DEBTOR AND CREDITOR CONSUMERS AND THE BANKRUPTCY REFORM ACT

Eugene M. Anderson Jr.
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I. INTRODUCTION

Societies have long struggled with the problems arising when a debtor can no longer pay or perform his obligation. Solutions range from the periodic debt forgiveness, of ancient Hebraic society 1 to the imprisonment of the debtor for failure to pay of recent Anglo-American jurisprudence.2 Aside from moral considerations, both of these alternatives are unthinkable in modern society where credit plays an important role. Such choices excessively chill the use of credit on opposite sides of the debtor-creditor relationship. To foster credit usage,3 it is necessary to at least offer the debtor a new opportunity in life and a clear field for future effort.4 At the same time, creditors must be given some assurance of equality of


1. At the end of every seven years thou shalt make release. And this is the manner of the release: every creditor who lendeth anything unto his neighbor, shall release it; he shall not exact it of his neighbor, or of his brother, because it is called the Lord' release.
Deuteronomy 15:1 (King James).

Not all of the ancient world was so debtor oriented. The Roman Laws of the Twelve Tables allowed creditor to take delinquent debtor, and either tie him by the neck, or put irons upon his feet, provided the chain does not weigh above fifteen pounds. If the debtor be insolvent to several creditors, let his body be cut in pieces on the third market day. It may be cut into more or fewer pieces with impunity. Or, if his creditors consent to it, let him be sold to foreigners beyond the Tiber.

2. The fate of these unfortunates is described by Mr. Justice Hyde:
If man be taken in execution and lie in prison for debt, neither the plaintiff at whose suit he is arrested, nor the sheriff who took him, is bound to find him meat, drink, or clothes; but he must live on his own, or on the charity of others: and if no man will relieve him, let him die in the name of God, says the law: and so say I.


treatment within their category of creditors. Congress, under a Constitutional grant of authority has gradually developed a solution to the problem of the insolvent debtor which leaves the debtor-creditor relationship structurally unchanged, but substantially alters from original expectations the method and substance of the satisfaction of the debtor's obligation.

Two widely differing general solutions to the problem of bankruptcy have evolved under the statutory scheme. The first, the chapter proceeding, attempts to rehabilitate the debtor who pays all, or much, of the debt. The other, the liquidation proceeding, protects creditor rights to the extent possible while giving the debtor a fresh start. In a liquidation proceeding, the court marshalls and liquidates the debtor's assets, and applies the resulting funds toward the debts. Subsequent judicially enforced collection of the debts from the debtor personally is barred.

Through history the primary attention of bankruptcy law has been on business bankruptcies. Consumer credit is a recent phenomenon. The draftsmen of the Bankruptcy Commission proposed far-reaching, radical legislative changes in attempting to deal with the problems of the bankrupt consumer and consumer creditors. Only some of these proposed changes survived the enactment process. This article examines the more significant substantive changes of the 1978 Bankruptcy Reform Act (the BRA or new Act)

5. U.S. Const. art. I, § 8, cl. 4.

It is typical of the BRA that its emphasis is on consumer debtors, that is, bankrupts rather than consumer creditors who have claims against debtors. "Debtors is the term used in the BRA to describe the entity which would formerly be called bankrupt. 11 U.S.C.A. § 101(12) (West Supp. 1979); cf Bankruptcy Act of 1898, 11 U.S.C. § 1(4) (1976) (repealed 1979). This article will frequently follow the old terminology of "bankrupt, the new terminology is far too imprecise. Debtor has many more generally accepted meanings in addition to the new legislative definition. It is unfortunately far from atypical of the terminology of the BRA which all too often does not make use of words with well known and specific meanings in bankruptcy law that substitutes instead terminology with general, imprecise meaning. Altogether, the BRA is extremely difficult to follow as a comprehensible piece of writing.

8. While the line between substance and procedure is not always clear, the significant procedural changes for consumers deserve separate treatment. For example,
that principally impact on the individual with debts or claims incurred primarily for personal, family or household purposes in a liquidation proceeding.

One commentator has stated that the liquidation bankruptcy proceeding offers the bankrupt an opportunity to retain "exempt" property and, more importantly to obtain the bankruptcy discharge.9 The Bankruptcy Reform Act deals with both of these objectives in significant ways.

II. EXEMPTIONS

It became generally accepted during the nineteenth century that certain property belonging to individuals should not be subject to levy under judicial process.10 This same policy was perceived to apply to bankruptcy. Consequently, each of the federal bankruptcy acts has provided that some property of the bankrupt not be liquidated, but be set aside for the bankrupt's use.11 Under the Bankruptcy Act of 1898, the trustee did not take title to the bankrupt's exempt property.12 Determination of exempt status was by the exemption from legal process law of the bankrupt's state of domicile.13 Since the administration of exempt property was not within the trustee's powers, bankruptcy proceedings became a confused struggle between claimants with state-recognized rights in exempt property, trustees with federal Bankruptcy Act rights, and bankrupts themselves.14 The reference to state law for exemptions pro-

