaron, Bankruptcy Law Fundamentals § 1.03 (1998).

25. Principally those who became creditors because the trustee exercised his avoiding powers under 11 U.S.C. §§ 545, 547, 548, 549 and because the trustee annulled executory contracts under 11 U.S.C. § 365.

26. *See* 11 U.S.C. § 523.

27. The benefits and detriments of Chapter 11 will appear in only minor portions of this article, as it is rarely used by consumers. I present it here so the different forms of discharge and fresh start available to the consumer may be understood.

28. 501 U.S. 157 (1991).

29. *Id.* at 160 (quoting 11 U.S.C. § 109(d)).

30. The plan may be prepared by other persons, including a trustee or a creditor under specified conditions. *See* 11 U.S.C. § 1121. This, however, rarely occurs.

financial difficulties.[31] The plan must be disclosed to creditors,[32] who must vote to approve the plan[33] before it may be confirmed by the court.[34]

Chapter 11 contemplates that the plan will create a new economic environment in which the debtor will exist free of the problems that brought it to bankruptcy. Generally, only a percentage of the outstanding debts will be paid, as stated in the plan. The percentage will usually be paid over a period of time into the future.[35] Those debts that are not paid under the terms of the plan (whether they are actually paid or not)[36] are discharged. All debtors in Chapter 11—the rare consumer, the individual proprietorship, the corporation, or the partnership—receive the discharge. The discharge of unpaid debts enables the debtor to continue its economic existence under more favorable conditions.

It may be said—although it is rarely accurate—that the debtor in Chapter 11, having been discharged from its debts, enters into a fresh start. Although the roseate future is dangled before the Chapter 11 debtor, few taste its benefits. Less than ten percent of the debtors who elect or who are involuntarily put into Chapter 11 come out the other end with a successfully performed plan.[37] Chapter 11 is frequently called a "slow Chapter 7," since so many of its debtors are ultimately liquidated.

3. Chapter 13

Chapter 13, the principle mechanism for a consumer reorganization, contains a discharge and fresh start that work in yet another manner. Chapter 13 is only available to "an individual with regular income"[38] whose unsecured and secured debts do not exceed limits set by the Code. Chapter 13 is designed for individuals of modest circumstance; its debt limits ensure that the wealthy do not resort to its simplified provisions. Consistent with this approach, the plan drafted by the

31. *See id.* § 1123.
32. *See id.* § 1125.
33. *See id.* § 1126.
34. *See id.* § 1129.
35. Of course, it is possible that all debts will be paid under the plan in the same manner as they existed at the time the petition in bankruptcy was filed. In such a case, relief may come to the debtor by other means: perhaps a downsizing of the employee pool or a reorganization of markets. This, however, almost never happens; a reduction in debts is standard and expected.
36. The discharge occurs upon confirmation of the plan. *See id.* § 1141(d). Because they approved the plan, the creditors are compelled to accept the debtor's discharge. If they are dissatisfied with the terms of a plan, creditors must vote against it and perhaps defeat it.
37. Ellyn Ferguson, *Filing Chapter 11 Bankruptcy Doesn't Guarantee Survival*, Gannett News Service, Oct. 28, 1996, *available in* 1996 WL 4389682.
38. 11 U.S.C. § 109. Section 101(30) defines an individual with regular income as an "individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title." *Id.* § 101(30).

debtor need not be formally disclosed to creditors, nor is their approving vote required. Rather, economy is the watchword.

Because creditors take no part in the approval process, their silence may not be deemed approval of the plan. Thus, the debtor will not be discharged until either payments under the plan are completed[39] or he is unable to complete payment under the plan "due to circumstances for which the debtor should not justly be held accountable."[40] In the latter event, the discharge is not as pervasive as in the former, and the fresh start is less robust.[41]

Both Chapters 11 and 13 involve a plan. In Chapter 11, the plan is usually written by the debtor; in Chapter 13, it always is. The debtor thus has an ample opportunity to define the degree to which he will pay his obligations and, consequently, the extent of the fresh start. While the judge must be satisfied that the plan is proposed in good faith,[42] nothing in the Code prescribes the extent to which obligations must be paid. The debtor has expansive discretion to define the extent of his own discharge and his own fresh start.

In contrast, Chapter 7 is strictly defined: all of the debtor's assets (subject to exemptions) are applied to his obligations. For a consumer, all remaining obligations are discharged, subject to § 523. The corporation and partnership simply fade away without a discharge, or leave with whatever assets are left over.[43]

II. The Source of Discharge and Fresh Start

A. *Historic Treatment of Consumer Debtors*

Bankruptcy laws are necessarily among our oldest commercial statutes. From the time caveman Gub said to his friend Lud, "I'm a little short of shells today, I'll pay you tomorrow," there was the chance that Gub would not be able to produce the required shells. Over the centuries, the law has provided various ways of handling this problem.

The Roman Twelve Tables (451-50 B.C.) arranged that a defaulting debtor be put before the public three times in the hopes that someone would pay his debts and avoid the dire consequences that would otherwise follow.[44] Failing payment, the Tables provided:

> [W]hen a defendant, after thirty days have elapsed, is brought into court a second time by the plaintiff, and does not satisfy the judg-

39. *See id.* § 1328(a).
40. *Id.* § 1328(b)(1).
41. *See id.* § 1328(c). Events for which a debtor should not justly be held accountable include the loss of employment because of illness, *see* Thompson v. Ford Motor Credit Co., 475 F.2d 1217 (5th Cir. 1973), and a terminated marriage and personal surgery, *see In re* Dark, 87 B.R. 497 (Bankr. N.D. Ohio 1988).
42. *See* 11 U.S.C. §§ 1129(a)(3), 1325(a)(3).
43. In the latter event, a business organization does not need a discharge at all, because its obligations have been satisfied.
44. *See* 1 S. Scott, The Civil Law 63-64 (1932).

> ment . . . the plaintiff, after the debtor has been delivered up to him, can take the latter with him and bind him or place him in fetters; provided his chains are not of more than fifteen pounds weight; he can, however, place him in others which are lighter if he desires to do so . . . . After he has been kept in chains for sixty days, . . . he shall be condemned to be reduced to slavery by him to whom he was delivered up; or, if the latter prefers, he can be sold beyond the Tiber . . . . Where a party is delivered up to several persons, on account of a debt . . . they shall be permitted to divide their debtor into different parts, if they desire to do so; and if anyone of them should, by the division, obtain more or less than he is entitled to, he shall not be responsible.[45]

Obviously, this approach offered little sympathy to the defaulting debtor. If he failed to pay his obligations, he was duly punished. Roman law gave consideration and the related benefits only to the creditor. A sense of humanity, however, probably kept creditors from regularly enforcing the draconian penalties in the Twelve Tables.[46]

Over the centuries, harsh debt collection statutes—which evolved into early bankruptcy laws[47]—generally took a punitive approach towards the defaulting debtor. Summary remedies against property and the debtor's person were generally available.[48] Debtors' prison was common in both England and the Colonies before the Revolution.[49] It became almost indistinguishable from the concept of indentured servitude, a device accepted voluntarily by many impecunious Englishmen as a means to emigrate to the New World.[50] These early laws did not confer any benefit similar to a fresh start that might have enabled a consumer debtor to commence a new economic life, free from unpaid obligations.

Bankruptcy laws developed as collection devices for creditors:

> [T]he bankrupt's property was to be seized by a common agent and thereafter there was to be a distribution *pro rata* of the proceeds. Holdsworth's conclusion that it was essentially an attempt to prevent frauds on creditors is still valid. This theme was fundamental to future legislation.[51]

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45. *Id.*

46. At least one commentator believes that they were essentially ignored. *See* 2 Patrick De Colquhoun, Roman Civil Law 352 (Fred B. Rothman & Co. ed., 1988).

47. The first English bankruptcy law was enacted in 1542. *See* 34 & 35 Hen. 8, ch. 4 (1542) (Eng.).

48. *See, e.g.*, Vern Countryman, *A History of American Bankruptcy Law*, 81 Com. L.J. 226, 227 (1976).

49. The story is told briefly in Countryman, *supra* note 48, at 226-28. For a more detailed treatment, see Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. Rich. L. Rev. 49 (1986).

50. *See* Countryman, *supra* note 48, at 227-28.

51. W.J. Jones, *The Foundations of English Bankruptcy: Statutes and Commissions in the Early Modern Period*, 69 Transactions Am. Phil. Soc'y 18 (1979) (footnote omitted).

To a considerable degree, modern bankruptcy laws continue to serve that function today.

B. *Early Consumer Solicitude*

The sympathetic approach to consumer insolvency embedded in the Code developed alongside increasingly liberal policies toward consumer discharge and a general social concern for the plight of the needy debtor. Despite the pro-creditor thrust of early insolvency law, those laws were not entirely insensitive to the needs of debtors. The Hammurabi Code, compiled during the reign of Hammurabi, King of Babylon from 1792-1759 B.C., and said to be based upon a body of Sumerian law in existence for centuries before,[52] compelled the forgiveness of interest in any year in which crops failed.[53] It also afforded debtors a continuing right to alternate forms of payment if they were unable to repay obligations in money.[54] Roman law provided an institution known as *cessio bonorum* (apparently promulgated by Julius Ceasar) that enabled an insolvent debtor to have his assets valued and surrendered to creditors in discharge of his obligations, so long as no fraud had been committed.[55]

Another example of sympathetic treatment of debtors appears in a more modern book, the Bible. The Old Testament provides a system of relief from debts: "At the end of every seven years you must cancel debts. This is how it is to be done: Every creditor shall cancel the loan he has made to his fellow Israelite."[56] A more expansive debt cancellation treatment appears later in Matthew: "Forgive us our debts, as we also have forgiven our debtors."[57]

The first indication of solicitude towards the debtor in contemporary English bankruptcy law appeared in 1705, when the Crown promulgated several property exemptions and a discharge of obligations.[58] The exemptions enabled the bankrupt to retain necessary family wearing apparel apart from the bankruptcy proceedings.[59] Under this law, a debtor was also to obtain a discharge if he surrendered his estate and made a full disclosure of his affairs.[60] Predictive of current bankruptcy law, the statute also provided that the discharge

52. *See* 5 Encyclopaedia Britannica 669 (1994).

