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COMMENTS

The Problem of Consumer Bankruptcy: Is Amendment of the Bankruptcy Act the Answer?

The question of whether the current frequency of consumer bankruptcy[1] is a necessary function of consumer credit remains unanswered.[2] The burgeoning number of consumer bankruptcies in a period of unparalleled national prosperity suggests fundamental weaknesses in the credit-oriented economy. Bankruptcy filings, now numbering nearly 172,000 annually, have trebled over the past decade.[3] For twelve consecutive years the number of petitions filed has exceeded that of the prior year.[4] Nonbusiness bankruptcies, most of which offer no assets for distribution, constitute ninety per cent of all filings.[5]

The cost of frequent bankruptcy is substantial, measured both by lost business profits and by the expense of maintaining the bankruptcy system. In fiscal 1963, when more than ninety-nine per cent of all bankruptcy petitions were voluntary,[6] 1.68 billion dollars in creditor claims were discharged by distributions to creditors of 51.23 million dollars, an average return of barely three cents per

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1. "Consumer bankruptcy" refers to bankruptcy of employees and others not in business. See ADMINISTRATIVE OFFICE OF THE U.S. COURTS, TABLES OF BANKRUPTCY STATISTICS FOR FISCAL YEAR ENDING JUNE 30, 1964, at 4, n.2 (1965) [hereinafter cited as 1964 BANKRUPTCY TABLES].

2. While some consumer failures are a normal result of consumer credit, their multiplication over the past decade has at least paralleled and perhaps exceeded the rate at which consumer credit has been extended. While one's conclusion depends upon the base year selected, in fiscal 1959 there was one consumer bankruptcy per 579,494 dollars consumer credit; in fiscal 1961, one per 438,935 dollars and in fiscal 1963, one per 502,187 dollars. *Compare* 49 FED. RESERVE BULL. 64 (1963) *with* ADMINISTRATIVE OFFICE OF U.S. COURTS, TABLES OF BANKRUPTCY STATISTICS FOR FISCAL YEAR ENDING JUNE 30, 1963, at 5 (1964).

Professor Frank R. Kennedy, addressing the 24th Annual Conference of Federal Judges of the Sixth Judicial Circuit, April 19, 1963, noted that in comparing the total outstanding consumer credit and the total number of bankruptcy filings by nonbusiness debtors for the years 1945 and 1962, "the ratio of consumer debt to consumer bankruptcy was identical. . . . I should like to suggest seriously that one of the prices of consumer credit is a statistically predictable percentage of bad debts."

3. 1964 BANKRUPTCY TABLES, table F-2. During the same period straight bankruptcy proceedings quadrupled, exceeding the annual records set in 1932 and 1935. See Countryman, *The Bankruptcy Boom*, 77 HARV. L. REV. 1452 (1964), for a thorough statistical analysis of the problem.

4. See 1964 BANKRUPTCY TABLES 1.

5. 1964 BANKRUPTCY TABLES 4. In fiscal 1964, the total 162,367 ordinary bankruptcies which were terminated included 16,942 nominal asset cases, in which the assets above exemptions were consumed by administrative expenses and 104,023 no-asset cases, in which assets in the bankrupts' estates failed to exceed exemptions. 1964 BANKRUPTCY TABLES 6.

6. 1964 BANKRUPTCY TABLES, table F-2. Virtually all involuntary proceedings are business bankruptcies; 88% of all voluntary proceedings are personal bankruptcies, and 80% are initiated by wage earners.

dollar.[7] The cumulative loss to creditors through bankruptcy proceedings represented 1.91 per cent of the total consumer credit outstanding in 1963 of 69.9 billion dollars.[8] The cost of sustaining the judicial and administrative bankruptcy system exceeded 22 million dollars in fiscal 1963.[9] While administrative fees and expenses in asset cases have risen to 26.6 per cent of the total proceeds realized, the average dollar realization per case has decreased to 4,840 dollars.[10]

The Bankruptcy Act of 1898 was designed to deal primarily with business failures; its draftsmen did not foresee the problems generated by credit-minded consumer debtors.[11] The allowance of a discharge in bankruptcy was meant to encourage business risk-taking in fields of low or unproved productivity. Realizing that somewhat different considerations may apply to nonbusiness bankrupts,[12] Congress instituted the wage earners' plan in the Chandler Act of 1938.[13] Under Chapter XIII, an insolvent debtor may commit himself to pay out of his future earnings his obligations in whole or in part pursuant to an extension or composition.[14] It was hoped that the debtor would prefer the Chapter XIII relief whenever feasible because it permits him to discharge his debts in a more dignified manner under limited judicial supervision without so greatly risking loss of employment and possessions.[15] But most wage earners' plans require from the debtor considerable frugality and determination. Unfortunately, widespread use of Chapter XIII has not been effected. In fact, fewer than twenty per cent of consumer bankrupts elect a wage earners' plan.[16]

Because wage earners' plans are beneficial to creditors and debtors,[17] various interest groups have striven to encourage debtors

7. *Id.*, tables F-6, F-9, F-10. The bankrupt is discharged from his obligations in 96% of all straight bankruptcies; 85% of petitioners in asset cases are discharged, and 99% in nominal and no-asset cases. *Id.*, table 4a.

8. 50 FED. RESERVE BULL. 1316 (1964).

9. 1964 BANKRUPTCY TABLES, tables F-7, F-8.

10. *Id.* at 8, 9. The percentage cost of administration, up from 26.4% in fiscal 1963, has not been exceeded since 1941; the average realization in fiscal 1964 decreased from the previous year's 5,511 dollars.

11. See Hilliard & Hurt, *Wage Earner Plans Under Chapter XIII of the Bankruptcy Act*, 19 BUS. LAW. 271 (1963). See generally Olmstead, *Bankruptcy—A Commercial Regulation*, 15 HARV. L. REV. 829 (1902).

12. The earliest American bankruptcy statutes extended the absolute discharge only to traders in the belief that non-traders did not merit relief from their improvident decisions. See 2 Stat. 19, 20-21 (1800).

