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NOTES

BANKRUPTCY—1970 Amendments to the Bankruptcy Act—An Attempt To Remedy Discharge Abuses

December 18, 1970, marked the end of a fifteen-year chapter in the history of American legislative proceedings dealing with “personal” bankruptcy.1 On that date Public Law Number 91-4672 took

1. Following the practice of writings on this topic, the terms “personal,” “consumer,” and “nonbusiness” bankruptcy are used interchangeably to indicate those bankruptcy proceedings not connected with any business activity other than wage earning.


Sec. 1. Clause (12) of subdivision a, section 2, of the Bankruptcy Act (11 U.S.C. 11(a)(12)) is amended to read as follows:

“(12) Discharge or refuse to discharge bankrupts, set aside discharges, determine the dischargeability of debts, and render judgments thereon;”.

Sec. 2. Subdivision b of section 14 of the Bankruptcy Act (11 U.S.C. 32(b)) is amended to read as follows:

“b. (1) The court shall make an order fixing a time for the filing of objections to the bankrupt’s discharge and a time for the filing of applications pursuant to paragraph (2) of subdivision c of section 17 of this Act to determine the dischargeability of debts, which time or times shall be not less than thirty days nor more than ninety days after the first date set for the first meeting of creditors. Notice of such order shall be given to all parties in interest as provided in section 58b of this Act. The Court may, upon its own motion or, for cause shown, upon motion of any party in interest, extend the time or times for filing such objections or applications.

“(2) Upon the expiration of the time fixed in the order for filing objections or of any extension of such time granted by the court, the court shall discharge the bankrupt if no objection has been filed and if the filing fees required to be paid by this Act have been paid in full; otherwise, the court shall hear such proofs and pleas as may be made in opposition to the discharge, by the trustee, creditors, the United States attorney, or such other attorney as the Attorney General may designate, at such time as will give the bankrupt and the objecting parties a reasonable opportunity to be fully heard.”

Sec. 3. Section 14 of the Bankruptcy Act (11 U.S.C. 32) is amended by adding at the end thereof the following new subdivisions:

“f. An order of discharge shall—

“(1) declare that any judgment theretofore or thereafter obtained in any other court is null and void as a determination of the personal liability of the bankrupt with respect to any of the following: (a) debts not excepted from the discharge under subdivision a of section 17 of this Act; (b) debts discharged under paragraph (2) of subdivision c of section 17 of this Act; and (c) debts determined to be discharged under paragraph (3) of subdivision c of section 17 of this Act; and

“(2) enjoin all creditors whose debts are discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt.

“g. An order of discharge which has become final may be registered in any other district by filing therein a certified copy of such order and when so registered shall have the same effect as an order of the bankruptcy court of the district where registered and may be enforced in like manner.

“h. Within forty-five days after the order of discharge becomes final the court shall give notice of the entry thereof to all parties in interest as specified in subdivision b of section 58 of this Act. Such notice shall also specify the debts, if any, theretofore determined by the court to be nondischargeable, the debts, if any, as to which applications to determine dischargeability are pending, and those contents of the order of discharge required by subdivision f of this section.”

[1347]
effect and thereby instituted changes in the Bankruptcy Act designed to "effectuate more fully the discharge in bankruptcy by rendering it less subject to abuse by harassing creditors." The legislative steps leading to the 1970 amendment began with the introduction of the first "dischargeability" bill in 1955. This initial effort at reform stimulated a continuing flow of similar proposals leading to the ultimate acceptance of new substantive and

Sec. 5. Clauses (2), (5), and (6) of subdivision a of section 17 of the Bankruptcy Act (11 U.S.C. 35(a) (2), (5), (6)) are amended to read as follows:

"(2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another;"

"(5) are for wages and commissions to the extent they are entitled to priority under subdivision a of section 64 of this Act;"

"(6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment;"

Sec. 6. Subdivision a of section 17 of the Bankruptcy Act (11 U.S.C. 35(a)) is amended by adding at the end thereof the following new clauses:

"(7) are for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female or for breach of promise of marriage accompanied by seduction, or for criminal conversation; or

"(8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision."

Sec. 7. Section 17 of the Bankruptcy Act (11 U.S.C. 35) is amended by adding at the end thereof the following new subdivisions:

"c. (1) The bankrupt or any creditor may file an application with the court for the determination of the dischargeability of any debt.

"(2) A creditor who contends that his debt is not discharged under clause (3), (4), or (8) of subdivision a of this section must file an application for a determination of dischargeability within the time fixed by the court pursuant to paragraph (1) of subdivision b of section 14 of this Act and, unless an application is timely filed, the debt shall be discharged. Notwithstanding the preceding sentence, no application need be filed for a debt excepted by clause (8) if a right to trial by jury exists and any party to a pending action on such debt has timely demanded a trial by jury or if either the bankrupt or a creditor submits a signed statement of an intention to do so.

"(3) After hearing upon notice, the court shall determine the dischargeability of any debt for which an application for such determination has been filed, shall make such orders as are necessary to protect or effectuate a determination that any debt is dischargeable and, if any debt is determined to be nondischargeable, shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof. A creditor who files such application does not submit himself to the jurisdiction of the court for any purposes other than those specified in this subdivision.

"(4) The provisions of this subdivision c apply whether or not an action on a debt is then pending in another court and any party may be enjoined from instituting or continuing such action prior to or during the pendency of a proceeding to determine its dischargeability under this subdivision.

"(5) Nothing in this subdivision c shall be deemed to affect the right of any party, upon timely demand, to a trial by jury where such right exists.

"(6) If a bankruptcy case is reopened for the purpose of obtaining the orders and judgments authorized by this subdivision, no additional filing fee shall be required."

procedural rules for discharge in bankruptcy. Prior response to the changes embodied in such proposals ranged from the belief that they were “revolutionary” to the view that they were merely a beneficial “updating [of] the procedural aspects of the discharge.”