53. *See* The Code of Hammurabi King of Babylon About 2250 B.C. § 48, at 27 (Robert Francis Harper trans., 1994).

54. *See id.* § 51.

55. *See* DeColquhoun, *supra* note 46, at 352.

56. *Deuteronomy* 15:1-2 (New Int'l Version).

57. *Matthew* 6:12 (New Int'l Version).

58. 4 Anne 17, 11 Stat. 162 (1705) (Eng.).

59. *See id.*, 11 Stat. at 162. The concept of exempt assets serves as one foundation of the present institution of the fresh start—the debtor should not be required to turn all his assets over to his creditors if he is expected to return to society.

60. *See id.* § II, 11 Stat. at 162-63.

shall apply only to debts "due and owing time that he, she, or they did become bankrupt."[61]

The 1705 Act was directed primarily at the financial problems of merchants and secondarily at those of the landed classes. At that time, the ordinary consumer debtor did not have sufficient economic impact to appear in a bankruptcy law. That the statute was targeted to serve the collection interest of creditors may be derived from its title: "An act to prevent frauds frequently committed by bankrupts."[62]

Before the Revolutionary War, a number of bankruptcy statutes existed in the American colonies. Like most early bankruptcy laws, they focused upon creditor collection rather than debtor relief. The consumer "discharge" afforded by these statutes was principally the physical discharge of a defaulting debtor from debtors' prison, which was generally obtained by placing all of one's property in the hands of the court, a trustee, or the creditors.[63]

Some statutes, however, did carry the concept of discharge from unpaid obligations.[64] The first bankruptcy statute in the post-Revolution United States was the Bankruptcy Act of 1800.[65] It was confined to merchants and only provided for involuntary proceedings.[66] Pro-debtor provisions, albeit restricted to the merchant class, were evident.[67] The statute enabled a bankrupt to exempt certain property, including a graduated percentage allowance taken from their total assets.[68] It provided for releases from debtors' prison and also offered a discharge.[69] Though written to expire in 1805, the statute was repealed in 1803.[70]

The expansion of debtor-related benefits continued over the years. The Bankruptcy Act of 1841 included voluntary proceedings for available both merchants and non-merchants.[71] Discharges were available to both, although a voluntary bankrupt who had made a preferential transfer could not obtain a discharge without the consent of a majority of the ordinary unsecured creditors.[72] The Bankruptcy Act of 1867 experimented with discharges that lacked creditor consent, but ulti-

61. *Id.* § VII, 11 Stat. at 165.
62. *Id.* ch. 17, 11 Stat. at 162.
63. *See* Jeffrey L. Zackerman, Comment, *Discharging Student Loans in Bankruptcy: The Need for a Uniform "Undue Hardship" Test*, 65 U. Cin. L. Rev. 691, 694 (1997).
64. *See id.* at 695.
65. Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803).
66. *See id.* § 1, 2 Stat. at 20-21.
67. *See id.* § 2, 2 Stat. at 21-22.
68. *See id.* § 34, 2 Stat. at 30-31.
69. *See id.* § 38, 2 Stat. at 32.
70. *See* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248.
71. Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843).
72. *See id.* § 2, 5 Stat. at 440.

mately required the consent of one-fourth of the number (and thirty percent of the amount) of claims.[73]

III. The Current Discharge and Fresh Start

A. *The 1898 and 1978 Acts*

The Bankruptcy Act of 1898[74] evolved without interruption into today's Code. It enhanced the debtor benefits that had been gradually incorporated into prior statutes. According to the statute, bankruptcy was either voluntary or involuntary, and discharges were granted without creditor consent.[75] Its most significant revision, the 1978 Bankruptcy Reform Act,[76] represented the zenith of pro-debtor bankruptcy law. Though modest modifications since 1978 have somewhat reduced the debtor's position,[77] United States law still confers significant economic benefits upon the debtor in bankruptcy.

B. *Changing Attitude Toward the Consumer Debtor*

Consumer benefits have been expanding since the beginning of the eighteenth century. The result of a failure to pay one's obligations became less punitive in approach: American society renounced debtors' prison for a kinder, gentler approach in which the troubled debtor is considered "one of us." This approach reflects empathy for the debtor, engendered by the realization that any of us could experience financial difficulty or failure due to circumstances beyond our control (e.g., illness, accident, job loss). One commentator has observed that the change in attitude was "[indicative] of the entrepreneurial spirit of the times."[78] A failure to repay an extension of credit was seen less as a gesture of disloyalty to the state or a measure of insubordination towards ruling classes than as one possible economic outcome that any other borrower might also experience. The loss of a job became less a rationale for physical harm than—consistent with the rise of unemployment insurance—a condition for all to share. The social marketplace, perceived broadly, is like a playing field on which some win and some lose. As in any game, we cannot predict with certainty who will fall in what category. Inability to repay debts due to corporate downsizing, for example, may be considered a form of "losing," but it has clearly ceased to be a reason for punishment.

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73. *See* Bankruptcy Act of 1867, ch. 176, sec. 31, 14 Stat. 517, 532.
74. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544.
75. *See id.* §§ 4, 14, 30 Stat. at 547, 550.
76. The only other major revision was the Chandler Act of 1934, ch. 424, 48 Stat. 911.
77. For example, 11 U.S.C. § 109 was amended in 1984 to provide in a new subsection (g) that a debtor could not take advantage of the benefits of bankruptcy law if his case had been dismissed within 180 days for certain described reasons. *See* 11 U.S.C. § 109(g) (1994).
78. Zackerman, *supra* note 63, at 695.

Despite current notions that we should bear responsibility for economic problems collectively, society has never taken up the responsibility of compensating the unpaid creditor for the debtor's failure to pay. The creditor still takes the loss.[79] On the other hand, we now assume that the creditors will "overcharge" the financially capable, converting unpaid debts into a cost of doing business. Thus, creditors are not ultimately harmed by defaulting debtors; rather, the solvent support those who will not—or cannot—pay. Ours has evolved into a society that bears the burden of its financial delinquents. The employed pay the costs of the unemployed through their insurance premiums; those in their working prime pay the cost of supporting the elderly; those who pay their debts will cover for those who do not. It is only where there are miscalculations, unexpected events, or an absence of planning that the allocation of losses will be laid at an unsuspecting door.[80]

Business credit serves the economy by providing a speculative basis for future wealth. It became a basis for economic development from the beginning of the eighteenth century. It is, however, recognized as an economic source that may fail as well as succeed.[81] The bankruptcy laws easily take account of its potential failure and divide the consequences between creditor and debtor. The creditor recovers what it can from the assets of the debtor. The debtor is no longer removed beyond the Tiber;[82] he is rehabilitated, forgiven, and awarded a fresh start. He is not in disgrace, but rather is still "one of us" and entitled to try again.

C. *The New Bankruptcy Laws*

Today, bankruptcy laws are not designed to destroy defaulting debtors. Nor are they intended to reward debtors for their mistakes at the expense of the creditor body. Rather, both legislatures and courts categorize the bankruptcy laws as continuing attempts to balance the needs of debtor and creditor in accordance with current social perceptions and requirements of the credit system. The search for the right spot on the scale is never-ending. An overly liberal debtor approach

79. Credit insurance has a strong presence in today's society. It only exists, however, where it was created for some particular social or economic reason. It is frequently offered by the creditor, who sees it both as legitimate insurance for the debtor's benefit and as a source of income much like an interest rate. International banks regularly offer it as an adjunct to some political purpose. This Article does not address credit insurance, however, because it does not generally affect liability for debts.

80. This is typified by the Southeast Asia financial crisis where improvident loans and distorted governmental controls are only two of the factors that have led to unexpected credit losses on a grand scale. *See* David S. Sanger, *After a Year, No Letup in Asia's Economic Crisis*, N.Y. Times, July 6, 1998, at A1.

81. For example, interest rates are scaled to account for the likelihood of failure.

82. *See supra* text accompanying note 45.

threatens to destroy credit by failing to remunerate creditors and imposing excessive costs on borrowers who repay their debts; at the same time, however, an unduly punitive approach threatens to impose the same result by creating a fear of borrowing among those who might otherwise profit from debt.

The bankruptcy laws thus represent a pendulum, constantly swinging between the two extremes, never reaching either and never at rest. Laws that increase the collection of debts benefit creditors at the expense of debtors. Relaxed responsibility upon debtors to pay their debts has the opposite effect. Any change, stimulated by either legislation or an unexpected judicial decision, pushes the pendulum.