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11. An Act to establish uniform system of bankruptcy throughout the United States, Ch. XIX, 2 Stat. 19 (1800) (repealed by An Act to repeal an act, entitled An act to establish uniform system of bankruptcy throughout the United States, Ch. VI, 2 Stat. 246 (1803)); An Act to establish uniform system of bankruptcy throughout the United States, Ch. IX, 5 Stat. 440 (1841) (repealed by An Act to repeal the bankrupt [sic] act, Ch. LXXXII, 5 Stat. 614 (1843)). Each of these Acts provided exemptions in the statute. An Act to establish uniform system of bankruptcy throughout the United States, Ch. CLXXVI, 14 Stat. 517 (1867) (repealed by An Act to repeal the bankrupt [sic] law, Ch. 160, 20 Stat. 99 (1878)). This Act employed federal exemptions as minimum, and adopted the exemptions of the state of domicile of the bankrupt as an alternative.
13. Id. § 6.
14. Countryman, For New Exemption Policy in Bankruptcy, 14 RUTGERS L. REV 678 (1960); see Kennedy supra note 10, at 453.
ducted extreme variations in the value of property retained by a bankrupt in bankruptcy. 15

The Bankruptcy Reform Act of 1978 improves and clarifies substantially the method of dealing with exempt property. Title to all legal or equitable interests of the bankrupt in property passes to the trustee. 16 The bankrupt then requests exemption of qualified property by filing a list of that property with the trustee. Unless objected to by a party in interest, the trustee will exempt the property on the bankrupt's list. 18 Property which would otherwise qualify as exempt, but which is subject to a judicial lien, may be claimed as exempt and the bankrupt may avoid the lien to the extent that the property is exempted. Similarly where exempt household and personal goods are subject to non-purchase money security interests, the security interest can be avoided. 19 Where property otherwise exempted has been involuntarily transferred and not concealed, the bankrupt or the trustee may avoid the transfer and claim the property. Where the trustee has exercised these avoiding powers, the property may be exempted and claimed by the bankrupt. 20 Waivers of exemption are unenforceable. 21

The Bankruptcy Reform Act also changes the method of determining what property may be exempted. The original Bankruptcy Commission Bill 22 sets out a list of allowable federal exemptions 23 which was to be the exclusive itemization of what could be

15. See Countryman, supra note 9, at 167 Professor Countryman uses some dramatic hypothetical examples which illustrate these extremes.
17. Id. § 552(e).
18. Id.
19. Id. § 522(f). The constitutionality of this provision may be questioned.
20. 11 U.S.C.A. § 522(g)-(j) (West Supp. 1979). The language of these subsections is obscure. It apparently derives from provision in the Commission bill which provided in clear language that "[n]o property recovered under provisions of this Act shall be allowed as exempt if the property recovered was concealed or voluntarily transferred by the debtor, unless so transferred to secure debt and then only to the extent the value of the property exceeds the debt. Comm. Report, supra note 3, at 125. It is difficult to see much practical application to the enacted version since most of the situations to which it would apply involve judicial liens covered in and provided by § 522(f)(1).
21. 11 U.S.C.A. § 522(e) (West Supp. 1979). Although much ink has been spilled on the subject, waivers of exemption were valid under state law in very few instances.
23. Id. at 125. The report states:

The reference to nonbankruptcy law to determine the exemptions is abandoned to eliminate diversity and reduce the amount of litigation having no direct relationship to the policy underlying exemptions, and because state
exempted. Many critics doubted the ability of a unified, federal system of exemptions to account for varying conditions and social viewpoints of the whole country. As enacted, the Bankruptcy Reform Act allows the bankrupt to choose either the federal exemption plan or the exemption scheme of his state of domicile. The result of this is to make the federal exemption the floor or basic exemption. This will compel lawyers for bankrupts to determine total allowable exemptions under both the federal and state schemes to judge which plan is larger unless the state provisions are extremely generous or niggardly. Where federal exemptions are markedly more generous, the Act encourages voluntary bankruptcy to protect the property which otherwise would be subject to execution and levy under judgments in state law.

III. DISCHARGE: NEW CONCEPTS TO PROTECT ITS EFFECTIVENESS

If exemptions give the debtor some minimum property with which to begin his fresh start, discharge is intended to give him that fresh start. For a variety of reasons, however, a debtor is often moved to reaffirm debts which would be discharged in a bankruptcy proceeding. This reaffirmation of debts which is then enforceable seriously undercuts the effectiveness of discharge.

exemption laws seem generally archaic and unduly generous in some states and exceedingly niggardly, particularly as to urban residents, in others.

Id. The policy of the first two bankruptcy acts was followed.

24. See note 10 supra and accompanying text.
26. One apparent weakness in the federal exemptions is that, following the modern trend in such statutes, the exemptions are expressed in dollar amounts which, it is supposed, will provide for flexibility in the present varied, largely urban, society. But these dollar amounts are absolute and become quickly out of date in periods of high inflation. The Commission Bill § 1-105 recognized this and provided that the amounts should be adjusted every two years by formula based on the Consumer Price Index. BRA § 104, reflecting a series of political compromises, provides for adjustments to be recommended by the Judicial Conference every six years with no standards given. 11 U.S.C.A. § 104 (West Supp. 1979). This scheme will shortly have the exemptions essentially worthless in periods of double digit inflation. See, 95 CONG. REC. H11,049 (daily ed. Sept. 28, 1978).