If the changes made by Public Law Number 91-467 were revolutionary, they effected a surprisingly quiet revolution: in both the House and the Senate, bills containing the reforms were favorably reported out of committee without hearings and were passed in their respective chambers without debate. However characterized, these recent amendments will have marked economic effects upon both lenders and consumer-borrowers. Consequently, this recent legislation warrants examination. To provide meaningful analysis, it is first necessary to examine the previous form and function of bankruptcy discharge as it applied to consumers.

The hallmark function of a nonbusiness bankruptcy can be described in one word: discharge. This device for attaining a new, debt-free economic life has changed very little since its origin in eighteenth-century England when chapter seventeen of the statute of 4 Anne provided that

[all] and every person and persons so becoming bankrupt ... who shall ... surrender him, her or themselves ... and in all things conform as in and by this act is directed, shall be ... discharged from all debts ... due and owing at the time ... [of bankruptcy].

The modern bankrupt “surrenders” himself to the process through a debtor’s petition, which includes a schedule of his provable debts, the names of the bankrupt’s creditors, and his assets. The petition concludes with a prayer for an adjudication of bankruptcy, which, for a personal bankrupt, affords a virtually automatic

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8. Although Chapter XIII wage earners’ plans do not usually involve discharge, they are not as widely utilized as straight bankruptcy. See, e.g., Hearings on H.R. 6665 and H.R. 12250 Before Subcomm. No. 4 of the House Comm. on the Judiciary, 91st Cong., 1st Sess. 27 (1969) [hereinafter 1969 House Hearings].
11. It is important to keep in mind the fact that the Bankruptcy Act does not apply to all debts but only to those that are “provable” as defined in § 63 of the Act, 11 U.S.C. § 103 (1964).
discharge. Once the petitioner has been adjudicated a bankrupt, the court orders a prorata distribution of his nonexempt assets among his creditors. Any remaining unsatisfied portion of such debts is discharged and is no longer collectible by legal processes.

Through this process, the bankrupt effectively trades his current assets for freedom from past debts and, in this sense, begins his economic life anew. This desirable result, however, is not easily obtained by every debtor. In addition to the deterrent effect of whatever moral stigma may attach to a bald admission of economic failure, invocation of the bankruptcy court's dramatic process is governed by substantial limitations. For example, the system may generally be utilized only at six-year intervals. Further, because the generally accepted theory underlying discharge in bankruptcy is that only "honest men" should be given relief from "honest debts," it follows that some men should not be able to free themselves of their debts simply by surrendering their current assets and that no one should be relieved of certain types of debt. To enforce such criteria, section 14 of the Bankruptcy Act establishes specific threshold limitations on the availability of the discharge process and section 17 of the Act enumerates particular classes of debt that are not extinguished by the discharge proceeding and that remain enforceable at law even though a general discharge has been obtained.


15. See text accompanying note 57 infra.

16. The bankrupt is not totally stripped of his possessions. Section 6 of the Bankruptcy Act, 11 U.S.C. § 24 (1964), recognizes certain state and federal exemptions—which supposedly leave the bankrupt with sufficient means to start anew. For an examination of the operation of this exemption provision, see R. DOLPHIN, AN ANALYSIS OF ECONOMIC AND PERSONAL FACTORS LEADING TO CONSUMER BANKRUPTCY 35-36 (1965).


19. 11 U.S.C. § 35 (1964), as amended, 11 U.S.C.A. § 35 (Supp. 1971). In brief, the provable debts not affected by discharge are those for (1) taxes; (2) liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting the debtor's financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another; (3) debts not timely scheduled, unless the creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) liabilities created by fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity; (5) debts for wages and commissions that have been earned within three months before the date of commencement of the proceedings in bankruptcy; (6) moneys of an employee received or retained by his employer to secure performance of an employment contract; (7) liabilities for alimony, child support, seduction of an unmarried female, breach of promise of marriage coupled with seduction, or criminal conversation; and (8) liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) above.
granted. While the recent legislation considered in this Note is primarily relevant to the operation of section 17, a preliminary examination of section 14 is needed in order to understand properly the functional differences between the two sections and to provide the necessary historical background for the problems that Congress sought to remedy through the adoption of Public Law Number 91-467.

Prior to amendment in 1960, section 14c(3) denied a discharge to anyone who had "obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition." During the 1950's, when nonbusiness bankruptcy became acceptable as an alternative to unmanageable debts, a major inequity in the application of section 14 to personal bankrupts became evident. The original congressional intent manifested in section 14 was that only palpably dishonest men should be denied the advantages of discharge. However, in actual application, the section 14 prohibition against discharge for debts based on false financial statements frustrated that intent for two reasons. First, the average nonbusiness borrower, and particularly the one in need of a discharge through bankruptcy, was not knowledgeable in financial matters. The false financial statements that such borrowers frequently filed generally reflected a lack of financial sophistication rather than a fraudulent design. Second, some lenders tacitly or explicitly encouraged borrowers to be less than thorough in completing financial statements. Such a creditor could then threaten to bring the arguably false statement before the bankruptcy court, which could use section 14 to deny the debtor discharge from any debts, unless the debtor made arrangements to bind himself to complete payment of the creditor's claim. Any debtor not willing to risk an adverse finding by the bankruptcy court would find it advantageous to settle such a claim out of court even though its collectibility might be legally tenuous.