Compared to earlier reforms,[83] current proposals that would push the pendulum between debtor and creditor tend to be relatively modest. In the modern era of bankruptcy, one would not anticipate any marked swing in favor of either debtor or creditor. Many belong to both categories: one might be a creditor in his capacity as stockholder of Citicorp and a debtor as a cardholder of the same entity. Moreover, debtors are not likely to suffer unduly as a result of new laws. For some reasonable time into the future, a debtor will not be called a bankrupt[84] and he will enjoy his fresh start free of disrupting creditor interference.[85]

D. *Advent of Consumer Discharge and the Fresh Start*

The concept of consumer discharge is deeply embedded in the Code. The Code uses the word "discharge" in numerous places and makes its meaning clear: a discharge applies designated assets to creditor claims and eliminates the debts remaining. The Code does not, however, provide specifically for the fresh start. The fresh start represents the consumer's post-discharge ability to live free of the restricting obligations that forced him into bankruptcy. It is the new economic life given to the debtor by the discharge.

Consumer discharge and the derivative fresh start were well-entrenched in United States bankruptcy law by the Bankruptcy Reform Act of 1978, which was the framework for today's Code. They have remained firmly in place under the aegis of the Code and are in no risk of major dislocation. The consumer entering bankruptcy through Chapter 7 (liquidation), very occasionally Chapter 11 (reorganization), or Chapter 13 (reorganization), along with the business that will

83. For example, the Bankruptcy Reform Act of 1978 enabled debtors to file in bankruptcy without the necessity of proving an "act of bankruptcy." 11 U.S.C. § 301 (1994). The House and Senate Reports refer to that change as permitting voluntary bankruptcies "without the necessity for an adjudication, as under the 1898 Act, which was adopted when voluntary bankruptcy was a concept not throughly tested." S. Rep. No. 95-989, at 31 (1978); *accord* H.R. Rep. No. 95-595, at 321 (1977).

84. *See* 11 U.S.C. § 101(13).

85. *See id.* §§ 524, 525.

generally be in either Chapter 7 (liquidation) or Chapter 11 (reorganization) can reasonably assume that they will, in due course, receive the appropriate discharge. Unless there is some particular complexity in the proceeding, such as a fraud or an abuse of the court, the discharge will be granted[86] and followed by the fresh start.

E. *Measuring the Discharge and the Fresh Start*

1. Evaluating the Fresh Start

From the consumer debtor's perspective,[87] the conditions of the discharge and the fresh start turn largely on two aspects of his condition. The first aspect is the division of the consumer's debts: the more debts are discharged, the stronger are the discharge and the resulting fresh start; the more debts are retained by the bankrupt consumer,[88] the weaker is the discharge and the less fruitful the fresh start. The second aspect is the division of the available assets: the more assets are retained by the bankrupt consumer,[89] the stronger the discharge and fresh start; the more assets are paid over to creditors, the weaker are those two elements.

The nature of the relationship between these two components—debts and assets—depends upon the chapter of the Code under which the consumer files. To a large extent, the treatment turns upon the logic of the particular chapter (for example, there is a plan in Chapters 11 and 13 but not in 7; Chapter 13 is voluntary only but Chapters 7 and 11 may be involuntary; creditors vote in Chapter 11 but not in Chapters 7 or 13). A number of provisions, however, seem to vary according to the climate of the drafters' intent, and not infrequently may be viewed as statutory accident. The following review of these three chapters provides some examples.

a. *Chapter 7*

In Chapter 7, both debts and assets are largely measured at the time the bankruptcy petition is filed, whether voluntary or involuntary.[90] Certain debts are discharged even if they occur after the petition,[91] as are certain assets included if acquired after that time,[92] but these tend to be relatively minor in overall import (although they can be decidedly consequential to debtors and creditors in individual cases) and will not be considered here in any detail. Most significantly, § 523

86. *See supra* note 22 and accompanying text.

87. The principles discussed in this section are, however, equally applicable to business bankrupts.

88. *See* 11 U.S.C. § 523.

89. *See infra* Part IV.A (discussing 11 U.S.C. § 522).

90. *See* 11 U.S.C. § 541.

91. *See id.* § 502(g)–(i) (dealing with allowed claims); *id.* § 727(b) (defining the obligations discharged in Chapter 7).

92. *See id.* § 541(a)(5).

details a series of debts that would be discharged but for that section. The sixteen different subdivisions of subsection (a) reflect various social policies supporting a denial of discharge. The underlying rationale for these exceptions is self-evident: the debtor remains liable for certain taxes[93] and family obligations;[94] he is not discharged from debts he incurred through fraud[95] or from those not listed in the bankruptcy;[96] he is not discharged from his basic educational debts;[97] nor is he discharged from "a fine, penalty or forfeiture" owing to a governmental unit.[98] Any of those obligations that the Code directs not to be discharged represents a continuing obligation to be carried by the debtor out of the bankruptcy and sustained during the fresh start period.

As to available assets,[99] assets acquired by the debtor after the commencement of a bankruptcy normally belong to him and will presumably add to the enjoyment of his post-bankruptcy life.[100] Certain property acquired post-petition, such as particular types of property acquired within 180 days of filing, however, is denied to the debtor and put into the estate for allowance to creditors.[101] Such assets include those received by bequest, devise, or inheritance, those received through a property settlement or agreement with one's spouse or a divorce decree, and those received under a life insurance or death benefit plan.[102]

Similarly, the Code contains exemption provisions that remove from the estate certain assets held by the debtor prior to filing, saving them from the grasp of creditors.[103] These are somewhat complex in operation and depend upon a mix of federal and state law. Assets received by operation of these provisions further enhance the debtor's enjoyment of his fresh start.

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93. *See id.* § 523(a)(1).
94. *See id.* § 523(a)(5).
95. *See id.* § 523(a)(2).
96. *See id.* § 523(a)(3).
97. *See id.* § 523(a)(8).
98. *Id.* § 523(a)(7); *see also* Kelly v. Robinson, 479 U.S. 36 (1986) (holding that § 523(a)(7) preserves from discharge in Chapter 7 any fine a state criminal court imposes as part of a sentence).
99. There is an unrealistic element that runs through this discussion of available assets. Due to the poverty of the typical debtor and the generosity of state exemption schemes, there are no assets available for distribution to creditors in over 90% of Chapter 7 cases. *See* Irving A. Breitowitz, *New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of "Substantial Abuse,"* 59 Am. Bankr. L.J. 327, 335 (1985).
100. Income earned by the debtor after bankruptcy has begun is normally his and represents a significant form of post-bankruptcy asset belonging to the debtor and not the estate. *See* 11 U.S.C. § 541(a)(6).
101. *See id.* § 541(a)(5).
102. *See id.*
103. *See id.* § 522. If assets are subject to a security interest, however, they remain so subject even if exempted out of the estate. *See id.* § 522(c)(2).

b. *Chapters 11 and 13*

Prescribing the obligations and the assets subject to Chapter 11 and 13 plans requires a different and less clear exposition. In general, Chapter 11 discharges obligations that exist at the time the plan is confirmed.[104] Chapter 13 discharges obligations provided for in the plan,[105] so the best date for defining those obligations is also the date of confirmation, up to which the plan may be modified.

The formal estate is of less significance in Chapters 11 and 13.[106] In Chapter 11, the debtor or trustee proposes and the creditors approve the assets which will be committed to the consummation of the plan. The content of the Chapter 13 estate is equivalent to that of a Chapter 7 estate, but also includes any assets acquired after the bankruptcy begins, as described in § 541.[107] The debtor remains in possession of all property which the plan does not commit to fulfill unpaid obligations.[108] Unlike Chapter 7, however, "human capital" or post-petition earnings become part of Chapter 11 and 13 estates.[109] Creditors typically receive the bulk of their payment from those earnings.

F. *Changes in the Discharge and Fresh Start*

Allocation of debts and assets to the discharge and the fresh start at one point in history does not guarantee similar allocation at another point. Perceptions of the appropriate relationship between debtor and creditor change over time. The actual amount of debts and assets accumulated under the related Code provisions at different times may themselves change, as debtor and creditor needs, expectations, and skills (not to mention the skills of their lawyers) in manipulating the debts and assets evolve.

Examples of both abound. For example, 11 U.S.C. § 523 was expanded in 1984 to exclude more debts from discharge by creating a presumption of fraud for certain consumer obligations incurred within short periods before the bankruptcy.[110] The scope of the discharge—and the pleasure to be derived from the fresh start—was thereby reduced. A simultaneously enacted provision increased discharge for debtors by allowing an aggregate exemption of $4000 for certain described assets.[111] The fresh start was thereby sweetened through removal of additional assets from the estate.

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104. *See id.* § 1141(d)(1).
105. *See id.* § 1328(c).
106. "[T]he concept of property of the estate takes on considerably less importance in chapter 13 than in a liquidation case under chapter 7." Collier on Bankruptcy ¶ 1306.01 (15th ed., Cum. Supp. 1996).
107. *See* 11 U.S.C. § 1306(a).
108. *See id.* § 1036(b)
109. *See id.* § 1306(a).
110. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 307(a), 98 Stat. 333, 353.
111. *See id.* § 306, 98 Stat. at 353.

There is no concept of reciprocity with respect to these changes. If the discharge is reduced, the fresh start is not necessarily increased equivalently. Actions dealing with either concept are taken without necessary reflection in the other, and changes do not always result in harmonious resolution. Any movement that believes the debtor class is overly abused in bankruptcy—or that it is overly benefitted—may sprout in Congress and create legislative changes to reflect that position. Unfortunately, legislators often focus solely on short-term goals, and lose sight of overall policies. The elimination of perceived current abuses takes precedence over maintenance of a well-balanced Code.