27. The legal basis for the enforcement of such reaffirmed debts is expressed by the New York Court of Appeals as follows: "[t]he debt is not paid by the discharge in bankruptcy. It is due in conscience, although discharged in law and this moral obligation, uniting with the subsequent promise to pay, creates right of action. Herrington Davitt, 220 N.Y. 162, 167, 115 N.E. 476, 477 (1917). For an outstanding study of this topic see Boshkoff, The Bankrupt’ Moral Obligation to Pay His Discharged Debts: A Conflict Between Contract Theory and Bankruptcy Policy, 47 IND. L.J. 36 (1971). See also 1A COLLIER ON BANKRUPTCY, ¶ 17.33, at 1753 (14th ed. 1971) [hereinafter cited as Collier].
While some bankrupts may feel that they should reaffirm those debts they can pay payment may always be made without reaffirmation. The fact that the vast majority of bankruptcies are voluntary\(^{28}\) suggests that most petitioners seek discharge relief. Thus, reaffirmation may not be motivated so much by a feeling of moral obligation as by some form of direct or indirect creditor pressure.

The 1970 amendments\(^ {29}\) to the Bankruptcy Act of 1898 have been cited as alleviating this problem.\(^ {30}\) Their effectiveness, however, is limited.\(^ {31}\) The pertinent amendments provided for a determination in bankruptcy court of the dischargeability of certain debts, and prohibited use of any "action or "process to collect debts that are determined discharged. This left a large range of creditor action available, including overt harassment. If the creditor could persuade the debtor to make a new promise after discharge, this promise would be enforceable.\(^ {32}\)

A number of situations which are particularly sensitive to creditor pressure have been identified and are dealt with in the new Act. For example, a lender may hold a security interest in exempt household and personal goods of the debtor. Such goods were subject to repossession by the lender after bankruptcy under the old Act. When the replacement cost of such goods was high, even though their value was low in comparison with the debt owed, the

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32. The BRA recognizes the distinction between legal action or other acts aimed at inducing the debtor to pay discharged debt and the legal reaffirmation of the debt giving rise to new legal cause of action. The BRA not only enjoins "[c]ommencement or continuation of any action, the employment of process but also, any act, to collect any [discharged] debt as personal liability of the debtor 11 U.S.C.A. § 524(a)(2) (West Supp. 1979) The House Report points out that this is an expansion of the old Act to cover "[a]ny act to collect, such as dunning by telephone or letter, or indirectly through friends, relatives, or employers, harassment, threats of repossession, and the like. House Report, supra note 6, at 366 reprinted in [1978] 5 U.S. Code Cong. & Ad. News 5963, 6321-22. The Report agreed that "[t]he change is consonant with the new policy forbidding binding reaffirmation agreements... but it is not the same thing and only has the same goal "to insure that once debt is discharged, the debtor will not be pressured in any way to repay it. Id.
debtor was frequently induced to reaffirm the entire debt rather than lose his property.  

The BRA deals with this problem in two ways in addition to the antireaffirmation provision. Under subsection 522(f)(2), a nonpurchase money security interest in exempt household goods may be avoided by the debtor. Secondly, under section 722, tangible personal property intended primarily for personal, family or household use, which is exempted or abandoned by the trustee as being of inconsequential value to the estate, may be redeemed by the debtor from a lien securing a dischargeable consumer debt. Operation of this redemption provision requires valuation of the collateral and the estate's interest in it to determine the extent of the secured claim under the BRA section 506. The secured claim of the creditor may not exceed the valuation of the estate's interest in the collateral. Any excess of the claim that remains is regarded as an unsecured claim. The debtor may redeem the collateral property by paying the holder of the lien the amount of the secured claim allowed. The concept of a secured creditor is irrelevant. Where the amount of the security interest is equal to the valuation of the collateral, or the amount of the security interest and the available exemption are equal to the collateral valuation, the debtor simply pays the amount of the security interest to the secured party and redeems the collateral.

33. Even though the debt might be discharged, the lien or security interest was not so discharged, and to the extent not avoided, could be enforced against both the exempt and nonexempt property of the debtor.

34. See text accompanying note 19 supra.

35. 11 U.S.C.A. § 506 (West Supp. 1979). The House Report, commenting on the valuation provision of this section explained: "Value does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply full going concern value. Courts will have to determine value on case-by-case basis, taking into account the facts of each case and competing interests in the case. House Report supra, note 6, at 356, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5963, 6311-12. See also S. REP No. 989, 95th Cong., 2d Sess. 68 (1978), reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5787-5854. The Senate Bill would not have adopted this standard but would have required the reclaiming debtor to pay "fair value. S. 2266, 95th Cong. 1st Sess. (1978). The effect that "fair value" was used intentionally, see S. REP No. 989, 95th Cong., 2d Sess. 381 (1978). The enacted version would seem to make possible squeezing of the secured creditor.


37 Comm. Report, supra note 3, § 4-504, at 130 n.2. It is interesting to speculate that, even if not eligible for exemption, such consumer goods collateral fully subject to security interest may and perhaps should, be abandoned by the Trustee under § 554 as of inconsequential value to the estate, thereby making it eligible for redemption under § 722. 11 U.S.C.A. §§ 554, 722 (West Supp. 1979).
Where the total exemption amount allowed together with the amount of the secured claim is not as great as the valuation assigned the collateral, the analysis is less clear. Assume that the collateral is an automobile valued at $2,500 and there is a secured balance owing on the purchase price of $1,200. The debtor may exempt an additional $1,200, leaving an interest in the estate of $100. May the trustee force a sale of the vehicle and force the debtor to replace it at a higher price? While it is true that the valuation could take care of this problem, replacing a car almost always costs more than appraisers will allow on an existing one. It is also true that the secured party has no leverage to force reaffirmation in this situation, but surely the redemption provision has a broader reach than this.38

Another example of a reason why debtors may reaffirm a dischargeable debt is to obtain a new loan from a prior lender who would, were it not for the reaffirmation, have collection of the earlier debt barred. The House Report expressed hope that such pressure to obtain new money immediately after bankruptcy would be alleviated by the new federal exemption floor provided in the BRA section 522.39 This hope is of doubtful validity.