Hoping to remedy this problem, Congress passed the Celler Amendment of 1960. This amendment restricted the operation of

22. See 1969 House Hearings, supra note 8, at 26-29 for illustrations of the rapid upswing in the number of personal bankruptcies.
24. For a sampling of the criticism directed at the operation of § 14 prior to amendment in 1960, see Personal Indus. Loan Corp. v. Forgay, 240 F.2d 18, 19-20 (10th Cir. 1966); IA W. COLIER, BANKRUPTCY ¶ 17.28, at 1725-26 (14th ed. rev. 1971); Friebolin, Re-Examination of Section 14c(3) as a Ground for Objection to Discharge, 39 MINN. L. REV. 673 (1955); Note, Bankruptcy Act: Abuse of Sections 14c(3) and 17a(2) by Small Loan Companies, 82 IND. L.J. 151 (1957).
section 14c(3) to those debtors who “while engaged in business . . . obtained for such business money or property . . . by making . . . a materially false . . . [financial statement].” Thus, the existence of a false financial statement alone would not preclude a nonbusiness bankrupt from obtaining a discharge in bankruptcy. However, the amendment did not provide that debts actually incurred on the basis of false financial statements were automatically discharged with other debts. While a general discharge was available under section 14, any particular debt obtained through a false financial statement was excepted from discharge by amended section 17. Therefore, after adoption of the Celler Amendment, the relationship between a debtor and a creditor arising from a debt based on a false financial statement was defined by section 17 rather than by section 14. Unfortunately, this relocation of emphasis failed to eliminate all of the abusive practices involving false financial statements. Instead, a potential for misuse inherent in the structure of section 17 was utilized by creditors to continue the coercive role of false financial statements in consumer bankruptcy situations. This structural defect, and the abusive practices that it made possible, prompted the reforms contained in the 1970 amendment to section 17. Accordingly, the nature of the problem created by old section 17 requires careful examination.

Although the determination of the appropriateness of a general discharge in pre-1970 bankruptcy proceedings was made according to nationally uniform section 14 criteria, prior to the recent amendments the effect of such a discharge upon any given debt was a matter for state court decision. This two-court process developed because


27. 11 U.S.C.A. § 35(a)(3) (Supp. 1971) (originally enacted as Act of July 12, 1960, Pub. L. No. 86-621, § 2, 74 Stat. 409). While the language of pre-1960 § 14 was explicitly incorporated into § 17a(2) to reflect the nondischargeability of debts founded on false financial statements, this change was largely superfluous; courts had previously concluded that false financial statements were subsumed by the false-representations clause of § 17a(2). See 1 A. W. COLLIER, BANKRUPTCY ¶ 17.01[3.1], at 1578 (14th ed. rev. 1971).

28. See text accompanying notes 36-40 infra.


30. There are two exceptions to this statement. Section 11a of the Bankruptcy Act, 11 U.S.C. § 29(a) (1964) provides that “[a] suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition by or against him, shall be stayed until an adjudication or the dismissal of the petition . . . .” To effectuate this provision, the bankruptcy court must determine whether a suit is founded upon a claim that would be released by discharge. This determination is usually made on the basis of pleadings in the court in which the claim was brought and is not binding upon future litigation. Thus, while the bankruptcy court may determine that a given debt subject to a suit at the time of petition for discharge is dischargeable, that conclusion will not prevent
even after a debtor had obtained a general discharge in bankruptcy he still could be sued on a debt in a state court and the discharge would be meaningless unless pleaded by the debtor as an affirmative defense.\textsuperscript{31} Furthermore, even when properly pleaded, the discharge did not terminate the debtor's liability if the creditor could prove that the debt was included in one of the nondischargeable categories enumerated in section 17.\textsuperscript{32} Consequently, the discharge, the bankrupt's key to a new life, had legal meaning only after certification by a state court that any particular debt was discharged. Under this system, a creditor who had participated in the bankruptcy proceedings and had taken his share of the bankrupt's surrendered assets could, by establishing that his debt was not dischargeable, subsequently sue for the balance of his claim.\textsuperscript{33} Alternatively, the bankruptcy proceedings could be bypassed altogether by a creditor who was willing to depend entirely upon a state court judgment for the satisfaction of his claim.\textsuperscript{34} The operation of this bifurcated system made possible a type of abuse similar to that which the Celler Amendment had sought to eliminate. As critics of the system suggested,\textsuperscript{35} the possibility of additional litigation in state courts decreased the utility of a discharge in bankruptcy and encouraged improper pressures on debtors to make out-of-court settlements. Consequently, while the 1960 legislation theoretically succeeded in eradicating improper creditor debt-collection leverage at the bankruptcy court level, similar pressures were effectively applied by creditors at the state court level after a general discharge had been obtained. As a result, the intended relationship between a consumer bankrupt and his creditor in the case of a debt based on an allegedly false financial statement became seriously distorted.

This distorted relationship permitted four types of abusive practices to develop. First, there existed the ubiquitous threat that im-

\textsuperscript{31} 1A W. Collier, Bankruptcy ¶ 11.04, at 1150 n.10 (14th ed. rev. 1971).

\textsuperscript{32} See note 20 supra and accompanying text.

\textsuperscript{33} 1A W. Collier, Bankruptcy ¶ 17.28, at 1725-26 (14th ed. rev. 1971).

\textsuperscript{34} Id.