13. 52 Stat. 930 (1938), 11 U.S.C. §§ 1001-86 (1958).

14. Bankruptcy Act § 623, 52 Stat. 932 (1938), 11 U.S.C. § 1023 (1958).

15. See Nadler, *Relief for the Wage Earner—A New Way To Pay Old Debts*, 60 COM. L.J. 33 (1955).

16. See Countryman, *supra* note 3, at 1461. Stiff repayment policies fostered and enforced by some courts have not been successful in combatting consumer bankruptcy by deterring the hard-pressed wage earners from being "extravagant."

17. See *ibid.* Since 87% of all straight bankruptcies distribute no assets to any creditor and the remainder pay off only 8% of their unsecured claims, the prospect of realizing 95% of all claims under a wage earners' plan is appealing.

to turn to Chapter XIII. Currently two groups, the National Bankruptcy Conference and the Consumer Bankruptcy Committee of the American Bar Association, are proposing to Congress amendments to Chapter XIII in the hope of making it more effective and more widely accepted.

I. Proposals of the National Bankruptcy Conference

The National Bankruptcy Conference[18] plays an important role in the continuing development of the Bankruptcy Act. The Chandler Act of 1938 was adopted by Congress on the Conference's recommendation practically without modification.[19] The 1952 and 1962 amendments to the Bankruptcy Act incorporate basically the changes proposed by the Conference.[20] In 1961 the Conference established a Committee on Wage Earners' Plans to recommend amendments to Chapter XIII "as comprehensive as were the Chandler Act amendments with respect to straight bankruptcy."[21] The Committee drafted recommendations which have been approved by the Conference for introduction into the 89th Congress.[22]

One significant revision proposed by the Conference is to redesignate the "trustee" in Chapter XIII proceedings a "distributing agent."[23] The change in terminology is intended to emphasize that the Chapter XIII trustee is not meant to assume the broad administrative functions of a trustee in straight bankruptcy, but rather to fulfill only the narrow role of receiving and distributing funds paid by the debtor pursuant to a wage earner's plan.[24] The extralegal

18. The Conference is a voluntary association of lawyers, referees, law teachers, and others interested in improving bankruptcy law and practice.

19. See Levy, *The Chandler Act for Creditors*, 43 Com. L.J. 464 (1938).

20. See Kennedy, *Bankruptcy Legislation of 1962*, 4 Boston College Industrial & Commercial L. Rev. 241, 242 (1963), citing H.R. Rep. No. 2320, 82d Cong., 2d Sess. 2 (1952); S. Rep. No. 1954, 87th Cong., 2d Sess. 2 (1962).

21. Resolution No. 35, National Bankruptcy Conference, Summary of Proceedings (1961). The initial problem confronting this Committee was whether to streamline existing administration of Chapter XIII while retaining the framework of the present act or to attempt a more extensive revision of the policies underlying Chapter XIII. The Committee limited its scope to existing bankruptcy law and practice in the belief that consistency in procedure and fairness in administration would eradicate many abuses under Chapter XIII and thereby encourage more widespread resort to it by debtors for relief. See generally National Bankruptcy Conference, Report of the Committee on Wage Earners' Plans (1963).

22. The approved proposals are set forth in Appendix A.

23. See Appendix A, Bankruptcy Act §§ 633(3), 662.

24. The comprehensive duties Congress delegated to trustees in straight bankruptcy contrast sharply with the enumerated functions of a Chapter XIII trustee. *Compare* Bankruptcy Act § 47, 52 Stat. 860 (1938), 11 U.S.C. § 75 (1958), *with* Bankruptcy Act § 633(4), 52 Stat. 932 (1938), 11 U.S.C. § 1033(4) (1958). See Krause, *Arrangements and Wage Earner Plans—Proceedings Under Chapters XI and XIII*, 15 Vand. L. Rev. 151 (1961). See generally Brown, *A Primer on Wage-Earner Plans Under Chapter XIII of the Bankruptcy Act*, 17 Bus. Law. 682 (1962); Sloan, *Wage Earners' Plan*, 7 Kan. L. Rev. 175 (1958), urging that the trustee should be authorized to challenge creditors' claims; to move to dismiss the petition, to increase or decrease installments by calling

functions performed by some Chapter XIII trustees have occasionally exceeded even the broad range of activities of their section 44 counterpart.[25] In some jurisdictions Chapter XIII trusteeships are well-organized, highly lucrative businesses, and the functionaries consider themselves to be the central, indispensable force in wage earner proceedings.[26] They frequently provide the debtor with services not authorized by Congress, such as family counselling and budget planning.[27] Unfortunately, the proposals do not deal with other significant shortcomings of the Chapter XIII trustee. Many trustees receive a high rate of compensation from fees and commissions which are taken from the wage earner's payments, a practice which seems inconsistent with the policy of impressing the debtor with frugality.[28] Perhaps a more serious criticism of the commission system of payment is that it tends to encourage unnecessary activity on the part of the trustee.[29] It would seem advisable, therefore, to place Chapter XIII officials on salary, or at least to limit their annual compensation.[30] It has also been alleged that in some areas the trustee, referee, creditors, and the debtor's employer combine to pressure the employee into "electing" an extension plan and that occasionally the debtor is refused a discharge in straight bankruptcy and must elect the Chapter XIII procedure.[31] Any such coercive practices should be authoritatively denounced.[32]

for an examination of the debtor, and to restrict indorsement of the debtor's paycheck; and to fulfill functions properly within the scope of the duties of the debtor's attorney. *Cf.* Rice v. Mimms, 291 F.2d 823 (10th Cir. 1961).

25. One practitioner described his conception of a Chapter XIII trustee as "the state trooper on the highway of credit, . . . [who] must function as attorney, a deterrent to irresponsible action by debtor and creditor alike, a prosecuting attorney, a probation officer, a violations clerk, and, in the bargain, an unpaid propagandist, economist, and philosopher." Meth, *The Importance and Responsibility of the Trustee in Chapter XIII Cases*, 17 PERSONAL FINANCE L.Q. REPORT 52, 53 (1963). See generally Rice, *The Trustee Under Chapter XIII*, 30 REF. J. 102, 103 (1958).