38. See Comm. Report, supra note 3, at 276. The Committee Report uses the following example:

[T]he debtor owned $2,000 car, subject to $1,200 lien, the debtor could exempt his $800 interest in the car. The debtor is permitted $1,500 exemption in car, [$1,200 in the Act as passed.] This section permits him to pay the holder of the lien $1,200 and redeem the entire car, not just the remaining $700 of his exemption. The redemption is accomplished by paying the holder of the lien the amount of the allowed claim secured by the lien. The provision amounts to right of first refusal for the debtor in consumer goods that might otherwise be repossessed. The right of redemption under this section is not waivable.

House Report, supra note 6, at 381, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5963, 6337. The Bankruptcy Commission would not have given any broader effect to its predecessor version of § 722. The Commission pointed out that the debtor may purchase at the trustee sale, which it apparently felt was sufficient protection. Comm. Report, supra note 3, at 1130.

39. House Report, supra note 6, at 163, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5963, 6124. An interesting contrast in comments on these generally agreed reasons for reaffirmation may be seen in the House Report which may be characterized on this point as writing from the perspective of the debtor and Mr. Twinem. See note 30 supra at 365. Mr. Twinem makes fascinating argument from creditor viewpoint. Pointing out that the debtor is not unlikely to need cash and is willing to enter into new transaction covering both the old debt and new loan to get it, he concludes:

This is practical consideration. If the old debt could not be affirmed, lender could not advance additional cash on new loan without cancelling the prior loan. If he did not cancel, the borrower would be indebted on two
One of the greatest areas of abuse arises out of the fact that if a debtor gives a false or incomplete financial statement to obtain a loan, that debt may be exempt from discharge. While in some cases the debtor is deliberately unfaithful, considerable evidence exists that some unscrupulous lenders encourage falsification to protect their interest from discharge in a bankruptcy proceeding. Such evidence led to the 1970 amendment to the Bankruptcy Act of 1898 providing that the creditor who contended his debt was nondischargeable for falsification must have the dischargeability determined by the bankruptcy court.

The House Committee concluded that, despite the amendment, some creditors might threaten to have the debt excepted from discharge and force the debtor to choose between paying the costs of litigation to determine dischargeability (or perhaps having his discharge held up for one disputed debt), and settling the claim by reaffirming all or part of the debt. The Commission Bill resolved the problem of creditor encouraged falsification by eliminating the exception from discharge where the debt in question was a consumer debt. This change was met with predictable op-

contracts of loan at the same time in violation of the Small Loan Laws. Unless cancelled the old loan must be paid off by the proceeds from the new loan. Twinem, supra note 30, at 365. It is hard to see how this could prevail against bankruptcy policy. Both the Senate and House Reports conclude, "In effect, the discharge extinguishes the debt". S. REP NO. 989, 95th Cong., 2d Sess. 80 (1978), reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5787, 5865-67. House Report supra note 6, at 365, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS, 5963, 6320-21. Section 366 deals with the special situation of utility service. 11 U.S.C.A. § 366 (West Supp. 1979). While much of the applicability of the section is to trustee continuing business under Chapter proceedings, by its terms the section also applies to debtors (bankrupts) and prohibits utility from altering, refusing or discontinuing service, or discrimination against debtor. Id. The legislative history of the section indicates that utility means one which has monopoly supplier position. House Report, supra note 6, at 350, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5963, 6306. The debtor must furnish adequate assurance of payment of past bankruptcy debts within 20 days of the beginning of the bankruptcy. The obvious implication of the section is that non-utility suppliers can refuse to deal with debtor-bankrupt, so the pressure for reaffirmation may still be great.

position\textsuperscript{45} and was not included in the Bankruptcy Judges Bill\textsuperscript{46} or the BRA subsection 523(a)(2).

Under the BRA, a creditor who loses a bid to have a consumer debt found nondischargeable for being induced by a false financial statement must pay the costs and attorneys' fees incurred by the debtor in opposing the creditor \textsuperscript{47} This removes the concern of the honest debtor willing to submit to litigation over costs of that litigation insofar as those costs were a factor in inducing reaffirmation. Monetary costs, however, may not be the major factor for reaffirmation. The time lost and the delay in the proceedings may be of equal or greater significance to the debtor \textsuperscript{48}

As a last example of reasons for reaffirmation, when an obligation is co-signed by a friend or a relative of the debtor the debtor may reaffirm to protect the co-obligor from being required to pay the obligation. While the new Act offers a solution in Chapter 13 cases, it is plain that this leverage will continue to encourage reaffirmation in liquidation proceedings.\textsuperscript{49}

The Bankruptcy Commission felt that the frustration of the "fresh start" goal by reaffirmation of debts was serious enough to deserve elimination by an absolute prohibition against reaffirmation.