\textsuperscript{35} See Hearings on S.J. Res. 100 before the Subcomm. on Bankruptcy of the Senate Comm. on the Judiciary, 90th Cong., 2d Sess. 17 (1968).
proper "sewer service" in a suit to collect a debt after bankruptcy proceedings would result in a default judgment for the creditor.36 Second, bankrupts often placed too much faith in a certification of discharge and believed that all scheduled debts had been finally discharged.37 Because of a false sense of security, bankrupts understandably tended to ignore properly served complaints and thus incurred default judgments.38 Third, even if a bankrupt was properly served and cognizant of the importance of the suit, having only recently surrendered himself and most of his assets to the bankruptcy court, he often was unwilling or unable to retain counsel for such subsequent state court suits.39 Finally, the majority of such suits were brought in lower-level state courts before judges often lacking familiarity with the important case law relating to section 17. As a consequence, creditors were able to obtain judgments on claims that should have been barred by the bankruptcy discharge.40

An additional, albeit rarely articulated, objection to the two-court process employed to ascribe meaning to a discharge stemmed from its effect on credit-granting practices. This objection assumed that—for the reasons discussed above—creditors were able to collect on debts that would have been discharged in a unitary system. It further assumed that the undue ability to collect debts after discharge under the two-court process contributed to spiraling bankruptcy rates by encouraging improvident credit-granting practices that would have been curtailed if the collection of high-risk loans was more difficult. The critics making this objection argued that the operation of the bankruptcy laws should strive to shift creditor emphasis and resources from attempts to collect on loans after discharge to closer credit investigations and more prudent credit-granting policies that might avoid consumer bankruptcy altogether.41 Conversely, creditors objected to the bifurcated system on a technical ground. They alleged that if a debt had been reduced to judgment prior to the bankruptcy proceeding, great difficulty was often encountered in convincing a second court, subsequent to bankruptcy, to look behind

37. Id.
38. See Phillips, Order of Discharge and Post-Bankruptcy Litigation, 16 MERCER L. REV. 409, 412-13 (1965). This misplaced reliance is not consonant with results of a study that revealed that more than 75% of the attorneys representing personal bankrupts initially counseled them in regard to the possible ineffectiveness of a discharge. 1969 House Hearings, supra note 8, at 92.
40. See, e.g., statement of Vern C. Countryman, Professor of Law, Harvard Law School, Vice-Chairman, National Bankruptcy Conference, 1969 House Hearings, supra note 8, at 65.
41. See, e.g., In re Caldwell, 33 F. Supp. 631, 635 (N.D. Ga. 1940). The underlying argument is that some borrowers should be denied credit for their own economic good. Lending institutions that become lax in screening out such borrowers contribute to the borrower's fiscal downfall, which may well end in bankruptcy.
that judgment in order to determine that the underlying debt did in fact fall within a nondischargeable category of section 17 and thus was still collectible.\textsuperscript{42}

These criticisms made clear to Congress that the Celler Amendment, although a good first step, was only one half of a needed reform. The 1960 legislation represented a reaction to intimations that creditors had misused leverage created by section 14 in order to distort the process by which a debtor could avail himself of a discharge in bankruptcy. Similarly, the 1970 legislation represented a reaction to suggestions that, although the path to the bankruptcy court and general discharge had been secured from abuse, the two-tiered system of making a discharge effective was likewise subject to improper practices that denied the discharge process much of its intended benefit.

In its second attempt at bankruptcy discharge reform, Congress moved directly against the shortcomings that were the sources of previous criticism. By amendments to sections 2, 14, 17, 38, and 58 of the Bankruptcy Act, the 1970 legislation empowers bankruptcy courts to define, in relation to particular debts, the exact meaning of the discharge of a bankrupt.\textsuperscript{43}

Prior to the 1970 amendment, section 17a(2) provided that a discharge would not release the bankrupt from obligations that were liabilities for (1) obtaining money or property by false pretenses or false representations; (2) obtaining credit or an extension or renewal of credit in reliance upon a materially false statement in writing respecting the debtor's financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive; (3) willful and malicious injuries to the person or property of another; (4) alimony or maintenance or support of wife or child; (5) seduction of an unmarried female; (6) breach of promise of marriage accompanied by seduction; or (7) criminal conversation.\textsuperscript{44} The 1970 amendment consolidates the prohibitions of the first two categories above into section 17a(2) of the Bankruptcy Act,\textsuperscript{45} creates a new paragraph seven for section 17a,\textsuperscript{46} com-


\textsuperscript{43} Although the legislation, as well as this discussion, is directed primarily to the dischargeability issue, two other areas are dealt with by the 1970 amendments. New § 17b, 11 U.S.C.A. § 35(b) (Supp. 1971), clarifies the status of debts in existence during two or more bankruptcy proceedings when the first proceeding did not result in discharge. Section 15, 11 U.S.C.A. § 33 (Supp. 1971), is amended to make more explicit the causes for which discharges, once granted, may be revoked. For a discussion of the amendments by one of its drafters, see Countryman, \textit{supra} note 30.


prised of the obligations found in categories four through seven above, and adds a new paragraph, 17a(8), for "liabilities for willful and malicious injuries to the person or property of another." This redesignation acquires significance through a new subdivision of section 17—subdivision c. Paragraph 1 of this new subdivision provides that either the bankrupt or any creditor may apply to the bankruptcy court for determination of the dischargeability of any debt. Paragraph 2 requires that any creditor contending that he holds a debt made nondischargeable by clauses (2), (4), or (8) of section 17a file an application with the bankruptcy court for a determination of the dischargeability of that debt. The court is directed to set a time limit within thirty to ninety days after the first meeting of creditors for the filing of such applications. If such application is not filed within the time set by the court, the exceptions covered by clauses (2), (4), and (8) of section 17a may not be asserted at a later time. A creditor who does file a timely application under either subdivision c(1) or c(2) of section 17 submits himself to the jurisdiction of the court only for the purpose of that application. Either party may, upon demand, obtain a jury trial when such right exists. Also, although section 17a(2) requires that a determination of dischargeability occur at a point in time close to the initial petition of the debtor, requests under section 17c(1) for determinations of dischargeability may occur long after the initial trip to the bankruptcy court. If such delayed relief is sought, the customary filing fees are waived.