26. See Maulitz, *Operations Under Chapter XIII*, 27 REF. J. 68 (1953); NATIONAL BANKRUPTCY CONFERENCE, REPORT OF COMMITTEE ON WAGE EARNERS' PLANS 9 (1963).

27. See Allgood, *Operation of Wage Earners' Plan in the Northern District of Alabama*, 14 RUTGERS L. REV. 578 (1960); Rice, *supra* note 25. The desirability of a debtor's counselling service is now under consideration. See JUDICIAL CONFERENCE OF THE U.S., REPORT OF 1964 PROCEEDINGS 82.

28. See Sloan, *supra* note 24. One trustee depicts his standing trusteeship as "a chance to help your fellow man . . . and, secondly, . . . a very profitable little practice; . . . for the work involved there, the fees allowed by the Court are rather generous." Rice, *Practical Application of Wage Earners' Plans*, 28 KAN. S.B.A.J. 165, 172 (1959).

29. See Walker, *Is Chapter XIII a Milestone on the Path to the Welfare State?*, 33 REF. J. 7 (1959).

30. Address by Frank R. Kennedy, *supra* note 2. Others fear that well-qualified trustees could not then be attracted for a sufficient tenure to make such a limitation practicable.

31. See Allgood, *Chapter XIII—Referee Allgood of Alabama Replies to Referee Walker*, 33 REF. J. 51 (1959). Statistical evidence tends to substantiate such allegations. For example, the Fifth Judicial Circuit and Alabama in particular entertain more Chapter XIII petitions in proportion to total bankruptcy filings than any other region.

32. See Walker, *supra* note 29. Debtors should also be permitted freely to file a

Proposed section 614[33] provides for the stay of enforcement of any lien during execution of the plan.[34] However, protection of the debtor and the unsecured creditors from foreclosure would be conditioned upon prompt payment to the lienor of the regular installments, thus leaving the value of the security substantially intact.[35]

Proposed sections 646(2) and 652(1)[36] would exclude automatically from an otherwise satisfactory plan any provisions that deal with a claim of a secured creditor who does not wish to be included in the plan. The proposal would repudiate *In re O'Dell*,[37] which held that a bankruptcy court must reject an entire wage earner's plan, even though acceptable to a majority of unsecured creditors in number and amount, whenever one secured creditor refused to assent to his inclusion in it. While under present law the debtor may amend his plan to omit that creditor,[38] this proposal would prevent the secured creditor's objection from delaying the administration of a plan otherwise satisfying the requisites for confirmation.[39]

An amendment to section 606[40] would exclude from the proceedings creditors' claims which arise after the debtor filed his wage earner's petition. This proposal was prompted by a widespread

voluntary Chapter XIII petition regardless of the particular judge's distaste for the proceedings. Chapter XIII's use is disproportionately low in Wyoming and areas of Texas. See 1964 BANKRUPTCY TABLES, table F-2.

33. See Appendix A. See generally JUDICIAL CONFERENCE OF THE U.S., 1962 REPORT 66. A bill, S. 3307, 87th Cong., 2d Sess., was introduced to amend the § 606(1) definition of "claims" to include those secured by real property and chattels real; the National Bankruptcy Conference disapproved the proposal as tending to complicate planning.

34. *In re* Garrett, 203 F. Supp. 459 (N.D. Ala. 1962), held that, while a mortgagee of realty could not be required to participate in a wage earner's plan as a method of paying the outstanding debt, the court retained jurisdiction over all the property of the debtor, including an equity of redemption in the property of substantial value, and could issue an injunction prohibiting foreclosure and sale. In Hallenbeck v. Penn Mut. Life Ins. Co., 323 F.2d 566 (4th Cir. 1963), *reversing* 209 F. Supp. 263 (W.D. Va. 1962), the court held that a referee had discretion to enjoin foreclosure because the general purpose of Chapter XIII is to rehabilitate the debtor and to relieve him from harassment.

35. *In re* O'Dell, 198 F. Supp. 389 (D. Kan. 1961). See generally Comment, 4 SANTA CLARA LAW. 72 (1963).

36. See Appendix A.

37. 198 F. Supp. 389 (D. Kan. 1961).

38. NATIONAL BANKRUPTCY CONFERENCE, REPORT OF THE DRAFTING COMMITTEE OF THE COMMITTEE ON WAGE EARNERS' PLANS 27 (1964), suggests that, for the purposes of Chapter XIII, a secured creditor ought to be one whose security interest is not voidable under any provision in Chapters I to VII inclusive, so that one holding a voidable security interest cannot retain his right in the debtor's property by withholding his acceptance of a plan that binds unsecured creditors. *Cf.* City Nat'l Bank & Trust Co. v. Oliver, 230 F.2d 686 (10th Cir. 1956), rejecting a reclamation petition filed in a wage earner proceeding by a nonconsenting chattel mortgagee who had failed to perfect his security interest. See generally Note, 70 HARV. L. REV. 721 (1957).

39. Imposing a burden on the secured creditor to object to the wage earner's proposal to include him in the plan might be more satisfactory. The court could treat the creditor's failure to reject the proposal as a waiver of his right to object and an implied consent to his inclusion in the plan.

40. See Appendix A.

practice among referees of allowing post-filing claims.[41] Enactment might tend to discourage the merchant or lender from extending credit without thoroughly examining his debtor's ability to pay and would favor creditors who extended credit to the wage earner at an earlier time on, presumably, a more justifiable basis.