IV. Division of the Assets

A. *Chapter 7 and the Exclusion of Future Income*

The Code contains a less than rigorous scheme for determining whether the debtor's assets will be paid to creditors in reduction of their obligations or awarded to the debtor for enjoyment in the fresh start. For the consumer debtor, I will examine this pattern as it shapes Chapter 7 (dissolution) and Chapter 13 (reorganization).[112]

The structure of Chapter 7 is relatively crisp. First, the appropriate assets comprise the estate.[113] Assets in the estate are paid to unsecured creditors.[114] An asset deemed not to be part of the estate, or removed from the estate by operation of a debtor's exemption,[115] will not be applied to unsecured obligations,[116] but rather belongs to the debtor and may be utilized by him in the fresh start.

A modified estate also serves as a basis for aspects of Chapter 13,[117] but the Code is less dogmatic in prescribing the assets surrendered to unsecured creditors. Those are fundamentally determined by the debtor in his plan and are subject to wide permissible variations. The estate in Chapter 13 thus affects creditors' benefits less directly. The estate may, for example, define those assets that fall within a command of the Code or the plan that estate assets be handled in a particular way.[118] It may define those assets that are subject to the automatic stay and therefore are protected for creditors.[119] It

112. As previously noted, Chapter 11 is not a significant part of consumer bankruptcy procedure. *See supra* Part I.C.2.

113. *See* 11 U.S.C. § 541.

114. *See id.* § 126(a)(2).

115. *See id.* § 522.

116. Secured assets are another story and will not be addressed here. Section 506 prescribes the secured creditor's ownership interest: If assets subject to a valid lien are exempted by the debtor, the lien remains and may be enforced by the secured creditor. *See id.* § 522(c)(2).

117. *See id.* § 1306.

118. *See In re* Calder, 973 F.2d 862, 866-68 (10th Cir. 1992).

119. *See In re* Ziegler, 136 B.R. 497, 500 (Bankr. N.D. Ill. 1992).

prescribes property that vests in the debtor upon confirmation of the plan.[120]

In Chapter 7, the definition of the estate measures those assets that are paid to creditors in reduction of their claims. It establishes a basic measure of the extent to which those claims are reduced and consequently determines the scope of the discharge and the extent to which obligations will not be satisfied. The discharge may be large or small, depending upon the quantity of obligations present in the bankruptcy and the quantity of assets applied to those obligations. The fresh start, however, always represents a debtor no longer encumbered by obligations. He comes out of bankruptcy free of unpaid debts[121] with assets of various qualities accorded to him by bankruptcy law. Among those assets are most assets acquired after the bankruptcy case has begun,[122] including income earned from "services performed by an individual debtor after the commencement of the case."[123]

It is by no means clear that such income should, as a matter of good social policy, be excluded from the estate and withheld from creditors. Obligations are generally incurred upon the expectation that they will be paid from future income.[124] This approach to consumer credit becomes even more significant as consumer obligations shift from the more traditional "asset-based" debts—such as automobile loans or furniture financing—to the modern unsecured credit card obligations, which are granted based upon expectation of future earnings and with little regard to one's accumulated assets. Middle- and lower-class families, who have little in the way of accumulated assets, now participate in the store of national wealth through the economic use of future income. Diminishing the value of that income may have an unfortunate effect upon such consumers. The current Code goes too far in eliminating future income as a source of payment.

120. *See* 11 U.S.C. § 1327(b); *In re* Petruccelli, 113 B.R. 5, 15-16 (Bankr. S.D. Cal. 1990).

121. Subject, of course, to those debts that are not discharged pursuant to § 523. The bankruptcy court has little discretion with respect to an award of Chapter 7 discharge. Section 727(a) provides that "[t]he court *shall* grant the debtor a discharge." 11 U.S.C. § 727(a) (emphasis added).

122. 11 U.S.C. § 541(a)(1) prescribes that the estate consists of "all legal or equitable interests of the debtor in property *as of the commencement of the case.*" *Id.* § 541(a)(1) (emphasis added).

123. *Id.* § 541(a)(6).

124. Mortgages are taken to provide for the situation where income proves to be insufficient. Most creditors, operating on a thin level of profit established by competition among fellow creditors, assume that they will lose money wherever they must resort to enforcement of a mortgage. Andrew F. Brimmer reflected the creditor position when he testified: "The typical lender expects to get repaid from the income generated by a borrower who continues to work and pay his debts. The typical lender does not extend credit on the assumption that it will be repaid out of liquidation of assets." *Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong. 10 (1981) (statement of Andrew M. Brimmer, President of Brimmer & Co.).

How different is future income from "[p]roceeds . . . of or from property of the estate" which is included in the estate and paid to creditors? If a debtor owns a dancing bear at the time of the bankruptcy, profits derived from the bear's services will be in the estate; if the debtor is a performer himself, profits from his own efforts—termed "human capital" at the time of the bankruptcy—will be excluded. A medical, law, or engineering license—perhaps the best evidence of human capital and the promise of future earnings—is not considered the equivalent of the bear; income as a doctor, lawyer, or engineer earned after the petition in bankruptcy will not be part of the estate.

A rationale for the exclusion appears in the landmark case of *Local Loan Co. v. Hunt.*[125] According to Justice Sutherland, one whose wages are committed in advance to creditors will simply not work:

> 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 as, 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.[126]

Is this rationale convincing? Absent bankruptcy, does the prospect that all or a substantial part of one's income will be assigned to the payment of previously contracted debts result in a refusal to work? If it did, few would work—or live in their own homes, or drive in their own cars—in today's credit economy. Professor Thomas H. Jackson has concluded as much in the 1985 *Harvard Law Review*: "The accommodation currently embodied in the Bankruptcy Code is by no means ineluctable. . . . Nor is there an obvious reason why bankruptcy law has itself chosen to protect human capital yet has largely delegated the choice of exemptions to state law."[127]

125. 292 U.S. 234 (1934).

126. *Id.* at 245.

127. *See* Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393, 1431 (1985) (footnotes omitted). Professor Jackson refers to two bills, one introduced in the Senate and the other in the House in 1982, that required future

Underlying the Code's distinction is the classic difference between tangible assets at one extreme—houses, automobiles, plant, and equipment—and the intangible human capital at the other. The possibility that an individual will work may not have been deemed sufficiently firm to be considered the equivalent of tangible wealth to be paid to creditors in reduction of their claims. Since Professor Jackson wrote his article, however, the burgeoning field of intellectual property has grown rapidly; its subject matter, largely intangible in nature, has become one of our dominant and accepted forms of wealth. One would marvel at the idea of Bill Gates, Chairman of Microsoft Corporation and possibly the world's richest man, walking through customs and saying "I have nothing to declare." The time may have arrived for the Code to recognize these new forms of wealth.

B. *Chapter 13 and the Inclusion of Future Income*

The Chapter 13 estate has differed from the Chapter 7 estate since 1978. Though excluded from the Chapter 7 estate, "earnings from services performed by the debtor after the commencement of the case" are included in the Chapter 13 estate.[128]

Chapter 13 has always assumed that future income will be taken into account in connection with a consumer bankruptcy. Section 74, the original form of present Chapter 13, was added to the Act in 1933 and imposed few limitations upon its arrangement provisions.[129] It authorized that, "Any person excepting a corporation may file a petition . . . stating that he is insolvent or unable to meet his debts as they mature, and that he desires to effect a composition or an extension of time to pay his debts."[130]

A more formal Chapter 13 Wage Earner Plan was added to the Bankruptcy Act with the Chandler Act of 1938.[131] It was founded on the premise that such a plan would be funded solely by future income, and that only future income would be considered in the creation thereof. Accordingly, "[a] plan under this chapter . . . (4) shall include provisions for the submission of future earnings or wages of the debtor to the supervision and control of the court for the purpose of enforcing the plan."[132]

Thinking had evolved by adoption of the Code in 1978. The Report of the Commission on the Bankruptcy Laws of the United States[133] observed that "[p]resent Chapter XIII contemplates that a plan

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earning potential to be considered in determining whether one qualified for straight bankruptcy. *See id.* at 1431 n.125.

128. 11 U.S.C. § 1306(a)(2).

129. *See* Act of March 3, 1933, Pub. L. No. 72-420, ch. 420, 47 Stat. 1467.

130. *Id.* § 74(a), 47 Stat. 1467.

131. Act of June 22, 1938, ch. 575, art. VIII, § 646, 52 Stat. 840, 934.

132. *Id.*

133. H.R. Rep. No. 93-137, pt. 1, at 175 (1973).

should provide for the payment of debts only out of 'future earnings or wages.'"[134] It proceeded to propose an estate for Chapter 13 comprised of the same assets as those assigned to the Chapter 7 estate, continuing the inclusion of future income.[135]

Though inconsistent with the Code's general policy of excluding human capital from resources available to pay creditors, its inclusion in Chapter 13 had several justifications. First, Chapter 13 bankruptcy is always voluntary. Thus, if the debtor consents to subject his future income to operation of the estate, there would seem to be no bar against it. Second, the estate in Chapter 13 does not prescribe those assets payable to creditors.[136] It does not, therefore, present the discouragement from work claimed by Justice Sutherland in *Local Loan*.[137] The effect of including future income in the Chapter 13 estate is consequently diluted.

V. Discretionary Denial of Consumer Discharge

Chapters 7 and 13 of the Code contain various reasons why a discharge might not be granted to a consumer debtor. In Chapter 7 cases, § 727 provides ten specific reasons (some of them sub-divided) why a discharge will not be granted.[138] Preclusion of discharge depends solely upon demonstrating the existence of one of those elements. Chapter 13 requires the court to confirm a plan[139] before a plan may be completed—the prerequisite to a discharge.[140] Absent one of the statutory requirements for confirmation, there can be no discharge.