In dealing with an application for determination of discharge-

49. New section 17a(2) deals with false financial statements, willful and malicious conversion, and obtaining money or property through false pretenses; § 17a(4) deals with fraud, embezzlement, and misappropriation or defalcation while acting as an officer or in any fiduciary capacity; and § 17a(8) deals with willful and malicious injuries except conversion. 11 U.S.C.A. §§ 35(a)(2), (4), (8) (Supp. 1971). See note 2 supra.
51. Bankruptcy Act § 17c(2), 11 U.S.C.A. § 35(c)(2) (Supp. 1971). See note 2 supra. However, § 17c(2) excepts claims under § 17a(8) if a suit is pending in another court and there exists a right to jury trial that either has been invoked or will be invoked. In that case, the § 17c(2) application for bankruptcy court determination of dischargeability is not mandatory, and that determination will be left to the court in which suit is pending.
While the amendment itself states that debts for which no application is filed under the authority of § 17c(2) will be discharged, that language is slightly misleading. A general discharge will be granted; however, later suit on the debt is still permissible if a § 17a exception other than those of clauses (2), (4), and (8) is asserted. As a practical matter, the discharge is virtually assured since few creditors will be in a position to assert those remaining § 17 grounds for exception to discharge.
ability under either section 17c(1) or (2), the bankruptcy court is empowered, after a hearing, to take the appropriate action in regard to the debt in question. If the debt is determined to be nondischargeable, the court must proceed to resolve any remaining issues and to render judgment upon the debt. The court also has the ancillary power to make any orders necessary to enforce the judgment. If it is decided that the debt is dischargeable, either by reason of the creditor's failure to make a timely application for an exception or by virtue of the merits as determined at the hearing, the accompanying order of discharge makes null and void—as against the bankrupt personally—any previous or subsequent judgment in any other court and enjoins any further action or process to collect the debt in question. The order of discharge may be registered in any district court by filing a certified copy of the order with that court; the registered order has the same effect as any order of the bankruptcy court of that district. Concurrent actions in other courts are deemed to have no effect upon the operation of the bankruptcy court in applying new subdivision c, and the bankruptcy court may enjoin such proceedings.

A simplified model may be used to illustrate the operation of the current procedure for nonbusiness bankruptcy. Following the filing of the debtor's petition and notification of all creditors listed therein, any creditor may object to a general discharge. Assuming that the hypothetical debtor has not run afoul of section 14 and that all other prerequisites are satisfied, a general discharge will be granted. At this point, the changes made by the recent legislation become important. Any creditor holding a debt alleged to be nondischargeable because of false pretenses or representations, false financial statements, willful conversion, fiduciary fraud, or willful injury at the inception of the obligation—i.e., any of the grounds covered in section 17a(2), (4), or (8)—must file an application with the court requesting determination of the dischargeability of that debt or else accede to the future nonavailability of such objections. In addition, the dischargeability of any other debt put in issue before the bankruptcy court by either the creditor or the debtor will be assessed at this time. Following determination by the court of these matters, judgment will be entered on any debt specifically found nondischargeable, and injunctions prohibiting future attempts to collect

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60. See note 20 supra and accompanying text and note 49 supra.
upon debts determined to be dischargeable will be issued. Any debts remaining after this process fall into one of two categories: (1) discharged and subject to the noncollection injunction; or (2) nondischargeable as liabilities for alimony, maintenance or support, or for any of the remaining section 17 exceptions. After such determinations by the bankruptcy court, no attempt may be made to collect any scheduled and provable debt without violating the bankruptcy court's injunction unless such an attempt is coupled with an assertion that the basis of the debt is within the scope of the remaining section 17 exceptions.

Earlier attempts to institute the reforms embodied in the 1970 amendments to the Bankruptcy Act were met with three basic objections. The first of these was that compelling either the bankrupt or the creditor to submit such questions of fact to a summary bankruptcy hearing would constitute an unjust deprivation of the right to trial by jury. The second objection was that the previous proposals did not authorize the bankruptcy courts to enter judgment in favor of a creditor whose debt was found nondischargeable and thus required further proceedings in another forum to obtain that judgment. Finally, it was feared that there would be a marked increase in litigation in the bankruptcy courts, causing inordinate delays, inconvenience, and expense to all parties concerned, if the reforms were adopted.

The first two of these objections are inapplicable to Public Law Number 91-467 because the right to jury trial, when appropriate, and power in the bankruptcy court to enter judgments on nondischargeable debts are explicitly granted by the amendments to section 17 of the Act. The third major criticism has been met with the observation that the referees in bankruptcy are quite ready to shoulder any increase in workload. Although this as-
sertion is something less than an overwhelming reply to the objection raised, it may actually be an adequate response because the floodgate or "jamming-the-bankruptcy-dockets" objection largely ignores the purposes behind the reforms.68 If it is the case that many attempts to except debts from discharge are motivated by hopes of obtaining an "improper" judgment through coercive leverage,69 then eliminating that leverage will bring about a sharp decline in the incidence of litigation. A determination whether this is an adequate justification for the measures taken by Public Law Number 91-467 and a sufficient response to the third objection requires an examination of the reasoning behind the conclusion that "improper" bankruptcy actions will be curtailed by the recent amendments.