\begin{itemize}
\item \textsuperscript{45} See, e.g., note 30 supra, at 363.
\item \textsuperscript{46} H.R. 32, 94th Cong., 1st Sess. § 95(b)(2) (1975).
\item \textsuperscript{47} 11 U.S.C.A. § 523(d) (West Supp. 1979).
\item \textsuperscript{48} The Bankruptcy Commission Report concluded:
\begin{quote}
One of the more troublesome exceptions to discharge under the present Act is the nondischargeability of consumer debt obtained by the use of false financial statement. Substantial evidence of the abuse of this exception by creditors has come to the attention of the Commission. The exception has also generated substantial amount of litigation and has partially frustrated the "fresh start" goal of the discharge. On balance, the abuses and the harmful effects far outweigh the benefit to creditors by this exception. No evidence has come to the Commission attention that indicates the exception has any prophylactic effect.
\end{quote}

Comm. Report supra note 3, at 176 (footnotes omitted). On the other hand, some creditors saw it differently:
\begin{quote}
[Debtors] were apprehensive that if they gave truthful statement, the credit would be denied. When confronted with the false financial statement either directly or often through their attorney, they realize their wrongdoing and are willing to reaffirm their obligation. In other cases, the attorney for the lender and the bankrupt\’ attorney will conclude that it is likely that the lender will prevail in case of suit (now on Nondischargeable Application), and so they will agree on terms of settlement.
\end{quote}

\textit{Twemem, supra} note 30, at 364.

\item \textsuperscript{49} 11 U.S.C.A. § 1301 (West Supp. 1979) provides for stay of action against nonprofessional co-debtor of consumer debtor, but BRA § 524(e) makes plain that such relief does not apply in liquidation.
\end{itemize}
Hence, Bill 8200 had a similar prohibition; however, reaf¬
firmation in a settlement of a proceeding to determine the dischargeability of the reaffirmed debt and reaffirmation in a re-
demption agreement were viewed as desirable exceptions to the prohibition. It was apparently felt that the controls and limita-
tions placed by the new proposals on these motivations for reaffir-
ma tIon were sufficient to obviate the burden which might be
placed on the "fresh start."

The BRA subsections 524(c) and (d) further retreat from the
Commission's recommendation of complete prohibition. Reaffirma-
tion agreements are permitted, but agreement must be entered
into before discharge and must be followed by a thirty day
"cooling-off" period after the agreement would otherwise become
enforceable during which time the debtor may rescind his reaffir
ma tIon.

If the debtor is an individual, before the reaffirmation is al-
lowed, the court must give advice about its effect and the lack of
legal requirement for it. Furthermore, if reaffirmation of a con-
sumer debt not secured by real property is at issue, the court
must find that it will not impose undue hardships on the debtor or
defendants and is in the debtor's best interests. On the other hand,
if the reaffirmation is part of a settlement of false financial state-
ment litigation or is part of a redemption agreement, the court is
required to find only that the settlement or agreement has been entered into in good faith.

50. Comm. Report, supra note 3, § 4-507(a), at 142. Although the section con-
tains cross-references to §§ 4-504(b) and 4-506(b) which might be thought exceptions, note to that Section explains:
Neither section upholds the reaffirmation of an extinguished debt. Section
4-504(b) permits the enforcement of an agreement which in effect enables
the debtor to purchase collateral securing dischargeable consumer debt.
Section 4-506(b) allows, with safeguards protecting the debtor, the enforce-
ment of an agreement settling whether or not debt is dischargeable.
Comm. Report, supra note 3, at 143 n.2.

51. H.R. 8200, 95th Cong., 1st Sess. § 524(b)-(c) (1978), House Report supra
In fact, both of these exceptions were part of the Commission proposals despite the
denial of their exceptional result. See note 23, supra. The language of the Senate Bill
was identical, S. 2266, 95th Cong., 1st Sess. (1978), but was subsequently amended.

52. It is interesting to note that creditor advocate proposed consumer
cooling-off period of 48 hours similar to the right to disaffirm contract entered into
at [the consumer's] place of residence through door-to-door salesman. Twinem,
supra note 30, at 366.

This does not seem sound. There may be good reason to allow reaffirmation agreements under supervision of the court in the settlement of false statement litigation and redemptions, but the hardship and best interest standards, rather than a nebulous "good faith" standard, should be imposed here where they have meaning relative to the issues being litigated.\(^{54}\) Hardship and best interest standards, when applied to other reaffirmations, are subjective and largely depend on the moral choices and viewpoints of the bankruptcy judge for content, and they may prove as nebulous as "good faith." The requirement that court supervised reaffirmation may be made only before discharge is granted should have a salutary effect in preventing blatant creditor pressure, but the standards for court guidance are vague. The section suffered much in the compromises made by the Congress.

IV DISCRIMINATION AGAINST THE BANKRUPT

After bankruptcy many have found that their fresh start has not been so fresh because bankruptcy often carries with it a stigma of irresponsible behavior. Congress sought to alleviate this stigma somewhat by the new legislation. The Bankruptcy Commission version of the antidiscrimination provision would have outlawed any discriminatory treatment of an individual because of involvement in a bankruptcy proceeding.\(^{55}\) The enacted legislation, BRA section 525, verbosely outlaws only governmental discrimination in grants of privilege and employment.

The House Report suggests that the difference between the provision enacted and the Commission proposal is merely that the latter would have extended the prohibition to any discrimination, even by private parties, whereas the enacted version applies only to governmental units.\(^{56}\) In fact, the enacted version is much narrower than the House Report suggests. First, it applies to only two activities: denying, revoking or discriminating in governmental grants of privilege, and denying, terminating or discriminating in employment. Furthermore, it is forbidden only when these activities are done solely because of involvement in bankruptcy or failure to pay a discharged debt.