The appropriateness of a denial of discharge can be determined for a large debtor group if the precluding factor is clear and distinct. The presence of such a factor can be identified from information submitted by the debtor or elicited from him through one of the investigative devices authorized by the Code.[141] Where the applicable test requires the exercise of judicial discretion based upon the specific facts of a case, however, the existence of a vast quantity of debtors poses a practical problem for an overworked judiciary.

134. *Id.*
135. *See id.*
136. *See supra* Part I.C.3.
137. *See supra* note 126 and accompanying text.
138. Discharge will not be granted where the debtor is not an individual, where the debtor has fraudulently conveyed, concealed, or misrepresented his assets, where other code provisions prohibit discharge, or where the court approves a written waiver of discharge. *See* 11 U.S.C. § 727 (1994).
139. *See id.* § 1325.
140. *See id.* § 1328. Discharges may also be granted after partial payment. *See id.* § 1328(b).
141. *See, e.g., id.* § 343 (requiring the debtor to submit to an examination under oath); *id.* § 521 (listing debtor's duties, including filing a list of creditors, a schedules of assets and liabilities, current income and current expenditures, and a statement of the debtor's financial affairs).

For example, confirmation of a plan under Chapters 11 and 13 requires that "the plan has been proposed in good faith."[142] "Good faith as the *sine qua non* for the filing and maintenance of a Chapter 11 case should be probed elastically and on a case by case basis."[143] Such a subjective test may be a sound approach, consistent with the Code, and may constitute an effective control over Chapter 11 where the numbers are relatively limited[144] and where creditors exert their own controls over the administration of the cases. It cannot, however, effectively adjudicate the excess of bankruptcy cases that now plagues our judicial system.

Administration of such a case-by-case analysis is particularly impractical in Chapter 7 cases, which currently number about a million a year.[145] Challenges to Chapter 7's analogous "good faith" provision have given rise to administrative difficulties. Section 707(b) provides:

> After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter.[146]

All aspects of this sentence have presented problems for the courts.[147] The most difficult of these is the meaning of the words "substantial abuse." The statute itself contains nothing of help, and the legislative history is at best confusing. When preceding § 707(a) was enacted as part of the newly-created Code in 1978, the Congressional Report stated:

142. *See id.* §§ 1129(a)(3), 1325(a)(3). This requirement may fairly be viewed as surplusage. The entire Code is equitable in nature and it is fair to observe that all acts must be taken in good faith. That a plan must be proposed in good faith cannot be taken as an indication of congressional intent that the remainder of the Code need *not* be performed in good faith. *See* Collier on Bankruptcy, *supra* note 106, ¶ 1129.03(3)(a)(ii).

143. *In re* Eden Associates, 4 Collier Bankr. Cas. 2d 1249, 1256 (Bankr. S.D.N.Y. 1981).

144. In 1996, Chapter 11 cases were approximately three percent of the Chapter 13 cases and under two percent of the Chapter 7 cases. *See* U.S. Bureau of the Census, Statistical Abstract of the United States 549 (117th ed. 1997).

145. Consumer bankruptcies—Chapters 7 and 13—reached an all-time high of 1.3 million in 1977 and, according to Visa U.S.A., will increase 69% or to 2.2 million by 2001. *See* Jaret Seiberg, *Visa Projecting a 69% Jump in Bankruptcy Filings by 2001*, Am. Banker, July 14, 1998, at 2.

146. 11 U.S.C. § 707(b).

147. For example, what is the result if a request is made by a party in interest? *See In re* Clark, 927 F.2d 793, 795 (4th Cir. 1991) (reversing lower court's decision that interpreted § 707(b) as barring a trustee from instituting motion at suggestion of creditor who is a party in interest). What is meant by "primarily" consumer debts? *See In re* Scheinberg, 132 B.R. 443, 444 (Bankr. D. Kan. 1991) (acknowledging disagreement over the quantum of proof required to support dismissal under § 707(b)).

> This section [707(a)] authorizes the court to dismiss a liquidation case only for cause, such as unreasonable delay by the debtor that is prejudicial to creditors or nonpayment of any fees and charges required under chapter 123 of title 28. These causes are not exhaustive, but merely illustrative. The section does not contemplate, however, that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal. To permit dismissal on that ground would be to enact a non-uniform mandatory chapter 13, in lieu of the remedy of bankruptcy.[148]

Some six years later, a contrasting statement was written in the consideration of subsequently enacted § 707(b): "[I]f a debtor can meet his debts without difficulty as they come due, use of Chapter 7 would represent a substantial abuse."[149]

Though a future income test was included in an initial draft of § 707(b), it was dropped before the provision's enactment.[150] In some early cases, courts refused to consider future income at all in deciding whether the bankrupt committed a substantial abuse of the Code, because of the legislature's deliberate omission of that test.[151] Subsequent decisions, however, quickly established that future income should be considered in determining whether a Chapter 7 case should be dismissed for substantial abuse of the Code.[152] Disagreement over the degree to which one's future earnings should influence a determination of "substantial abuse" then developed.

Brian Wildermuth's representative article on the subject[153] purports to summarize three separate positions that have been taken on the role of future earnings in abuse determinations: (1) a debtor's ability to pay a substantial portion of his debts constitutes substantial abuse of Chapter 7; (2) a debtor's ability to pay is only one factor which must be accompanied by other ingredients to find substantial abuse;[154] or (3) a debtor's ability to pay justifies dismissal only if it is accompanied by some "egregious circumstance," "unfair advantage," or evidence of bad faith.[155]

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148. S. Rep. No. 95-989, at 94 (1978).

149. S. Rep. No. 98-65, at 54 (1983).

150. *See* David L. Balser, *Section 707(b) of the Bankruptcy Code: A Roadmap with a Proposed Standard for Defining Substantial Abuse*, 19 Mich. J.L. Reform 1011, 1018-19 (1986).

151. *See In re* Antal, 85 B.R. 838 (Bankr. W.D. Mo. 1988). Having accepted the precedent of its district court that future income may not be considered in measuring abuse, the bankruptcy court concluded, "707(b) . . . is now a dead letter." *Id.* at 841.

152. *See In re* Bell, 56 B.R. 637, 641 (Bankr. E.D. Mich. 1986); *In re* Grant, 51 B.R. 385 (Bankr. N.D. Ohio 1985); *In re* Edwards, 50 B.R. 933, 937 (Bankr. S.D.N.Y. 1985).

153. *See* Brian Wildermuth, In re Lee: *Tithing as Grounds for Dismissing Under Section 707(b) of the Bankruptcy Code*, 26 U. Tol. L. Rev. 725, 729-30 (1995).

154. This "totality of the circumstances" has been called the "prevailing view." *Consumer Bankruptcy Reform on the Hill*, Bank. L. Letter, May 1998, at 4.

155. Wildermuth, *supra* note 153, at 730. This position is said to be held by only a small group of courts. *See id.*

This Article contends that the courts have not, in fact, adopted these three approaches but rather adhere to only one—the first. Though they sometimes pay lip service to the other two, the courts have failed to apply either in a manner which would justify calling them "positions."[156] Wildermuth conspicuously fails to identify a single case supporting the third approach. Proposed amendments to § 707(b) that would codify the first position do not change bankruptcy law but, rather, clarify the policy already applied by the courts.

A. *Statutory Development of Discharge Denials*

The provisions of the Code discussed above are composed of many elements, large and small. I have referred to provisions that represent a debt that may or may not be discharged or an asset that may or may not be included in the estate. Other provisions, to which I now turn, are broader and bolder in approach; they may prohibit a discharge and a subsequent fresh start entirely. In somewhat different forms, these denials reside throughout the Code. For example, § 305 announces the judicial power to "dismiss a case . . . if . . . the interests of creditors and the debtor would be better served by such dismissal."[157] The power to dismiss a case also resides in particular provisions of Chapter 7,[158] Chapter 11,[159] and Chapter 13.[160] Confirmation of a plan may be rejected under either Chapter 11 or 13.[161] Failure of the plan results in the absence of a discharge and, consequently, the failure to achieve a fresh start.

Sections 727 and 523 stand in neat distinction to one another. Section 727(a) lists ten factors that will cause the debtor not to obtain a discharge in Chapter 7. Section 523, on the other hand, assumes the grant of a discharge and isolates a series of well-defined obligations that will not be discharged themselves. Presumably, the situations barring discharge are entirely more serious than those in which only certain obligations are retained. This presumption is not, however, entirely clear—or perhaps the relative seriousness of these situations is in the eyes of the beholder (or legislator). For example, if a debtor transfers property within a year of the bankruptcy with intent to hinder a creditor, the discharge is entirely denied; if he commits larceny, only that single obligation is barred from discharge.

156. One commentator has come close to this position: "Of the four factors considered by courts that reject the ability to repay standard, it can be argued that each factor is simply a restatement of the same general inquiry—the ability of the debtor to use future income to repay the debts under a chapter 13 repayment plan." Vandiver, *supra* note 4, at 559 (citation omitted).

157. 11 U.S.C. § 305(a) (1994).

158. *See id.* § 707.

159. *See id.* § 1112.

160. *See id.* § 1307.

161. *See id.* §§ 1129, 1325.