An assumption basic to the conclusion that the 1970 amendments will prevent "improper" suits and thereby reduce rather than increase the docket burden in the bankruptcy courts is that a large portion of the objections to discharge were brought (and would otherwise continue to be brought) under the false-financial-statement and false-representation clauses of old section 17.70 While it is clear that no adequate empirical evidence exists on this point,71 experienced bankruptcy referees estimate that somewhere between eighty and ninety per cent of all dischargeability cases were based upon these exceptions.72 There is even less empirical support for the conclusion that expectations of improper judgments motivate these suits. Except for a great deal of conclusory language about the motives of some creditors—particularly small-loan companies73—there are no available credible indications that a desire to capitalize upon structural deficiencies in the law rather than legitimate good-faith

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68. Countryman, supra note 30, at 22.
69. See notes 36-40 supra and accompanying text.
70. Although the grant of exclusive jurisdiction to the bankruptcy court includes clauses (4) and (8) of section 17a as well as the false-financial-statement exception found in clause (2) (see notes 49-51 supra and accompanying text), it was clearly the misuse of the latter section that drew congressional attention and evoked action. While Professor Countryman, writing after the fact, explains the inclusion of clauses (4) and (8) (Countryman, supra note 30, at 12-17), his statement at the most recent hearings on the dischargeability issue spoke only to the presence of abuses in regard to the exceptions found in clause (2). 1969 House Hearings, supra note 8, at 66-67. When acting on the legislation, Congress believed that the serious abuses that it sought to correct revolved around assertion of the false-representation and false-financial-statement exceptions. 1970 S. REP., supra note 3, at 2.
71. "There is, of course, no statistical evidence [on the invocation of these exceptions] . . . . I don't know how such statistics could be compiled." Testimony of Professor Vern C. Countryman, 1969 House Hearings, supra note 8, at 75.
72. See, e.g., testimony of Referee Cowans, Hearings on S. 578, S. 1316, and H.R. 2517-19 Before the Subcomm. on Bankruptcy of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess. 78 (1967) (95%); testimony of Royal E. Jackson, id. at 24 (90%); Friebolin, Re-Examination of Section 14c(2) as a Ground for Objection to Discharge, 39 MINN. L. REV. 673 (1955) (80-90%—a poll of referees).
73. See note 24 supra and accompanying text.
claims brings creditors into the bankruptcy courts. Although there is a clear potential for abuse in the two-court system of effectuating discharge, there is scant evidence regarding the realization of that potential. It should, however, be noted that the hypothesis that any abuses that do occur take place in nonrecord state courts is at least consistent with an inability to cite exact numbers to support the theory. Therefore, because of the paucity and seeming unavailability of desirable hard data, one must either accept or reject conclusions central to evaluating the recent legislation on the strength of little more than intuition and faith. While eliminating even unrealized potential for abuse is a generally laudable goal, in this instance the desirability of the reform measure seems to depend at least in part upon the existence of genuine abuses. If there have been only few improper creditor attempts to except debts from discharge, which will be curtailed by eliminating the hope of succeeding in such improper suits, the transference of a substantial number of new proceedings to the bankruptcy courts may well have the disruptive effects hypothesized by some critics.

If, however, one accepts, as did Congress, the joint propositions that the majority of creditor attempts to avoid discharge of a debt occur under the false-representation and false-financial-statement provisions of section 17 and that these efforts are motivated by the desire to secure an improper judgment through the coercive leverage implicit in a two-court system of effecting discharge, the 1970 legislation seems both practical and desirable. Unintended defaults should be eliminated by the notice requirements and procedures of the bankruptcy courts. It also seems improbable that a debtor would fail to appear at a hearing to determine dischargeability under the mistaken assumption that his discharge protected him when that hearing is conducted under the authority of the bankruptcy court and occurs—at least in time sequence—as a part of the discharge process. And, in the case of later hearings authorized by section 17c (1), the authority of the bankruptcy court may serve to impress the debtor with the importance of his appearance. Further, there can be little doubt that the level of competence and accountability of the bankruptcy bench surpasses that of lower-level state courts. Finally, it seems at least probable that the costs of a dischargeability hearing roughly contemporaneous with the obtaining of a general discharge

74. See note 71 supra and accompanying text.
75. See text accompanying note 66 supra.
76. See text following note 42 supra.
77. See text accompanying notes 48-54 supra.
78. At any rate, if most cases fall into the false-representations category, they will take place almost contemporaneously with the grant of general discharge. See notes 50 & 51 supra and accompanying text.
79. See text accompanying note 40 supra.
will be lower than the costs of such a suit brought a considerable
time after the initial encounter with the bankruptcy court.\textsuperscript{80} These
operational factors, taken together, should effectively insulate the
discharge process from creditor ability—real or imagined—to collect
on debts that are properly dischargeable. Thus, procedurally at least,
the 1970 reform legislation seems to effectuate the desired congressional
purpose.

It remains troublingly apparent, however, that the advantages
discussed above would apply just as well to the other section 17 exceptions as to those found in clauses (2), (4), and (8). Why has
Congress been so parsimonious in the breadth of its reform? Al­
though it may be that change should be limited to those areas in
which the envisioned harms are most prominent, the grant of jurisdic­tion in section 17\textsuperscript{81} does not seem directly responsive to this
logic. Although the harm uppermost in congressional concern was
creditor abuse of the false-financial-statement exception, the exclu­sive federal determination of dischargeability includes paragraphs
(4) and (8) of section 17.\textsuperscript{82} One must at least wonder whether a
genuine aversion to change or a healthy respect for the possibility
of unforeseen disadvantages motivated the inexplicable form of
congressional response to the problem it had articulated as its
major concern. Despite these uncertainties, if it is the case that
"[t]he preference for State court determination [of dischargeability] enunciated by the Supreme Court in Local Loan Co. v. Hunt does
not seem justified . . . by consideration of convenience to the parties,
r rapidity of disposition or great familiarity with the law on the part
of State court judges,"\textsuperscript{83} then Public Law Number 91-467 has properly
made some inroads upon that preference.