\(^{54}\) The term is not defined, but commercial lawyers are familiar with the largely meaningless "honest-in-fact" standard of U.C.C. § 1-201(19).

\(^{55}\) H. 31, 94th Cong., 1st Sess. § 4-508 (1975). The Commission Bill went on to provide that other factors such present or prospective financial condition or managerial ability could be considered. \(\text{Id.}\)

The House further indicates that the section codifies Perez v. Campbell.\textsuperscript{57} That result, however, is largely codified elsewhere in the BRA.\textsuperscript{58} The Perez decision held that a state could not employ its Motor Vehicle Responsibility Law to coerce payment of a discharged debt, in that case, a judgment arising out of a motor vehicle accident. The antidiscrimination section obviously exceeds Perez, but encompasses more than the holding in ways that are unclear. It applies to denial of governmental privileges and employment where the denial is solely due to involvement in a bankruptcy proceeding. The question follows, May bankruptcy involvement be considered at all? For example, May state bar examiners ask applicants questions about prior bankruptcies? May this have any relevance? The language of the Commission Bill would have answered these questions negatively. The legislative history of the BRA also tends toward a negative answer.\textsuperscript{59} The literal language of the Act, however, seems to prohibit such conduct only where the conduct is based completely on such involvement. It is unlikely that a complainant would be able to show that the sole consideration in denying a license and in terminating or refusing employment was involvement in a bankruptcy proceeding. The legislative history of the antidiscrimination section indicates, however, that the intended thrust of the section was to limit specific kinds of action by government defendants, rather than to emphasize the exclusivity of the

\textsuperscript{57} 402 U.S. 673 (1971). The thrust of the case is that by requiring judgment debtor, in an action arising out of motor vehicle accident to pay the judgment as condition for maintaining valid driver license, even though the judgment debt is discharged in bankruptcy, the state frustrates the congressional purpose and interferes with the operation of the bankruptcy laws. Therefore, regardless of the laudable purpose of the state, such law offends the supremacy clause and is constitutionally invalid. To the extent that it is an act which operates to collect discharged debt, it is enjoined by the BRA. 11 U.S.C.A. § 524(a)(2) (West Supp. 1979). To the extent that it is reaffirmation of such debt, it would have to pass the prerequisite to validity posed by the BRA. Id. at § 524(c), see note 54 supra.

\textsuperscript{58} To the extent that it operates to collect discharged debt, the discriminatory activity is enjoined by the BRA. 11 U.S.C.A. § 524(a)(2) (West Supp. 1979). In that it is reaffirmation of such debt, it would have to pass the BRA strainer. 11 U.S.C.A. § 524(c) (West Supp. 1979). See text accompanying note 54 supra.

\textsuperscript{59} [P]rohibition extends only to discrimination or other action based solely on the basis of the bankruptcy, on the basis of insolvency before or during bankruptcy prior to determination of discharge, or on the basis of nonpayment of debt discharged in the bankruptcy case (the Perez situation). It does not prohibit consideration of other factors, such as future financial responsibility or ability, and does not prohibit imposition of requirements such as net capital rules, if applied indiscriminately.

reason for the discrimination. There is a clear invitation in the legislative history for the courts to consider the issue broadly. "[T]he section is not exhaustive. The enumeration of various forms of discrimination against former bankrupts is not intended to permit other forms of discrimination." The wording of the section is far from clear and its effectiveness is very much in doubt.

V CONSUMER CREDITORS

Consumers may be creditors just as any other entity may be a creditor, but individuals in pursuit of personal, family or household purposes may unwittingly become creditors of a bankrupt in unconventional ways. These individuals may not even think of themselves as creditors. They are certainly not equipped by virtue of their creditor position to protect themselves by using the knowledge typical of a commercial lender. In limited areas, the Bankruptcy Reform Act has increased protection for these "consumer creditors.

A troublesome problem involving consumer purchasers and lessees arises where the bankrupt is a seller or lessor who has taken a down payment or security deposit on the purchase of consumer goods or rental property. Under the 1898 Bankruptcy Act, a trustee could disaffirm a contract for the sale of goods and reduce the purchaser to the status of an unsecured claimant for the amount paid towards the price. Consider the heartrending hypothetical of a poor couple who has struggled to make the downpayment on a "layaway" of Christmas toys for the children, only to be deprived of the money and the toys upon bankruptcy of the toy store before the toys are completely paid for and delivered. It is cold comfort for the poor couple to be told that they are now


61. The interrelationship between bankruptcy and U.C.C. § 2-502 offered little help for the typical consumer purchaser, whatever the effectiveness of the U.C.C. section in other contests, and this has been matter of much dispute. Countryman, Buyers and Sellers of Goods in Bankruptcy, 1 N.M.L. REV. 1435 (1971); see Schrag & Ratner, Caveat Emptor—Empty Coffer: The Bankruptcy Law Has Nothing to Offer 72 COLUM. L. REV. 1147, 1157 (1972). The buyer must show that (1) the debtor insolvency occurred within ten days after the first installment of this purchase was paid, and (2) that the goods had been identified to the contract of sale. U.C.C. § 2-502.

unsecured creditors of the toy store. They are unlikely to understand how to pursue their claim having never thought of themselves as creditors at all. Nor are they likely to realize enough in a distribution to unsecured creditors to purchase replacement toys. Such stories have moved many a law student to protest that this area of bankruptcy is particularly harsh on the unsuspecting public. Unfortunately although this situation probably occurs many times in real life, the amounts involved rarely lead to reported cases.\(^63\)

The problem is not limited to "layaway purchases, but includes many different situations, for example, prepaid appliance service repair contracts, prepaid contracts for other services such as dance lessons or exercise courses, and deposits made on merchandise to be delivered subsequently.