Changing perceptions of the same element may cause that element to be moved from one function to another over time. The evolution of § 523 and the exceptions to discharge provide one such example. Subdivision (2) provides that a debt obtained by a false statement in writing[162] may not be discharged. In its original form, the section provided that such a false statement prevented the full discharge:

> The judge shall hear the application for a discharge . . . and discharge the applicant unless he has . . . (3) obtained money or property on credit upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person.[163]

This language became part of section 14 (the predecessor to § 727 of the present Code) until 1960, when it was moved to section 17 (which served as the model for § 523 and defined specific debts that were not subject to a discharge).[164] The Senate Report accompanying the 1960 amendment stated:

> The committee believes that complete denial of a discharge is too severe a penalty in the case of the individual noncommercial bankrupt. It is also a penalty which experience has shown to be subject to abuse. An unscrupulous lender armed with a false financial statement has a powerful weapon with which to intimidate a debtor into entering into an agreement in which the creditor agrees not to oppose the discharge in return for the debtor's agreement to pay the debt in full after discharge.[165]

B. *The Representative Cases*

Roughly 350 cases have been brought in the federal courts—including the Bankruptcy Court—dealing in some way with § 707(b) since its enactment in 1984.[166] Some 139 of these cases have dealt with the question of whether or not a Chapter 7 case should be dismissed because the debts were primarily consumer in nature and there was substantial abuse of the provisions of the Code.[167] Of those cases, 107 have found that the Chapter 7 case should be dismissed because the debtor has human capital, or future income, in excess of his needs that could be used to pay all or a substantial portion of his obligations within a reasonable time.[168] A review of other circumstances may or

162. *See* § 523(a)(2)(B).
163. Act of June 25, 1910, Pub. L. No. 61-294, ch. 412, § 6, 36 Stat. 838, 839.
164. Act of June 12, 1960, Pub. L. No. 86-621, 74 Stat. 408.
165. S. Rep. No. 86-1688, at 2955 (1960).
166. Search of Westlaw, FBKR-CS database (Sept. 15, 1998).
167. The remaining cases relate to § 707(b) in some way that is at best tangential to the matters discussed in this article—§ 707(b) may be mentioned in connection with a review of the statutory history of § 707(a), or the case may deal with a denial of discharge under § 727 or an exemption under § 522. A list of these cases is on file with the *Fordham Law Review*.
168. A list of these cases is on file with the *Fordham Law Review*.

may not be a part of the analysis. An additional six cases find that, although there was insufficient income to pay creditors, the Chapter 7 case should be dismissed because the debtor abused the Code in other ways.[169] Only seven cases find that, although there was enough surplus income to make a meaningful payment to creditors, the Chapter 7 case should not be dismissed because a review of the "totality of the circumstances" (or some analogous test) failed to uncover some equitable abuse of the Code.[170]

1. The Excess Income Test[171]

The great bulk of the cases find that the debtor has income in excess of his reported needs and, therefore, can allocate portions of his future income to the repayment of creditors whose obligations would otherwise be discharged. In other words, they find that a fresh start is inconsistent with the purposes of the Code when the debtor will receive income that could be used to pay his creditors at the time of bankruptcy without reducing his style of living. In re *Struggs*[172] summarizes the position that future income sufficient to pay obligations suffices to demonstrate an abuse of Chapter 7: "[T]he Court finds that the debtor can pay a meaningful part, in fact all, of his unsecured debt in a Chapter 13 plan, and that therefore granting him relief under Chapter 7 would be a substantial abuse of the Bankruptcy Code."[173]

2. The Totality of the Circumstances Test

Some other courts, however, seem to require more than the excess income test: in addition to surplus income, the "totality of the circumstances" must demonstrate some element of unfairness if the debtor were to receive a fresh start.[174] The cases present this test in various

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169. *See In re* Gavita, 177 B.R. 43, 47 (Bankr. W.D. Pa. 1994); *In re* Ragan, 171 B.R. 592, 596 (Bankr. N.D. Ohio 1994); *In re* Veenhuis, 143 B.R. 887, 889 (Bankr. D. Minn. 1992); *In re* Palmer, 117 B.R. 443, 448 (Bankr. N.D. Iowa 1990); *In re* Jones, 114 B.R. 917, 924 (Bankr. N.D. Ohio 1990); *In re* Bruno, 68 B.R. 101, 103 (Bankr. W.D. Mo. 1986).

170. *See* Green v. Staples, 934 F.2d 568, 573 (4th Cir. 1991); *In re* Higuera, 199 B.R. 196, 201 (Bankr. W.D. Okla. 1996); *In re* Butts, 148 B.R. 878, 880 (Bankr. N.D. Ind. 1992); *In re* Fortune, 130 B.R. 525, 526 (Bankr. C.D. Ill. 1991); *In re* Hammer, 124 B.R. 287, 289 (Bankr. C.D. Ill. 1991); *In re* Keniston, 85 B.R. 202, 223 (Bankr. D.N.H. 1988); *In re* Deaton 65 B.R. 663, 664 (Bankr. S.D. Ohio 1986).

Five other cases also relate to situations where the Chapter 7 case is retained, but do not fail to support the totality of the circumstances test for other reasons. *See infra* note 183. The remaining 16 cases retain Chapter 7 because of some ingredient not directly relevant to the subject matter of this Article—for example, the obligations were not substantially consumer in nature.

171. This standard can also be called the "ability to pay" test.

172. 71 B.R. 96 (Bankr. E.D. Mich. 1987).

173. *Id.* at 99.

174. Items two and three in the three classifications given above are taken from the Wildermuth article. *See* Wildermuth, *supra* note 153, at 729-30.

ways. Some give themselves room for a wider evaluation, but do not require it:

> Although, the ability to repay one's obligations is a major consideration in a section 707(b) inquiry, it is not the only one. Where necessary, the court may consider such things as:
>
> a. the circumstances which motivated the petition, in terms of whether the debtor has suffered an unforseen calamity, or is merely using chapter 7 provisions to gain relief from past excesses.
>
> b. whether the debtor has fully and accurately disclosed his monthly income and whether the proposed budged [sic] is excessive or extravagant.
>
> c. whether or not the information the debtor has supplied, in connection with the bankruptcy schedules and statements, accurately reflects the debtor's true financial condition, and, if not, whether this amounts to an attempt to mislead the court.
>
> This list is not exhaustive.[175]

Courts frequently give lip service to the totality of the circumstances test(s) but fail to apply it in any meaningful sense. For example, the North Dakota Bankruptcy Court began its evaluation of *In re Kress* by stating:

> [T]he most important criteria in determining whether a particular filing constitutes "substantial abuse" is the debtors [sic] ability to make repayment, but this is not the only criteria. More appropriately, a bankruptcy court, when considering whether substantial abuse exists in a given case, ought to consider the totality of the circumstances, bearing in mind that the basic purpose of Chapter 7 is to provide the honest debtor with a fresh start.[176]

Following that introduction, however, the court considered only the factor of disposable income and whether it could cover creditor claims.[177]

A variation of the foregoing approach conflates the totality of the circumstances test with the excess income test but achieves the same result. For example, a Georgia bankruptcy court has held that denial is appropriate wherever "[a]n evaluation of the totality of circumstances shows Debtors have an ability to pay a substantial portion of their unsecured debt within a reasonable time."[178] In other words,

175. *In re* Ploegert, 93 B.R. 641, 642 (Bankr. N.D. Ind. 1988) (citations and internal quotation marks omitted); *see also* Gomes v. United States Trustee, 220 B.R. 84, 87 (B.A.P. 9th Cir. 1998) ("[T]he debtor's ability to pay his debts when due, as determined by his ability to fund a chapter 13 plan, is the primary factor to be considered in determining whether granting relief would be substantial abuse." (quoting *In re* Kelley, 841 F.2d 908, 914 (9th Cir. 1988))).

176. *In re* Kress, 57 B.R. 874, 878 (Bankr. D.N.D. 1985).

177. *See id.*

178. *In re* Lee, 162 B.R. 31, 43 (Bankr. N.D. Ga. 1993).

"[d]ebtor's honesty[179] is measured by an ability to repay debts out of future earnings."[180]

Another incarnation of the totality of the circumstances test examines the surrounding circumstances, not to determine whether there are reasons to support dismissal of the Chapter 7 case, but rather to determine whether any extenuating circumstances that indicate that it should *not* be dismissed. This approach is exemplified in *In re Busbin*.[181] After looking to various factors to see whether a Chapter 7 dismissal should not be granted and describing the outstanding debts, the Court stated that:

> [I]t does not appear that Debtor is inflicted with "crushing debt burdens and severe financial problems" or even with debts he cannot pay. It is apparent Debtor filed his Chapter 7 petition for the sole purpose of discharging a single debt which he does not wish to pay. Accordingly, it is hereby ORDERED [that the Chapter 7 case be dismissed].[182]

The true application of a totality of the circumstances test can be confirmed only by a case in which a court finds that surplus income does in fact exist, but nevertheless refuses to dismiss the Chapter 7 case because there are no other supportive circumstances. Only this situation can verify that the court is really considering the totality of the circumstances, and not just the presence of surplus income. There, the significance of the other circumstances is holding, not dicta.

Only seven such cases exist in the scores of § 707(b) opinions.[183] Six of those cases, however, are in bankruptcy court (which is not a Constitutional Article III court) and thus can hardly be the basis of a judicial doctrine interpreting the will of Congress.

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179. Honesty is another of the traditional circumstances.

180. *In re* Sanseverino, 171 B.R. 46, 48 (Bankr. N.D. Ohio 1994).