Under proposed section 644, no interest would accrue on unsecured claims after the filing of the Chapter XIII petition.[42] Section 642 would provide that, in ascertaining the amount of damages inflicted by the trustee's rejection of an executory contract, the court must require mitigation of damages by the creditor and take into account his lost profits, state law to the contrary notwithstanding.[43] Other proposed changes include requiring the wage earner to file his proposed plan simultaneously with his petition, or at least prior to the first meeting of the creditors,[44] and requiring each creditor to satisfy the court that his claim is free from usury before being allowed to participate in distributions.[45]

II. The Consumer Bankruptcy Committee Proposal

The rather conservative, piecemeal nature of the amendments advanced by the National Bankruptcy Conference sharply contrast with the proposal of the Consumer Bankruptcy Committee of the American Bar Association's Section of Corporation, Banking, and Business Law.[46] The Committee seeks enactment of legislation that would require the referee, upon a determination that the petition-

41. See Gates, *My Practice in Chapter XIII Proceedings*, 17 Ref. J. 95 (1943).

42. See Appendix A. The argument for permitting interest to accrue after confirmation is that some unsecured creditors have anticipated and provided for trouble. See Allgood, *Wage Earner Petitions Under Chapter XIII*, 46 Com. L.J. 17 (1941). But it seems desirable that bankruptcy courts should jealously guard their advantage over private debt consolidation plans whereby some creditors can profit by excessive interest charges for refinancing. The usual rule is that interest does not accrue on unsecured debts after a bankruptcy court takes over the debtor's assets for administration.

43. See Appendix A.

44. See Appendix A, §§ 623, 624, & 632. The first meeting will be more useful if creditors have had an opportunity to acquaint themselves with their rights under the proposed plan. A proposal to permit the debtor to schedule the payment of debts out of funds not derived from employment was defeated. Such freedom to plan might give greater flexibility to the debtor and larger payments sooner to creditors.

45. See Appendix A, § 656(b). The current practice of barring confirmation until all filing creditors have proved that their claims are nonusurious tends to penalize the debtor, rather than the lax or usurious creditor; courts withhold relief from the debtor for his creditor's failure to comply with the plan under which both may benefit. Bankruptcy General Order No. 55(4) was intended to remedy this situation, but it failed. The proposed legislation makes some proof of nonusurious rates a prerequisite to each claim's participation in the plan, which will not be delayed confirmation by a creditor's reluctance to come forward. Such procedure should alert the courts generally to unfair credit practices.

46. See Appendix B. A minority within the National Bankruptcy Conference doubts that it should oppose the proposals of the Consumer Bankruptcy Committee without further study. See generally National Bankruptcy Conference, Report of the Committee on Wage Earners' Plans (1964).

ing bankrupt has failed to show that he could not obtain adequate relief under Chapter XIII, to vacate the adjudication and dismiss the proceedings in bankruptcy unless the debtor changes his petition to one for a wage earner's plan.[47]

Although it would likely increase the proportion of Chapter XIII filings in bankruptcy, this proposal goes too far. The court would have practically unlimited discretion to force a wage earner to pay outstanding debts from future income.[48] Any hope of fostering responsible, voluntary debt-paying would be hampered if wage earners' plans become involuntary.[49] Even if the desirability of developing moral fiber in consumer debtors by encouraging them to pay their debts is accepted,[50] circumstances may arise that justify a grant of the absolute discharge, such as unemployment, disability, or unanticipated losses or liabilities. While the committee's proposal permits a wage earner proving the inadequacy of Chapter XIII relief to resort to straight bankruptcy, the absence of criteria for "adequate relief" accords too much administrative discretion to bankruptcy courts, and bankruptcy courts in certain areas of the country would be extremely unlikely ever to find Chapter XIII relief inadequate, even under severe circumstances.

Referees do not now tend to administer wage earners' plans uniformly.[51] The broad discretion implicit in the Committee's proposal could lead to a further lack of uniformity in administration of Chapter XIII proceedings, thus frustrating one of the basic goals of the National Bankruptcy Conference's recommendations.[52] Chapter XIII is employed most frequently in low-income areas as a result of heavy pressures from the employer, the creditors, referee, and trustee

47. See Appendix B.

48. See generally Snedecor, *Chapter XIII—Wage Earners' Plans*, 14 REF. J. 33 (1939).

49. See Meth, *Ethical and Economic Considerations in Chapter XIII Proceedings*, 36 REF. J. 41 (1962). "[T]he program of Chapter XIII . . . arrives at the terms of payment . . . not by ethical analysis but by an ad hoc negotiation between the debtor and interested creditors. No attempt is made to evaluate the claims of non-usurious creditors so as to aid the needy creditor or the person who, for example, has rendered services, as against the lender at interest or the retail vendor. Indeed, a strict policy against preference is adhered to. No attempt is made scientifically to analyze the debtor's budget. . . . The program is therefore ethically satisfactory but no more ideal than the limited imagination and energy of the debtor and his creditors make it. Where, after a term of years only a percentage of indebtedness is liquidated, and principal and interest charges are unpaid, discharge leaves the debtor in only somewhat better ethical (and emotional) condition than conventional bankruptcy." See generally Note, 6 U. CHI. L. REV. 459, 462-63 (1939).

50. *Cf.* Hamilton, *In re the Small Debtor*, 42 YALE L.J. 473, 481 (1933), stating that "the man who, even though he is under no legal compulsion, consecrates his life to the satisfaction of debts improvidently contracted is today a hero in the worlds of fact and of fiction. In the scheme of values which prevails, contractual obligation is still too elevated, even in comparison with liberty and the pursuit of happiness, to be dislodged from its strategic place in the law." *But see* Coulter, *The Family as a Unit in Industrial Society*, 196 ANNALS 20, 23 (1938).

51. See note 31 *supra* and accompanying text.

52. See note 21 *supra* and accompanying text.

on the wage earner to elicit his assent to the plan. In these regions of the country the proposed change would likely eliminate, as a practical matter, the possibility of an employee's gaining relief of absolute discharge in straight bankruptcy, even when it is the only feasible alternative.