Beyond such facile conclusions there remains the hazy sense of
dissatisfaction that inevitably accompanies legal reforms whose op­
erations are not fully explicable in terms of the goals claimed by the
reformers. For all of its fifteen years in the legislative wings, Public
Law Number 91-467 may be an inadequately considered piece of
legislation.\textsuperscript{84} As noted above,\textsuperscript{85} the assumption of certain unproved

\textsuperscript{80} The attorney who assisted in the preparation of the initial petition and par­


\textsuperscript{82} See note 49 supra and accompanying text. As pointed out in note 70 supra, the

\textsuperscript{83} Cowans, \textit{An Agenda for Bankruptcy Reformers}, 43 REF. J. 47, 49 (1969).

\textsuperscript{84} Countryman, \textit{supra} note 30, at 23.

\textsuperscript{85} See notes 70-80 supra and accompanying text.
facts allows the conclusion that the amendment will achieve its purposes; this conclusion does not, however, mean that the amendment will achieve nothing more. The question of concern therefore becomes whether there are potentially deleterious side effects awaiting the application of such reforms to the institution of personal bankruptcy.

In approaching this question, it is necessary to re-examine the process of discharge in a slightly different light. Despite occasional suggestions that the entire bankruptcy system is excessively costly and panders to economic escapism, the concept of the discharge in bankruptcy continues to be popularly justified on the theory that it gives “the honest but unfortunate debtor . . . a new opportunity in life and a clean field for future effort, unhampered by the pressure and discouragement of preexisting debt.” This sentiment may be based on nothing more than a sense of fair play; but there are at least suggestions in the language that there is a more practical aspect to discharge. Economic difficulty of a certain magnitude does not appear susceptible to self-extrication—the more maneuvering and refinancing indulged in, the more helpless becomes the situation. If this is so, it seems wise in an economic sense to provide a public rescue effort as soon as the morass of past debt has taken irreversible hold of an individual. Expeditious action may minimize the over-all loss to all parties and result in a bankrupt freed from debt, hopefully somewhat wiser, and able to go forth and live at peace with the marketplace as a proper producer and consumer rather than as a tottering, fiscal wreck. Discharge, if so conceived, is neither gift nor encouragement to economic irresponsibility; rather, it is a generally advantageous salvage operation, the cost of which is borne, not by the general public, but by the bankrupt’s creditors.

If this interpretation of discharge as economically reasoned intervention has merit, a consonant reading of the bars to discharge embodied in section 14 enhances that merit. The majority of the grounds for refusing discharge have as their foundation some form of dishonesty or lack of cooperation by the bankrupt. Thus, one might conclude that the basically dishonest debtor will not respond

87. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
88. This conclusion, though often suggested, is not well supported with data. For a limited indication of the ineffectiveness of some refinancing, see R. Dolphin, supra note 16, at 71-72.
89. As pointed out in note 102 infra and accompanying text, the cost may in fact be passed on to a wider public.
to the rehabilitative purposes of discharge and cannot be counted on to become a stable and productive member of the economy. Section 14 is designed, then, to enhance the efficiency of discharge by screening out those for whom discharge would be a wasted effort. Assuming for the moment that section 14 does properly separate those who are capable of "proper" economic behavior in the future from those for whom a second chance would only be an invitation to repetitious abuses, what then is the function of section 17? Under what rationale does it make sense to keep only some debts enforceable after discharge—i.e., to give only a partial fresh start to a bankrupt? Since the expense of the bankrupt's new life is placed upon his creditors,91 a seemingly plausible function of section 17 is to cull those debts whose transference from debtor to creditor is economically disadvantageous or undesirable.

A closer examination of the types of debt made nondischargeable by section 17 belies the notion that economic evaluation, as hypothesized, is the exclusive function of this section. For example, section 17a(3) removes from the operation of discharge those provable debts that "have not been duly scheduled in time for proof and allowance . . . unless [the] creditor had notice or actual knowledge of the proceedings in bankruptcy."92 It has been observed that

[i]t would seem to be the application by Congress to bankruptcy proceedings of the familiar constitutional principle that "due process of law" intended to deprive one of property contemplates notice of some kind to the party whose property is to be taken that he may have his day in court and be heard before the court adjudicates against him.93

Although quite plainly extra-economic in emphasis, this exception from discharge actually does not detract from the concept of section 17 as an economic arbiter, but rather imports a well-recognized legal theory to mark off boundaries for the rescue operation of general discharge.

An examination of the opening phrases of paragraph 7 of section 17a,94 which provides that liabilities for alimony, maintenance, or child support shall not be dischargeable, exposes a purpose closer to the economic discrimination tentatively assumed to be the function of section 17. This exception from discharge accomplishes directly what was achieved indirectly in the early cases that insisted that these obligations were not "debts" at all but were "duties"

91. See note 89 supra and accompanying text.
expressed in terms of dollars. Indeed, it does make economic sense that, as the married bankrupt would not be relieved of his "duty" to provide support for his family, the bankrupt who has availed himself of divorce proceedings should not be freed of that responsibility, at least so long as child support and alimony are viable concepts. Viewed in another way, it may be felt that persons dependent upon the bankrupt are not economically attractive repositories for the expense of his fiscal rebirth.

Paragraph (2) of section 17a legislates nondischargeability for debts based upon false pretenses, false representations, false financial statements, and willful and malicious conversion of property. If Congress is correct in its evaluation of the bankruptcy system, it must be assumed that false representations, particularly in the form of false financial statements, provide the basis for the overwhelming majority of all exceptions from discharge. This assumption, coupled with the fact that these debts, as contrasted with the nondischargeable familial responsibilities, are contracted in the commercial setting of the consumer money market, gives rise to a particularly strong interest in the economic effects of this denial of dischargeability. Aside from purely visceral reactions that might dictate that the scurrilous borrower who has in some way lied to obtain credit should not be relieved of his debt because he is a scoundrel, what economic justifications are there for refusing to relieve a bankrupt from this sort of debt while canceling other debts of the same man? More particularly, how does this process make sense from the standpoint of the creditor? An adequate answer to either of these questions requires a very brief examination of the workings of the consumer credit market.