181. 95 B.R. 240 (Bankr. N.D. Ga. 1989).

182. *Id.* at 246.

183. *See supra* note 170. Of these six, two were decided by the same judge in the same year, and consequently do not really serve to broaden the doctrine. *See In re* Fortune, 130 B.R. 525 (Bankr. C.D. Ill. 1991); *In re* Hammer, 124 B.R. 287 (Bankr. C.D. Ill. 1991).

Five additional cases deny the presence of substantial abuse and retain the Chapter 7 case, but do not actually support the totality of the circumstances doctrine. *See In re* Williams, 155 B.R. 773 (Bankr. D. Idaho 1993) (retaining Chapter 7 where surplus income existed but was insufficient to fund a Chapter 11 or 13 case); *In re* Hampton, 147 B.R. 130 (Bankr. E.D. Ky. 1992) (retaining Chapter 7 case involving only a *modest* amount of surplus income that could pay only five percent of the unsecured credit over a period of 36 months); *In re* Harris, 125 B.R. 254 (D.S.D. 1991) (denying Chapter 7 dismissal because of the totality test); *In re* Martin, 107 B.R. 247, 249 (Bankr. D. Ala. 1989) (retaining Chapter 7 case in which only a *limited* amount of surplus income existed and noting that debtors "should not be pushed to the edge of financial survival because a plan looks feasible on a cold financial statement"); *In re* Tefertiller, 104 B.R. 513 (Bankr. N.D. Ga. 1989) (retaining the Chapter 7 case after difficulty in determining whether surplus income actually existed and failing to articulate any specific totality of the circumstances test).

In re Green,[184] however, is a court of appeals case extensively cited for the proposition that dismissal under § 707(b) must be supported by the totality of the circumstances, and not by excess income alone. In *Green*, the debtor's most recent annual income of $46,000 resulted in a surplus of $638 a month that could be applied in reduction of his pre-petition obligations.[185] The trustee so argued, but the court rejected that position in favor of the alternative approach, that a Chapter 7 dismissal must be based upon a totality of the circumstances.[186]

As the court noted, however, the debtor anticipated that his next year's income would be only $26,000, leaving him nothing to apply to his debts.[187] A lawyer arguing the case would have realized that the $638 monthly surplus was merely a theoretical number, and that, in fact, there was no surplus income available for payment of debts. The case for dismissal was thus lost from the outset. The court's discussion of a totality of the circumstances test was not essential to the holding, and was therefore dicta.[188] Thus, the single most important affirmation of the test is, in reality, just legal conversation.

3. Synthesis

These cases, along with the many others dealing with the § 707(b) issue of substantial abuse, do not fall into the neat three-class system expressed in the Wildermuth article.[189] Rather, they reveal a spectrum of views—none of which constitute a discrete doctrine. These cases do, however, share a common element: the presence of sufficient future income to pay all or a substantial portion of the outstanding obligations as of the bankruptcy. Such income is universally held to be either the sole measure of substantial abuse or the dominant ingredient thereof.[190] Surplus future income is essential; something more may or may not be required, and what is required is, at best, uncertain. In those many cases where the other circumstances are

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184. 934 F.2d 568 (4th Cir. 1991).
185. *See id.* at 569.
186. *See id.* at 572.
187. *See id.* at 569.
188. One commentator has summarized dicta as follows:

> "Where a decision rests on two or more grounds, none can be relegated to the category of obiter dictum." This is the traditional view when there are alternative grounds for a decision. But suppose . . . that the court relies far more heavily on one of the two grounds . . . . Many courts have said that "opinions of a judge which do not embody the resolution or determination of the court, and [are] made without argument, or full consideration. . . ." are dicta.

Comment, *Dictum Revisited*, 4 Stan. L. Rev. 509, 511 (1952) (quoting Woods v. Interstate Realty Co., 337 U.S. 535, 37 (1949), and State v. Tingle, 60 So. 728, 729 (Miss. 1913)). Since dicta is not essential to the decision, the courts may not have fully considered the issues involved. *See* Toni M. Fine, American Legal Systems: A Resource and Reference Guide 39 (1997).

189. *See supra* note 153 and accompanying text.
190. *See supra* Parts V.A, V.B.

practically disregarded, the totality of the circumstances test is certainly a misnomer, and probably no more than dicta. If it is merely dicta, the test need not be followed by subsequent courts. Though some cases do appear to take the test more seriously, it is difficult to draw the line beyond which the test matters and short of which it does not.

A small group of six cases also hold that surplus income is not necessary if bad faith or abuse of the Code can be separately demonstrated.[191] This alternate standard is perfectly appropriate as a separate test of substantial abuse and should be retained in whatever statutory amendment that is adopted. But the addition of other tests to the surplus income test as a dual standard has not, I believe, been adopted by the courts in any meaningful way—nor should it be. Courts have not adopted (and should not adopt) any of the various totality of the circumstances tests identified in the preceding part. In many cases, the tests are not considered at all; in others, the tests are articulated but not applied; and in others, the application is essentially meaningless. The totality of the circumstances test can hardly be sustained by the rare cases in which the courts have found the existence of surplus income and then required the satisfaction of other criteria in order to dismiss a Chapter 7 case for substantial abuse.

VI. Articulating a Clearer Doctrine of Substantial Abuse

A. *Policy Concerns and Legislative Goals*

This Article argues that the courts have manifestly adopted a doctrine which holds that a Chapter 7 case should be dismissed if the debtor has surplus income sufficient to pay all or a substantial part of his obligations—or where the debtor has engaged in acts of bad faith towards the Code. Such a debtor does not deserve the benefit of a Code designed 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."[192] Courts have not infrequently said that they look for other factors, but, in reality, almost never do. They often give lip service to a totality of the circumstances test, but fail to apply it where the debtor has a surplus amount of income. Where courts consider circumstances other than income, such consideration is generally in the lowest jurisdictional courts in the federal system, the bankruptcy courts, which do not operate uniformly enough to create or apply a doctrine.

191. *See supra* note 169 and accompanying text.

192. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554-55 (1915)).

The courts' confusing rhetoric works a great disservice to the bankruptcy system. The courts stretch for a test of substantial abuse of the Code. The abuse may be indicated by motion of the court itself or by the United States trustee.[193] Once the existence of substantial abuse is properly brought to the court's attention, its actual presence must be separately decided in each case. Certainly, such a task cannot be accomplished in a bankruptcy system that in 1997 measured 1,404,145[194] cases and is growing in 1998.[195] There are not enough judges and there is not enough time for § 707(b) to be applied on a "case-by-case" basis.[196]

If a substantial abuse test is to become meaningful, it must be applied in a relatively mechanistic manner, as is most of the remainder of the Code,[197] and it must be based upon the dominant test of surplus income. A revised § 707(b) must contain an income test that is precise and ascertainable. The Code may require a relationship of income to actual expenses or it may, as do some of the bills presented to Congress, establish a test in accordance with certain established norms.[198] The Code will set out the test, but the mechanical form of presentation should probably be contained in the Official Forms which determine the essential manner that information is disclosed to the court. For example, with a precise requirement for the disclosure of income on the one hand and expenses on the other, the amount that is not required for basic enjoyment of the fresh start can be ex-

193. *See* 11 U.S.C. § 707(b) (1994).

194. In 1984, it was anticipated that § 707 (b) would "make bankruptcy a far less attractive option for the consumer debtor." Breitowitz, *supra* note 99, at 329. That this did not occur may well have been due to the escalating cases and their inappropriate relationship to § 707(b).

195. *See Consumer Bankruptcy Reform on the Hill*, Bank. L. Letter, May 1998, at 5. Two 1998 studies, one by SMR Research of Budd Lake, N.J. and the other by Columbia University conclude that the rate of bankruptcy filings will decrease into 1999. The former study predicts that the actual number of cases will diminish in 1999. Other studies predict that the rise will continue, perhaps at a lower rate. *See* Heather Timmons, *Studies Say Refis, High-LTV's Could Cut Bankruptcy in '99*, Am. Banker, Aug. 10. 1998, at 1, 12.

196. "Ultimately, the question of whether or not a substantial abuse exists can only be determined on a case-by-case basis . . . ." *In re* Ploegert, 93 B.R. 641, 642 (Bankr. N.D. Ind. 1988).

197. The problem with case-by-case determination has appeared in the cases. For example, one court has commented:

> Congress rejected this [mandatory Chapter 13] proposal, at least in part, because its adoption would have laid an unbearable burden on the bankruptcy court system as presently constituted. That system depends for its viability upon the administrative disposition without significant intervention by the bankruptcy judge, of the great bulk of consumer Chapter 7 cases. To require that official to review every Chapter 7 case and make the kind of careful determination required in determining whether a successful Chapter 13 case could be maintained by the debtor, would call for a great expansion of manpower, and consequent expense, in the bankruptcy court system.

In re Deaton, 65 B.R. 663, 665 (Bankr. S.D. Ohio 1986).

198. *See infra* Part VI.B. (discussing H.R. 3150).

posed. If a substantial abuse is disclosed, a Chapter 7 discharge should be—and can easily be—denied.[199]

The degree by which income exceeds actual or statutorily established expenses in order to dismiss the Chapter 7 plan is beyond the scope of this Article and an issue that is unnecessary to its thrust.[200] The cases have employed a number of different tests when dealing with actual expenses. Some base their findings upon income sufficient to fund a Chapter 13 plan covering outstanding obligations in varying percentages;[201] others require payment of "all of her or his creditors within a reasonable time,"[202] yet others simply look for the ability to pay a "meaningful part"[203] or "all or a substantial proportion"[204] of outstanding obligations. While the amount of surplus income is, of course, an important number and consequential to the final legislative product, this is a computation that can be negotiated in the process of legislative drafting.