Proponents of the bill argue that, because wage earners' plans are not mandatory, there is nothing to preclude one who earns a high income from obtaining a complete discharge in straight bankruptcy if he is willing to liquidate his assets. Consequently, such an individual can utilize bankruptcy law to evade his contractual obligations. If a choice must be made, however, it would seem preferable to allow a few high-income bankrupts to abuse the act than to subject many low-income wage earners to a form of wage servitude under the Committee's proposal. In any event, the high-income bankrupt problem might better be alleviated by incorporating the conditional discharge into straight bankruptcy proceedings for voluntary, nonbusiness bankrupts.[53] The availability to a voluntary bankrupt of complete, nearly automatic discharge for all debts is peculiar to American jurisprudence.[54] Both English and Canadian legislation, for instance, condition discharge in bankruptcy on payment of a minimum portion of the petitioner's debts.[55] Unconditional discharges could be limited to a bankrupt who can establish that he contracted his debts in good faith and with a reasonable belief in his ability to pay;[56] that he will satisfy a predetermined percentage of provable debts;[57] or that he has obtained the consent of a predetermined percentage of his creditors in number and amount to his absolute discharge.[58] Due regard should be taken, of course, for

53. See generally MacLachlan, *Puritanical Theory for Wage Earners*, 68 COM. L.J. 87 (1963). The Hastings-Michener Bill proposed to incorporate the concepts of the conditional and suspended discharges into the American bankruptcy system, a scheme leaving wide discretion in the bankruptcy court to fashion a decree granting a discharge that is effective only after a period in which the bankrupt has fulfilled certain obligations specified by the court. *Cf.* S. Doc. No. 65, 72d Cong., 1st Sess. 17-18, 101-07 (1932). Considerable opposition to the legislation came from the National Bankruptcy Conference, which feared that extensive judicial powers would further subjugate the bankrupt.

54. See generally Salter, *Brief Comparison of the United States and British Bankruptcy Acts*, 62 COM. L.J. 358 (1957).

55. Bankruptcy Act, 1914, 4 & 5 Geo. 5, c. 59, § 26; CAN. REV. STAT. c. 14, § 129 (1952). See generally Joslin, *Bankruptcy Chat From England*, 38 REF. J. 22 (1964). Under Canadian law the court has unlimited discretion to condition the discharge, regardless of any mitigating factors.

56. See, *e.g.*, Bankruptcy Act, 1914, 4 & 5 Geo. 5, c. 59, § 26.

57. The Bankruptcy Act of 1800 required consent of two-thirds of the creditors in number and amount if the debtor does not satisfy 50% of his provable debts. 2 Stat. 19, 31 (1800). The Bankruptcy Act of 1867 required satisfaction of 50% of the provable debts or consent of a majority in number and amount. 14 Stat. 517, 533 (1867).

58. This could be designed along the lines of Bankruptcy Act §§ 651, 652, 52 Stat. 934 (1938), 11 U.S.C. §§ 1051, 1052 (1958), which provide for confirmation of a plan.

cyclical economic recessions affecting both businessmen and consumers.

An alternative might be to permit the court to deny, suspend, postpone, alter, or condition the discharge of a wage earner who annually earns an amount of income substantially in excess of his provable debts.[59] Although standards would have to be developed by Congress to implement the conditional discharge,[60] the discretion granted the court need not be so broad as to permit commitment of the debtor's future earnings indefinitely. Most important, a debtor with a sizeable income could be forced to recognize a legal obligation to pay his creditors, at least to a greater degree than required when an absolute discharge is available.

III. The Roots of Consumer Bankruptcy

The foregoing proposals would help ease the symptoms of an infirm credit economy, but they would not treat the problem at its source.[61] Perhaps the former is a more proper purpose of bankruptcy legislation. However, to identify the causes of excessive consumer bankruptcy, the precipitating factors must be distinguished from the more basic, underlying ones. Among the precipitating causes are wage garnishments,[62] deficiency judgments,[63] harsh debt collection

59. See generally McKenzie, *Suspended or Conditional Discharges*, 19 Ref. J. 45 (1945).

60. See Woods, *Against Conditional or Limited Discharges*, 19 Ref. J. 47 (1945). Opponents of a scheme of conditional discharge point to its impractical aspects, such as additional administrative expense, the need for extensive judicial supervision, and the business and credit uncertainty created by the conditions imposed. *But see* Woodbridge, *Wage Earners' Receiverships*, 23 J. Am. Jud. Soc'y 242 (1940).

61. "Increased use of Chapter XIII is considered the most important because it would be the easiest to accomplish and would show results very quickly." Misbach, Personal Bankruptcy in the United States and Utah (1964) at 40. "Not until bankruptcy is thought of as a congeries of problems, such as housing, home buying, small loans, collection methods, unemployment, medical costs, retail credit practices, instalment buying, automobile accidents, *etc.*, rather than as an institution, will more effective control over these problems and their various agencies eventuate." Douglas, *Wage Earner Bankruptcies—State vs. Federal Control*, 42 Yale L.J. 591, 642 (1933).

62. See Snedecor, *Consumer Credit and Bankruptcy*, 35 Ref. J. 37 (1961), who attributes consumer bankruptcies primarily to garnishment or threat of garnishment of wages in conjunction with a state wage exemption law that is highly favorable to the creditor. It has been suggested that amortization of debts will be quite successful if the required payments are less than those that can be obtained by garnishment. See Nadler, *supra* note 15. See generally Sadd & Williams, Causes of Bankruptcies Among Consumers (1933).

63. "In almost every instance, the loan companies who make loans secured by liens on household furniture, and the no down payment appliance dealers, will have liens on property which on liquidation is probably not worth the amount of their lien." Rice, *supra* note 25, at 105. The interests of small loan companies, sales finance companies, and installment sellers seem to be mainly in sales or loan volume, not appraisal of credit risks on an individual basis. See Countryman, *The Bankruptcy Boom*, 77 Harv. L. Rev. 1452, 1458-59 (1964). The lenders' lack of concern over whether the product sold is sufficient security has led to a proposal to deny deficiency judgments to creditors that have repossessed personal property. See Snedecor, *supra* note 62.

procedures,[64] and allegedly irresponsible practices by a minority of the legal profession.[65] Often these factors are used as justifications by some who readily resort to bankruptcy without concern for the social stigma.[66] Modification of state laws to remove certain pressures on debtors such as wage garnishment would decrease the incidence of consumer bankruptcies somewhat; but for most insolvent debtors, the precipitating cause of bankruptcy would probably be merely postponed. Probably the most significant underlying cause of consumer bankruptcy is the debtor's extravagance, his unrealistic belief that someday he will have enough money to pay for what he wants, although marital strife, unemployment, and unforeseen medical expenses also contribute. This undying faith is too often fortified by unjustifiable extensions of credit and credit practices.[67] Perhaps the eternal optimism of the debtor cannot be cured, but something can be done about the credit practices of the seller.