In a very general sense, the cost of borrowing money is reflected by interest rates. Such rates mirror the range of returns available through the alternative uses of money and the administrative costs involved in lending. These administrative costs may conveniently be divided into three types. There are first the costs of collection, which arise because not all borrowers cheerfully repay their outstanding obligations. Some must be sued and eventual collection may involve obtaining judgments, garnishing wages, participating in judgment sales and, sometimes, locating the errant debtor. All of these processes entail expenses that must be offset. The second class of administra-
tive costs arises from the fact that at times, either because the debtor cannot be located, because he is judgment proof, or because his debt has been terminated by some legal process such as discharge through bankruptcy, some loans will not be collectible. This fact gives rise to the costs of noncollection. As a variant of this cost, the costs of collection will occasionally exceed the amount that would be realized upon collection; minimizing losses in such circumstances therefore may dictate forgoing collection attempts and settling for non-collection. Finally, there are the administrative costs of predicting collectibility. Because interest rates are set before the costs of collection or noncollection are known in any given lending situation, these costs must be predicted in advance and allowed for in determining the interest rate. The expenses of completing and analyzing loan applications to determine the probable collectibility in any given set of financial circumstances comprise the major cost factors in this category.

As intimated previously, the underlying theory of consumer lending is that when all of these factors are properly evaluated, credit will flow to those who "should" have it and that those who "should not" will be faced with sufficiently high interest rates to deter them from borrowing. However, there may be some borrowers who want money and who should, but will not, be deterred by high interest rates. Usury laws then reinforce the barriers for improper borrowers by setting limits upon interest rates. Lending institutions are dissuaded from extending loans to these high-risk individuals because the institutions cannot charge interest at a rate commensurate with the risk.

Usury and lending laws also operate to separate loans into different classes—on such bases as security interests, loan use, and dollar amount of loan—and prescribe maximum interest rates for each class. Within each such class the allocation of administrative costs described above provides a further breakdown of borrowers in terms of individual loan risk. When the cost of lending is increased in any loan class, the lender, unwilling to absorb the expense and unable to reflect it through increased interest rates, must compensate by removing the highest-risk, highest-cost borrowers from his lending class. Increased lending costs, then, result in foreclosure of legal credit outlets to the poorest credit risks and may additionally

99. See note 41 supra and accompanying text.
100. See B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965); Curtan, Legislative Controls as a Response to Consumer Credit Problems, 8 B.C. Ind. & Com. L. Rev. 409 (1966). See also Shay, The Impact of the Uniform Consumer Credit Code upon the Market for Consumer Installment Credit, 33 LAW & CONTEMP. PROB. 752 (1968).
101. Those borrowers with higher estimated costs of collection and noncollection are obviously less desirable borrowers at any set interest rate.
increase the borrowing costs—up to the statutory maximum—for any borrower within a given class.

What then is the effect of a borrower within any loan class whose ranking within that class is determined from false risk-assessment information—a false financial statement or other false representations? If subsequent bankruptcy and discharge make his debt uncollectible, thereby increasing the cost of lending within the pertinent class, the expense of that bankrupt’s second chance will be borne by those potential borrowers excluded from the lending class by reason of the increment in cost attributable to discharged debts that were based upon false financial statements. By making debts based upon false representations nondischargeable, Congress has indicated dissatisfaction with such a distribution of expense. Since such debts are not discharged, theoretically at least, the lending costs in any loan class will not be altered by the presence of such fraudulent debts.

In what ways has Public Law Number 91-467 altered this cumbersome equation? First, it is apparent that Congress desires that the expense of debts obtained through false representations remain the burden of falsifying bankrupts rather than the burden of some other segment of the borrowing public. If, however, as suggested by some critics of the new legislation, it becomes more expensive to obtain exemption from discharge and to secure judgments on those debts incurred through false representations—either because of delays in the bankruptcy courts, increased debtor willingness to litigate the issues, or because litigation in federal courts is generally more costly than similar suits in state tribunals—such additional costs will be passed on, through denial of credit or increased interest rates, to certain innocent borrowing groups. Likewise, even if Congress was correct in believing that prior to the 1970 amendment creditors were collecting on debts that should have been discharged in bankruptcy and if Congress has succeeded by that amendment in eliminating such improper collections, the result will again be a shifting of the burden to innocent borrowers. The dollar amounts previously collected “improperly” from bankrupts through creditor allegations of false representations will be re-integrated into the costs of lending and will fall—through the denial of credit or increased costs of credit—upon the marginal group of highest-risk borrowers in any given lending class.

102. As contrasted to discharged debts granted upon accurate risk-assessment information, where the interest rate will reflect the chances of bankruptcy and discharge, loans written on the basis of false information will result in unanticipated expense if discharged through bankruptcy. This expense will be general to the loan class; i.e., it will not be attributable to any determinable group of borrowers and thus will have to be accounted for in the manner suggested.

103. See text accompanying note 66 supra.
Whether such results are proper, desirable, or reasonable as a matter of economic policy is open to speculation. But it is clear that these "incidental" economic effects of Public Law Number 91-467, with their concomitant advantages or disadvantages, were in no way controlling of the congressional action that created them.\textsuperscript{104} In amending the discharge provisions of the Bankruptcy Act, Congress has simultaneously disturbed the complicated and important, although virtually ignored, relationship between bankruptcy in general (and discharge in particular) and the consumer credit market. If the institution of bankruptcy is to operate in tandem with a market mechanism designed to deter the causes of bankruptcy, a closer examination of the nexus between the two forces is warranted.

\textsuperscript{104} Examination of the record of congressional hearings on the new discharge-ability legislation discloses virtually no references to the possible economic effects in the consumer credit market. See note 7 supra and accompanying text.