Security deposits made by tenants to a lessor who subsequently becomes bankrupt is a similar situation. Here, fortunately the need for a remedy is not so acute.\(^64\) Some states have enacted legislation making these deposits a trust fund to which the lessor holds only legal title.\(^65\) Trust property is not part of the bankrupt's estate under the 1898 Act and the trustee receives only bare legal title under the Bankruptcy Reform Act.\(^66\) Moreover, under the

\(^{63}\) See House Report, supra note 6, at 188, reprinted in [1978] 5 U.S. CODE CONG. & AD. NEWS 5963, 6148-49. In testimony before the Congressional Committee, witnesses used the much publicized W T. Grant & Co. bankruptcy to illustrate the point. The more recent J. M. Fields Co. bankruptcy is also on point.

\(^{64}\) See generally 4A Collier, supra note 27, ¶ 70.44, at 539.


\(^{66}\) 11 U.S.C. § 541(d) (1976) (repealed 1979). This assumes that the debtor has complied with the law and segregated the trust funds. This is a dubious assumption in the case of failing lessor; all too frequently it is suspected that the best the lessee can hope for will be that the debtor has commingled the funds with other general business cash deposits. If so, the intricate rules of tracing apply.

Whether the bankruptcy court will apply federal equity law or state law in resolving the difficult tracing problems has not been authoritatively settled. 4A Collier, supra note 27, ¶ 70.25 at 339. It has been suggested:

State law, including its common law, must generally determine whether trust relation existed and whether the cestuis has sufficiently identified the trust property. There is no general federal law of trusts. But the problem does not end at this point. There is the further question, and this federal one: What is the distribution contemplated by the Bankruptcy Act in the situation at bar? State trust law must not be allowed to pervert or override the distributive provisions of the Bankruptcy Act. A state rule which purports to fasten a general lien on person estate in the event of insolvency or general liquidation must be regarded as priority in disguise and incompatible with the order of distribution prescribed for bankruptcy [The Bankruptcy Act] intended to make clear that state rules of priority of distribution must yield in bankruptcy cases to that prescribed in the Act.
BRA, if the lessor's trustee rejects the lease, the lessee has the right to maintain possession of the rental property against the trustee, or treat rejection as termination of the lease and offset rental and other amounts due the lessor at the time of bankruptcy against the net amount of the security deposit. These solutions, however, fall far short of complete protection of tenants, because trust fund protection is available only where legislatures have acted. Tenants may not wish to maintain possession if services are terminated.


69 The BRA makes plain that tenant who chooses to remain in possession for the balance of the term of the lease after the lessor trustee has rejected the lease may offset, against the rent due, damages occurring after rejection caused by nonperformance of obligations in the lease. 11 U.S.C.A. § 365(h) (West Supp. 1979). It must be remembered that lease is both conveyance of real property and contract. As Professor Powell has expressed:

In practice, the modern law concerning estates for years consists chiefly of rules determining the construction and effect of lease covenants. Thus the background as conveyance, built solidly by 1500, has tremendous foreground, evolved largely since 1880, which is purely contractual in character. The modern law is the synthesis of these two historical factors. Sometimes the background peeks through and controls. Sometimes the foreground is alone considered as determinative. The lawyer problem is to determine which of these two factors is to control in his specific controversy.

2 R. POWELL, REAL PROPERTY, ¶ 221[1], at 181 (1977). This dual nature was recognized by the 1898 Act with the provision in § 70b which provided that rejection of such lease or any covenant therein by the trustee of the lessor does not deprive the lessee of his estate. 11 U.S.C. § 110(b) (1976) (repealed 1979). While this much was clear, little else was. See, e.g., Siegel, Landlord' Bankruptcy: A Proposal for Treatment of the Lease by Reference to Its Component Elements, 54 B.U.L. REV 903 (1974). The provisions permitting offset of damages for failure to perform landlord covenants of rejected lease clarify the area so far as the lessee is concerned; it may be unfair to the creditors and windfall to the tenant. As an illustration, assume that at the time of the lease the monthly rent is set at $500 with $250 of that allocated to the cost of provisions of services. At the time of the bankruptcy, the cost of services has increased to $300, and so has the value of the occupancy of the premises, for total of $600. If the lessee offsets the service substitute cost of $300, however, he will be obligated to pay only $200 net rent for his occupancy. While it may be argued that, in fact, this is all the interest the bankrupt lessee had, it hardly seems fair that the lessee should come out so much better than others dealing with the bankrupt. It would seem that this situation is result of the congressional draftsmen failure to consider the rather unique characteristics of lease as not just an executory contract. The language of the BRA is equally illustrative of this point. 11 U.S.C.A. § 365(f)(2) (West Supp. 1979). If applied literally it will never allow the trustee of lessor in liquidation proceeding to reject the lease since he must assume the lease in order to assign it. Id. This works well enough in the usual executory contract when performance will cease by both parties to the contract if rejected, but it is not appropriate where the lessee may remain in possession of the premises and must then continue to pay rent. The Bankruptcy Commission evidently considered this
and the offset offered under the BRA may be insufficient.