Instances of unwarranted credit extensions and improper credit practices are rife. Lenders in some states, shielded by exceptions to state usury laws, charge their debtors as much as thirty-six per cent simple interest.[68] Advertising whets the consumer's appetite, and then high pressure sales tactics and "easy credit" claims or promises of postponed payment lower his sales resistance.[69] Credit investigations which may reveal one's inability to pay out of future earnings and the small value of the collateral, if any, are often disregarded.[70] Collusion between retailers and lenders to maximize sales, dealer "reserves" for "selling the financing and for selling credit life and liability insurance to the purchaser," and salesmen's commissions often overshadow the financial well-being of the ultimate individual con-

64. See Banks, *The Forgotten Remedy—Wage Earners' Plans Under the Bankruptcy Act*, 29 REF. J. 125 (1955). Dr. Milton J. Huber, Director of Public Relations of the Michigan Credit Union League, in an address to the 8th Annual Conference of the Council on Consumer Information, March 1962, attacked credit grantors that charge exorbitant interest and resort to garnishment for their security.

65. Linn K. Twinem, *The Bankruptcy Problem and What Can Be Done About It*, an address before the National Retail Merchants Association, September 24, 1962.

66. "Taking bankruptcy" has recently become a popularized method of paying old debts. See Nadler, *supra* note 15.

67. See Krause, *Developments in Bankruptcy Law*, 17 BUS. LAW. 772 (1962); Nadler, *Quo Vadis, O Ye Insolvent Wage Earner—Nine Out of Ten Bankrupts Are Wage Earners*, 7 N.Y.L.F. 331 (1961).

68. See Countryman, *supra* note 63. One reason for the discouragement of Chapter XIII proceedings is the feeling among many attorneys and referees that debtors have been victimized by sharp credit practices and should not have to pay in full. See Comment, 55 NW. U. L. REV. 372 (1960).

69. See *The Consumer Bankruptcy Question*, 31 FINANCIAL EXECUTIVE 46 (July 1963) noting that "ads inviting recent bankrupts to apply for credit [are] a very common practice of used car dealers and loan companies. . . . [S]uch advertisers will have the debtors at their mercy, and may use collection techniques from which bankruptcy will not be an escape for six years."

70. See Sturges & Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L.J. 487, 514-15 (1933).

sumer.[71] Emphasis on generous time purchasing plans to increase sales' volume to wholesalers, retailers, and consumers is replacing competition in the quality of the services and goods sold;[72] and various deceptive and irresponsible credit schemes have been developed.[73]

There is clear need for stricter regulation of lenders in general and the retail sales installment and small loan businesses in particular.[74] It hardly seems practicable to recommend that states alone act to regulate the credit practices of these institutions. Remedial legislation, even if considered, would lack uniformity in application and effect.[75] Federal "truth-in-lending" legislation, which requires disclosure to the consumer of the true cost of financing a transaction

71. See generally PHELPS, INSTALMENT SALES FINANCING: ITS SERVICES TO THE DEALER (1953). Frequently lenders will approve financing of marginal credit risks in return for the opportunity to obtain from the same seller one or more good credit risks.

72. See Krause, *Decries Intensified Demand for Extended Credit as Unsound Drag on Turnover of Receivables*, 60 CREDIT AND FINANCIAL MANAGEMENT 10 (Sept. 1958). See generally *Credit Administration and Profits*, 65 CREDIT AND FINANCIAL MANAGEMENT 40 (Jan. 1963).

73. For example, the "double-dip," the "balloon note" and the "flip." When a purchaser cannot establish a sufficient down-payment to merit one creditor's financing the entire balance of the price, a "double-dip" obtains two extensions of credit for the purchase of the same item, one loan being secured by the chattel purchased, the other by the debtor's furniture or nothing at all. The "balloon note" is used to induce the potential purchaser to buy a chattel by offering him a lower schedule of payments for, say, the first 35 months of a 36-month installment contract; the unpaid portion accumulates in a "balloon" which is payable on the 36th month or which can be refinanced at a more exorbitant rate of interest. The "flip" amounts to a consolidation of existing installment and non-installment debts for the purpose of spreading the expense over a longer period; but when an interest-bearing debt is refinanced, the advantage of more numerous, lower payments is weakened by the additional financing charges. See generally Kennedy, *Debt Pooling Arrangements v. Chapter XIII Proceedings*, 32 REF. J. 109 (1958). No comprehensive list of deceptive and irresponsible credit practices has been compiled. Specific practices with explanatory text are noted in PLUMMER & YOUNG, SALES FINANCE COMPANIES AND THEIR CREDIT PRACTICES 227-43 (1940). See generally BLACK, BUY NOW, PAY LATER 211-21 (1961): "It is the thesis of this book that the American consumer who buys on credit is often being abused and deceived and in some instances outrageously swindled. . . . During the past decade, however, sellers of credit discovered more profit could be derived from debt itself so that the sale of merchandise and goods became subordinated to the sale of credit. For the consumer this meant that he was buying something which had no function, no use, no purpose. . . . One cannot avoid the conclusion that a new class—the indigent debtor—is emerging in America. This class is made up of people from all walks of life with a wide variety of incomes who have been overloaded and oversold debts they are unable to pay. . . . The most disturbing aspect of debt merchandising is that it is generally based on deception. The deception varies in degree and amount, but it occurs almost every time someone is sold debt. Moreover, what really jars the moral nerve is that much of this deception is now considered normal behavior by most of the nation's respected and respectable business institutions. . . . [W]e can no longer as individuals and people countenance such an atmosphere of deception, sharp practices, and, on too frequent occasions, unmitigated fraud."

74. See Werson, *Public Relations for the Consumer Finance Industry*, 33 REF. J. 103 (1959). *Cf.* Comment, 73 YALE L.J. 886 (1964).