B. *Recent Legislation*

House Bill 3150, passed by the House of Representatives on February 3, 1998, does not base its determination of substantial abuse upon the debtor's actual expenses as related to his income. Rather, the following are deducted from the debtor's future monthly income: (i) the "expense allowances under the applicable National Standards, Local Standards and Other Necessary Expenses allowance (excluding payments for debts), issued by the Internal Revenue Service . . . in the area in which the debtor resides, . . . (ii) payments on account of secured creditors and . . . (iii) priority payments."[205] If the remainder

199. Chapter 13 and its availability need not be part of this approach. Some cases have not dismissed a Chapter 7 plan because the debtor is for some reason unavailable for Chapter 13. *See In re* Kelly, 841 F.2d 908 (9th Cir. 1988); *In re* Williams, 155 B.R. 773 (Bankr. D. Idaho 1993); *In re* Wegner, 91 B.R. 854 (Bankr. D. Minn. 1988); *In re* Mastroeni, 56 B.R. 456 (Bankr. S.D.N.Y. 1985). Whether whatever surplus income may be found is sufficient to fund a Chapter 13 plan is not particularly relevant to the instant inquiry. It is within the discretion of the debtor, once a Chapter 7 plan is rejected, whether he wishes to pay expenses outside of bankruptcy or whether he wishes to enter into Chapter 13. The choice is not imposed by the court and such issues as whether a mandatory Chapter 13 represents unconstitutional slavery are inapplicable.

200. Other commentaries on this subject contain pronounced views on what the test should be. *See, e.g.*, Balser, *supra* note 150, at 1029 (recommending that the income be sufficient to pay 100% of the obligations within three years).

201. *See In re* Andrus, 94 B.R. 76, 78 (Bankr. W.D. Pa. 1988) (discussing cases where available Chapter 13 plans would cover between 68% and 100% of outstanding obligations).

202. *In re* Zaleta, 211 B.R. 178, 181 (Bankr. M.D. Pa. 1997); *see also In re* Barnikow, 211 B.R. 176, 177-78 (Bankr. M.D. Pa. 1997) (accompanying case).

203. *In re* Struggs, 71 B.R. 96, 97 (Bankr. E.D. Mich. 1987).

204. *In re* Ploegert, 93 B.R. 641, 643 (Bankr. N.D. Ind. 1988).

205. H.R. 3150, 105th Cong. § 101(3) (1998).

can repay twenty percent or more of unsecured nonpriority claims, the Chapter 7 plan is dismissed.[206]

In the Senate version of this bill, passed September 23, 1998,[207] a lesser degree of specificity is required.[208] Upon a finding of abuse of Chapter 7 (no longer *substantial* abuse as in current law) the court may either dismiss the case or, without the debtor's consent, move the case to Chapter 13.[209] In deciding whether there is an abuse, the court shall consider whether the debtor's future income would enable it to pay thirty percent of the non-priority claims.[210] Although the thirty percent test is a clear benefit over the generalities of existing law, I believe that the Senate bill still contains too much in the way of judicial discretion to be workable in today's bankruptcy regime.

House Bill 3150 also contains an alternate basis for dismissal of a Chapter 7 case. Even if a debtor's income is insufficient to fund the twenty percent standard as above, the court will find that there is an inappropriate use of the provisions of Chapter 7 and the case will be dismissed if "the totality of the circumstances of the debtor's financial situation demonstrates such inappropriate use."[211] By retaining the existing generalized approach that the penalties may be imposed in the event of abuse of Chapter 7, the Senate version also contains an alternate basis.[212] As previously noted, these are reasonable alternate tests.[213] A second or alternative test basing substantial abuse upon real bad faith (or a totality of the circumstances) might be appropriate for cases in which surplus income does not exist but the debtor exhibits other affronts against appropriate application of Code relief. These are truly unusual situations, judgeable on a case-by-case basis, and can be so handled in the Code without undercutting the essential test—the existence of surplus income sufficient to pay all or a substantial portion of debtor's outstanding liabilities. The nature of the abuse need not be defined—as the nature of bad faith is typically not prescribed—and the standard need not be restrictively applied.[214]

This Article posits that a substantial abuse test of the sort now contained in § 707(b) simply cannot be administered to the excess of bankruptcies pending in the United States unless it is made more mechanical. If such a test were established, however, one may well ask, "What of the abused consumer?" It is impossible to define all

206. *See id.*
207. *See* S. 1301, 105th Cong. (1998).
208. *See id.* § 102.
209. *See id.*
210. *See id.*
211. H.R. 3150, 105th Cong. § 103.
212. *See* S. 1301, 105th Cong. § 102.
213. *See supra* Part V.B.
214. Applicable circumstances might include, for example, unrestrained spending before the bankruptcy, living without regard for the limitations of one's income, fraud in the bankruptcy filing itself, efforts to secrete assets, etc.

cases with appropriate equity under one umbrella test. It may, therefore, be that individual consumers will experience unusual or unexpected problems that make dismissal of their Chapter 7 case unfair. An amended Code should probably contain a provision for the debtor to introduce some equitable reason—such as the presence of some dominating personal need—why, even in the face of surplus income, his Chapter 7 should not be dismissed.[215] Such cases undoubtedly should be handled on a individual basis but it will exemplify the exception rather than the rule.[216]

House Bill 3150 does contain such a provision. Section 101's definition of projected monthly net income contains the concept of "extraordinary circumstances" that can be utilized to adjust the debtor's surplus income designated for the benefit of unpaid creditors.[217] This is not the only available approach to the problem, but it does illustrate one solution.

Conclusion

This Article maintains that if a consumer debtor in a Chapter 7 case has sufficient income to pay all or a substantial part of his creditors after satisfying his own expenses of living, he should not receive a Chapter 7 discharge. It is also my position that this viewpoint is supported by § 707(b) of the Code and has already been adopted by the United States courts. Courts frequently announce expansions of this test—such as the additional factors that constitute the "totality of the circumstances"—that are mere legal window-dressing, and that do not add to or subtract from the fundamental standard for denial of discharge. Cases truly applying these additional factors are so few and far between that they do not amount to what can seriously be called a legal doctrine.

To recognize that a Chapter 7 discharge is unavailable when the debtor can pay his creditors serves the additional function of putting Chapters 7 and 13, the two major avenues for debtor bankruptcy relief, and Chapter 11 (a lesser but growing consumer resort)[218] into clearer consistency. While there obviously are differences among the

215. It has been argued that extenuating circumstances of this nature should be more broadly applied in the Code. According to this argument, a debtor may commit fraud because of pressing personal needs and the § 523 exemption from discharge should not be applied. *See* Luther Zeigler, *The Fraud Exception to Discharge in Bankruptcy: A Reappraisal*, 38 Stan. L. Rev. 891, 903 (1986).

216. Similarly, undue hardship may make educational loans dischargeable. *See* 11 U.S.C. § 523(a)(8) (1994).

217. H.R. 3150, 105th Cong. § 101(4) (1998).

218. *See* Toibb v. Radloff, 501 U.S. 157 (1991) (holding that the Code's plain language permits individual debtors not engaged in business to file for relief under Chapter 11); *In re* Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (holding that post-petition, pre-confirmation earnings of a debtor who had filed as an individual under Chapter 11 were included in the property of the estate).

three chapters in various respects (otherwise they would not exist separately), it is not an acceptable distinction that a debtor with income should pay creditors under one but retain his income and not pay under the others. As already noted, present law does not dictate such a result. The cases reject it under Chapter 7. Under Chapter 11, it is inequitable for a debtor to retain substantial amounts of income for the technical reason that it is not included in the bankruptcy estate.[219] Under Chapter 13, if a creditor objects to a plan, the creditor must either be paid in full or it must be demonstrated that the debtor will apply all of his projected disposable income for three years to payments under the plan.[220] To recognize that a debtor must commit available income under 7 as well as under 13 simply raises an existing consistency to the surface.

If the concept is going to be reasonably applied in United States bankruptcy law, however, it cannot be addressed—as courts profess to address it today—on a case-by-case basis. There are too many cases for such an approach. A mechanical test must be created for this purpose. Fortunately, the nature of surplus income and of creditors' obligations indicate that such a test is well within our reach. Indeed, modern bankruptcy bills do create an approach of this type.

It is further asserted here that a mechanical test that prescribes dismissal of a Chapter 7 case in situations where income can be applied to a substantial part of unsecured obligations is not novel to bankruptcy law. Rather, such a test would clarify and refine the courts' current approach to Chapter 7 dismissals. Many possible approaches to the surplus income test exist, some of which appear in recently enacted and pending bills. If this review of existing bankruptcy law is considered and found acceptable, creative minds can join together in a continuing refinement process so that those who can pay their debts will assume their social responsibilities.

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219. *See In re* Weber, 209 B.R. 793 (Bankr. D. Mass. 1997).

> [T]he fact that a debtor's postpetition earnings are not property of the estate does not mean that the court is precluded from considering those earnings in connection with a determination of a debtor's good faith in proposing a plan. . . . [T]his Court believes that the disposable income test, while it cannot constitute a bright line for determining good faith in all individual Chapter 11 cases, is useful as a guideline to determine whether a debtor has committed sufficient available resources to a plan.

Id. at 798-99.

220. *See* 11 U.S.C. § 1325(b)(1).