It seems that the BRA subsection 507(a)(5) offers substantial help to consumers who become unwitting unsecured creditors when the trustee disaffirms executory contracts involving the purchase or lease of property or services for personal, family or household use. The subsection gives such creditors a fifth priority for claims up to a total amount of $900 resulting from retained deposits for goods and services not delivered or provided. Since the debtors involved are usually business bankrupts with assets, and since the categories of unsecured creditors having greater priority are limited, the fifth priority consumer creditor has a significant chance of recovery. Moreover, under BRA subsection 724(b)(2), tax liens are “postponed” until the first five priority claimants are paid, and property subject to a tax lien is used first to satisfy these claims to the extent of the amount of the tax lien.

Similar problems involving real estate purchase contracts or other arrangements where the buyer does not receive the property until the purchase price is completely paid are not resolved by the fifth priority for consumer deposits up to $900 because larger amounts of money are usually in issue. The purchaser in these situations has merely an executory contract subject to rejection by the trustee.

problem. It provided in its bill, that rejection of lease abandoned the leased property to the lessee rather than causing breach of the lease. H. 31, 94th Cong., 1st Sess. § 4-602(c) (1975). The Commission commented:

[This provision] obviates the need to distinguish between leased covenants that are part of the estate of the lease and those that are not. As result, the court is not invited to reform the lease agreement entered by the parties. Instead the lessor trustee, or the debtor in possession, is called upon to compare the negative value of an unprofitable lease with the remaining value of the leased property. If the outcome shows negative net value, he should abandon the leased property to the lessee. Abandonment is not breach of the lease, however, and the lessee receiving the abandoned property is not permitted claim for loss of bargain.


70. Administrative expenses have first priority in distribution to unsecured creditors. The second priority goes to claims, surely of limited number, which arise after the commencement of the case in an involuntary bankruptcy, but before the appointment of trustee. Third and fourth priorities are allowed for wage claims of, and contributions to, employee benefit plans of the bankrupt. These are subject to substantial limitations. 11 U.S.C.A. § 507(a)(1)-4 (West Supp. 1979).

71. A similar concept was embodied in The Bankruptcy Act of 1898 § 67(c), which “postponed” non-possessory tax liens on personal property to the claims of first and second priority creditors. 11 U.S.C. § 107(c) (1976) (repealed 1979).

New provisions of the BRA substantially paralleling those dealing with leaseholds mitigate the harshness of the doctrine of rejection where the purchaser is in possession. The purchaser may terminate his obligations and receive a lien on the property in the amount of the purchase price already paid, or he may remain in possession and continue to make purchase payments, offsetting damages caused after rejection by the debtor's nonperformance under the contract. There is no other liability on the estate for damages. The right of offset is the purchaser's only remedy. Upon completion of payments, the purchaser is to receive title from the trustee. These provisions seem to envision chapter proceedings but not liquidation proceedings. In liquidation the estate is wound up and the seller-bankrupt's interest in the property including legal title, presumably will be sold. It is not clear whether the buyer at this sale is then subject to the control of the bankruptcy court or how a deed to the original buyer could ultimately be executed.

VI. CONCLUSION

Consumers, whether as bankrupts or creditors of the bankrupt, while not receiving the proportionate consideration accorded owners or financiers of shopping centers in the Bankruptcy Reform Act, have at least received recognition for some of their special problems. As creditors, consumers' inability to protect themselves in special deposit situations has been recognized. The $900 limitation on recovery seems adequate to cover most small deposits, and the fifth priority category of unsecured creditors offers reasonable hope of substantial payment. The present claims procedure, however, is far too cumbersome for the small amounts involved in consumer creditor litigation. The new bankruptcy rules should provide for some sort of automatic recognition of these potential claims to increase the practical benefit of the new provisions to most consumers. Consumers and other buyers of real estate through the use of contracts now have greater protection in event of the seller's bankruptcy. Litigation will almost certainly be necessary to clarify some areas. Similarly lessors of bankrupt landlords

74. Id. § 365(j). This same lien relief is available for purchaser not in possession.
75. Id. § 365(h).
76. There are similar, less complex, problems with leaseholds when the lessor becomes bankrupt. See note 66 supra.
are accorded greater protections, although uncertainty still remains due to Congress lack of recognition of the legal complexities of leaseholds.

While consumer bankrupts have not been given the full measure of protection under the Bankruptcy Reform Act that the Bankruptcy Commission and some consumer advocates desired, the "fresh start" provisions of the old Bankruptcy Act have been enhanced in a number of areas. In states with stingy exemption laws, the BRA creates a federal floor on exemptions. In those states, voluntary bankruptcy is encouraged because federally exempt property otherwise subject to levy under state law would remain the debtor's upon bankruptcy. It is perhaps for this reason that the very peculiar provision permitting states to elect not to use the federal exemptions was inserted.\footnote{78. \textit{Id.} § 522(b)(1).} The increased ability of the debtor to avoid both consensual and nonconsensual liens on exempt and abandoned property and redemption as of right of property subject to a security interest should increase the usable property left to the debtor after bankruptcy.

The direct economic effect on consumer credit of these "fresh start" provisions, while incalculable, is probably not great. Their indirect effect is a different question. As this article has attempted to demonstrate, these provisions work indirectly to discourage reaffirmations of debts. The provisions of the Act dealing directly with reaffirmation are of uncertain utility although most extreme forms of abuse should be prevented. Much depends on how they are interpreted by the courts.

Most obscure in effect are the antidiscrimination provisions. While these could be of substantial significance, they may amount to nothing at all, depending once again on the courts application of the principles.