75. *But see* Buerger, *The Uniform Law Commissioners' Consumer Credit Project*, 19 PERSONAL FINANCE L.Q. REPORT 46 (1965); Shay, *The Proposed Uniform Consumer Credit Law*, 19 PERSONAL FINANCE L.Q. REPORT 9 (1964).

and disclosure requirements of state small loan and retail installment sales statutes are not likely to correct the existing pattern of reckless credit extension.[76] Perhaps greater federal control over unfair credit practices, posited on the power to regulate interstate commerce,[77] would effect substantially uniform credit practices without significantly restricting the free market and the flow of commerce. Such legislation might require federal licensing of retail credit and small loan businesses, conditioned upon a showing that the company does not engage in unfair credit practices such as charging exorbitant interest rates, utilizing deceptive financing schemes, and extending credit to a debtor with knowledge of his probable inability to meet his obligations. If credit extensions to persons patently unable to pay their debts were prohibited, the result could represent a positive economic saving.

An alternative to such general federal regulation of credit practices would be a statutory system awarding priority in asset distribution in bankruptcy among creditors on the basis of when credit was extended and what the debtor's ability to pay appeared to be when the credit was extended. Such a plan would encourage rational lending by rewarding the creditor who investigates and decides to lend on the basis of the individual's ability to pay rather than favoring the creditor who is most diligent in pursuing judicial remedies.[78] However, the difficulty of administering a priority system would be prohibitive. Unless a detailed filing system, which probably would not be used by most creditors, were instituted for unsecured debts, bankruptcy courts would be inundated by creditors litigating close questions of fact concerning the reasonableness of extending credit to the debtor at a particular time.

Conclusion

There is no imminent legislative solution to what are probably the greatest causation problems of consumer bankruptcy: unwar-

76. See Countryman, *supra* note 62; Beck, *The Douglas Bill—Where Is It Headed?*, 17 Personal Finance L.Q. Report 42 (1963). See generally Johnson, Methods of Stating Consumer Finance Charges (1961).

77. The constitutional basis of interstate commerce which would apply to such legislation has been set forth in Senate hearings on a bill to establish the federal licensing of corporations. See *Hearings on S. 10 and S. 3072 Before the Subcommittee on Federal Licensing of Corporations of the Senate Committee of the Judiciary*, 75th Cong., 1st & 3d Sess. 1-795 (1937-38). The legislation, ostensibly to license and to regulate the formation and operations of corporations involved in interstate commerce, was intended to permit greater federal control over state and regional labor conditions and manufacturing operations and to permit more equitable distribution of wealth to the ultimate consumer. *Cf.* Braucher, *Federal Enactment of the UCC*, 16 Law & Contemp. Prob. 100 (1951). An alternative basis for such legislation might be the bankruptcy power. See generally Martin, *Substantive Regulation of Security Devices Under the Bankruptcy Power*, 48 Colum. L. Rev. 62 (1948).

78. See Countryman, *supra* note 63.

ranted credit extensions and unfair credit practices. The National Bankruptcy Conference's recommendations are significant and, if enacted, should prove effective in making more uniform the law and administration of wage earners' plans. The likelihood remains that the Conference too narrowly restricted its purpose to increasing the effectiveness of the existing law of consumer bankruptcy, rather than attempting to attack the remaining underlying causes of bankruptcy. The proposals of the Conference and the Consumer Bankruptcy Committee are not mutually exclusive, but their major purposes conflict. The Consumer Bankruptcy Committee's proposal granting the courts great discretion to dismiss a petition in straight bankruptcy unless the bankrupt shows he could not obtain satisfactory relief under a wage earners' plan would increase the disparity that already exists in the administration of Chapter XIII between various jurisdictions and could undermine the voluntary nature of the wage earners' plan.

Support given by credit grantors to legislation which promotes such untrammelled judicial discretion and which seems to place the total blame of consumer bankruptcy on the debtors reflects the credit business community's unwillingness to correct its own abuses. The fault of the consumer debtor for the prevalence of bankruptcy cannot be accurately measured until more responsible credit practices by the lenders are observed.[79] Federal legislation could be instrumental in promoting credit integrity, lowering the cost of credit, and, incidentally, restoring consumer integrity. Once responsible credit practices are enforced, legislators will better be able to determine when and how to apportion financial responsibility to bankrupts. Until then, the task is to perfect existing means of debtor rehabilitation with enactment of legislation such as the National Bankruptcy Conference's proposals and to encourage credit grantors to clean their own houses.

C. William Garratt

APPENDIX A

AMENDMENTS OF THE BANKRUPTCY ACT, CHAPTER XIII PREPARED BY THE DRAFTING COMMITTEE AND APPROVED BY THE EXECUTIVE COMMITTEE OF THE NATIONAL BANKRUPTCY CONFERENCE

SEC. 606. For the purposes of this chapter, unless inconsistent with the context—

(1) "Claims" shall include all claims of whatever character against the debtor or his property, whether or not provable as debts under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent, but shall not include claims secured by [estates] *interests* in real property or chattels real, *or claims arising after the filing of the petition under this chapter.*

SEC. 614. The court may, in addition to the relief provided by section 11 of this Act and elsewhere under this chapter, enjoin or stay until final decree the

79. *Cf.* Comment, 68 YALE L.J. 1459, 1497-1502 (1959), suggesting that while some consumer failures are predictable and may be a necessary incident of consumer credit, social welfare legislation is not the best means to achieve debtor rehabilitation.

commencement or continuation of suits *in any jurisdiction* other than suits to enforce liens upon the property of a debtor, and may, upon notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the *real or personal* property of a debtor. *Such injunction or stay of any proceeding to enforce a lien may be continued after confirmation of the plan only upon condition that the debtor shall, (1) in such manner and at such time as the court may fix, make all payments on the secured debt which became due without acceleration before confirmation, and (2) comply with the security agreement or applicable state law as to payments becoming due thereafter without acceleration.*

SEC. 623. A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature and that he desires to effect a composition or *an* extension, or both, out of his future earnings or wages. *The petition shall set forth the provisions of or be accompanied by the plan proposed by him, or shall state that he intends to propose a plan pursuant to the provisions of this chapter.*

SEC. 624. *(1)* The petition shall be accompanied [—(1)] by a statement of the executory contracts of the debtor[;] and the schedules and statement of affairs, if not previously filed, [:Provided, *however*, That] *except that* if the debtor files with a petition a list of his creditors and their addresses and a summary of his assets and liabilities, the court may, on application by the debtor, grant for cause shown further time, not exceeding ten days, for filing the statement of the executory contracts and the schedules and statement of affairs, and such time shall not further be extended except for cause shown and on such notice and to such persons as the court may direct [; and].

(2) [where a petition is filed under section 622 of this Act, by payment to the clerk of $15 to be distributed, $10 to the Treasury of the United States for deposit in the referees' salary and expense fund and $5 to the clerk, in lieu of the fees of $32 and $8 as prescribed in sections 40 and 52 of this Act: Provided, *however*, That such fees may be paid in installments, if so authorized by General Order of the Supreme Court of the United States.] *If a plan is not set forth in or does not accompany the petition, a plan shall be filed by the debtor within ten days of the filing of the petition under this chapter, and such time shall not be further extended except for cause shown and on such notice to such persons as the court may direct.*

. . . .

SEC. 632. *(1) Promptly after the filing of the plan* [The judge or referee] *the court* shall [promptly] call a meeting of creditors [,] upon at least ten days' notice by mail to the debtor and his creditors.

(2) The notice of such meeting shall be accompanied by a copy of the proposed plan, and may state the time for the filing of the application to confirm the plan and the time for the hearing on confirmation including objections thereto.

SEC. 633. At such meeting, or at any adjournment thereof—

(1) [no change]

(2) [delete in its entirety]

(3) [renumber (2)]

[(4)] (c) the court shall, if the plan is accepted, appoint a [trustee] *distributing agent* to receive and distribute, subject to the control of the court, all moneys to be paid under the plan and shall require such [trustee] *distributing agent* to give bond with surety to be approved by the court in such amount as the court shall fix; and

[(5)] *(4)* the court shall fix a time for the filing of the application to confirm the [arrangement] *plan* and for a hearing on the confirmation thereof or any objection to the confirmation, unless such times have [already] been [named] *stated* in the notice of the meeting or unless all creditors affected by the [arrangement] *plan* have accepted it.

SEC. 642. [retain entire section, with the exception of the proviso which is to be deleted, adding the following] *The* court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. *Notwithstanding any state law to the contrary, in determining damages resulting from the rejection of any executory contract, the court shall require that the*

creditor mitigate damages, and shall take into account loss of profit as an element of damages.

SEC. 644. *Interest shall not accrue on unsecured claims after the filing of a petition under section 622 or, if the petition was filed under section 621, after the date of the filing of the original petition in bankruptcy, unless the proceeding is dismissed.*

SEC. 646. A plan under this chapter—

. . . .

(2) may include provisions dealing with secured debts severally, upon any terms[;] *but if any secured creditor does not accept, the provisions of the plan dealing with his rights shall be excluded from the plan and he shall not be affected thereby; . . .*

SEC. 652. If a plan has not been so accepted, an application for the confirmation of the plan may be filed with the court within such time as the court shall have fixed in the notice of such meeting, or at or after such meeting and after, but not before—

(1) it has been accepted in writing, if unsecured creditors are affected by the plan, by a majority in number of all such creditors whose claims have been proved and allowed before the conclusion of the meeting, which number shall represent a majority in amount of such claims, and by the secured creditors whose claims are dealt with by the plan *except as provided in subdivision (2) of section 646 of this Act;* and

(2) the debtor has made the deposit of moneys required of him under this chapter and under the plan.

SEC. 656. . . .

(b) [Before confirming any such plan the court shall require proof from each creditor filing a claim that such claim is free from usury as defined by the laws of the place where the debt was contracted.] *No creditor may participate in distributions under the plan unless he establishes by affidavit or in such other manner as the court may require that his claim is free from usury as defined by the laws of the place where the debt was contracted.*

SEC. 657. *(1) Claims, including those of the United States, a State, or a subdivision thereof, which are not filed within six months after the first date set for the first meeting of creditors called pursuant to section 632 of this Act shall not be allowed to participate in a plan under this chapter. The court may, however, on application, before the expiration of such period grant further time, not exceeding six months, for the filing of a claim.*

(2) Upon confirmation of a plan, the plan and its provisions shall be binding upon the debtor and upon all creditors of the debtor, whether or not they are affected by the plan or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed or are allowable.

. . . .

SEC. 662. Upon the consummation of a proceeding under this chapter, as provided either in section 660 or section 661 of this Act, the court shall enter a final decree discharging the [trustee] *distributing agent,* closing the estate and making such provision, by way of injunction or otherwise, as may be equitable.

APPENDIX B

88th Congress
2d Session

H.R. 12784

Introduced October 2, 1964
Referred to the Committee on the Judiciary

A BILL to amend the Bankruptcy Act with respect to the use of Chapter XIII.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 55(b) of the Bankruptcy Act (11 U.S.C. 91(b)) is amended to read as follows:

"b. At the first meeting of creditors, the judge or referee shall preside and, before proceeding with other business, shall, if the bankrupt is a wage earner within the meaning of subsection (8) of section 607 of this Act, determine whether the bankrupt has shown that adequate relief cannot be obtained under

Chapter XIII of this Act. In the event that the judge or referee shall determine that the bankrupt has failed to make such a showing, he shall enter an order vacating the order of adjudication and dismissing the bankruptcy proceedings with notice to all of the bankrupt's creditors, unless, within such time as the judge or referee shall fix, the petition be amended to comply with requirements of Chapter XIII for the filing of a debtor's petition. In the event that the bankrupt is not a wage earner or shall make such a showing as aforesaid, the judge or referee may then allow or disallow the claim of creditors there presented, and shall publicly examine the bankrupt or cause him to be examined, and may permit creditors to examine him."