

1-1-1975

Prospects for Structural Reform of the Bankruptcy System

Marjorie L. Girth

Georgia State University College of Law, mgirth@gsu.edu

Follow this and additional works at: https://readingroom.law.gsu.edu/faculty_pub

 Part of the [Administrative Law Commons](#), [Bankruptcy Law Commons](#), and the [Jurisprudence Commons](#)

Recommended Citation

Marjorie L. Girth, Prospects for Structural Reform of the Bankruptcy System, 63 Cal. L. Rev. 1546 (1975).

This Article is brought to you for free and open access by the Faculty Publications at Reading Room. It has been accepted for inclusion in Faculty Publications By Year by an authorized administrator of Reading Room. For more information, please contact mbutler@gsu.edu.

Prospects for Structural Reform of The Bankruptcy System

Marjorie Girth†

Professor Girth compares and evaluates the three major proposals for structural reform of the bankruptcy system. The analysis is focused on the potential impact of the proposed revisions on the bankruptcy caseload, and on the relative efficiencies of the alternative proposals. The Article concludes with a discussion of some obstacles to reform of the system.

Congress is presently considering the possibility of structural reform for the processes of handling bankruptcy cases in this country. Major revision of the Bankruptcy Act¹ has not occurred since 1938 and the several suggestions for reform indicate that a substantial change is overdue.² This Article analyzes the three major proposals for possible revisions of the bankruptcy system. It then assesses the impact of the proposed revisions on the bankruptcy caseload and concludes with a discussion of the current obstacles to structural bankruptcy reform.

I

ALTERNATIVE PROPOSALS FOR REVISION OF THE BANKRUPTCY LAWS

Three proposals for revision of the bankruptcy system are being considered by Congress. Each of them attempts basic structural changes which distinguish these proposals from substantive and procedural amendments enacted since 1938. The proposals themselves differ

† Associate Professor of Law, State University of New York at Buffalo. A.B. 1959, Mt. Holyoke; LL.B. 1962, Harvard. Professor Girth is a co-author of the Brookings Institution study of bankruptcy administration, D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* (1971). The author wishes to thank her colleague John A. Spanogle, Jr. for encouraging her efforts on this Article.

1. The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, as amended by the Chandler Act of 1938, ch. 575, 52 Stat. 883. The Bankruptcy Act is codified at 11 U.S.C. §§ 1 *et seq.* (1970).

2. Reform legislation was originally introduced in October, 1973. See note 4 *infra*. Two years later, the House and Senate Judiciary Committees are making very slow progress toward legislative enactments. Hearings are now scheduled for completion in 1976. Letter from Rep. Don Edwards, Chairman, Subcommittee on Civil and Constitutional Rights, U.S. House Judiciary Committee, to author, July 24, 1975.

largely in the structures which they recommend, while reflecting greater agreement on substantive changes.³ This section summarizes the structural provisions of the three proposals.

A. *The Presidential Commission's Bill*

This legislation [hereinafter called the Commission Bill] resulted from the work of the Commission on the Bankruptcy Laws of the United States.⁴ The Commission began its work in light of widespread agreement that the present structure for handling bankruptcy cases was seriously outmoded.⁵ This consensus, however, did not survive the articulation of the Commission's suggested solution, which was to separate the "administrative" and "judicial" functions presently performed by the bankruptcy judges.⁶ Specifically, the Commission proposed the creation of two new entities: (1) the United States Bankruptcy Courts;⁷ and (2) the United States Bankruptcy Administration.⁸

The Bankruptcy Administration would be an independent agency within the executive branch of the federal government. All bankruptcy petitions except those for railroad reorganizations, but including those for the reorganization procedures which merged the provisions of chapters X, XI, and XII of the present Bankruptcy Act, would be filed with this agency.⁹ The new bankruptcy court would serve two main functions: (1) the initial step for review from decisions made within the

3. This Article does not attempt a definitive analysis of the substantive proposals, but it uses them to illustrate the impact of the proposed structural changes.

4. Congress authorized the commission in 1970. It completed work in July 1973. See Kennedy, *Foreword, Bankruptcy Reform—1973*, 21 U.C.L.A. L. REV. 381-87 (1973) (Professor Kennedy was the Executive Director of the Commission). This version of the proposed bankruptcy act was first introduced as H.R. 10792, 93d Cong., 1st Sess. (1973) and S. 2565, 93d Cong., 1st Sess. (1973). It was then reintroduced as H.R. 31, 94th Cong., 1st Sess. (1975) and S. 236, 94th Cong., 1st Sess. (1975) [hereinafter cited as the Commission Bill]. A second bankruptcy bill pending, H.R. 32, 94th Cong., 1st Sess. (1975) and S. 235, 94th Cong., 1st Sess. (1975), is commonly referred to as the Judges' Bill. The pertinent provisions of the Judges' Bill are summarized in Part I section C *infra*.

5. Cyr, *Chapter XIII and the Commission on the Bankruptcy Laws of the United States: A Time of Reckoning*, 75 COM. L.J. 385 (1970). Similar concerns were stated in the statute which authorized the Commission, Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

6. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, PART I, H.R. DOC. NO. 93-137, 93d Cong., 1st Sess. 1, 5-8 (1970) [hereinafter cited as REPORT: PART I].

7. Commission Bill §§ 2-101 *et seq.* Judge Edward Weinfeld dissented from the portion of the commission report which recommended the creation of the separate system of bankruptcy courts, preferring instead to retain the current system for handling judicial functions. REPORT: PART I, at 299-301.

8. Commission Bill §§ 3-101 *et seq.*

9. *Id.* §§ 4-202(b), 4-207(b), 9-202(b), 9-204(b).

agency;¹⁰ and (2) the initial trial forum for certain issues, such as objections to discharge.¹¹ Issues appealed from the bankruptcy court would be heard successively in the local United States District Court, the appropriate Circuit Court of Appeals, and the United States Supreme Court.¹²

The structural division attempted to meet two long-standing criticisms of the present system. The first charged that bankruptcy judges intimately involved in the administration of cases could not be objective when they had to decide litigated issues.¹³ Second, it seemed more efficient to separate people who were "selected and compensated for judicial responsibilities" from those who handle administrative details demanding lesser skills.¹⁴

The effort to separate "administrative" from "judicial" duties inevitably made the Commission's report subject to criticism for improper classification.¹⁵ The Commission seemed to feel that the existence of assets beyond those necessary to pay administrative expenses turned a case into one requiring "a judicial setting" even if no dispute arose.¹⁶ It also concluded that even the most routine dispute required resolution in a bankruptcy court.¹⁷ Thus, uncontested decisions were perceived as resulting from administrative duties, unless those decisions were made in cases which ultimately resulted in payments to creditors. Despite these classification problems, enactment of the Commission Bill would be an important reform because many uncontested cases could be processed without court intervention.¹⁸

Several other important features of the Commission's structural proposals should be mentioned. The Commission Bill provides for expansion of the jurisdiction of the bankruptcy court to include all controversies arising out of a bankruptcy case.¹⁹ Thus, the opportunity

10. For examples, see *id.* §§ 4-101, 2-205(a).

11. *Id.* § 4-505(b).

12. *Id.* § 2-210.

13. REPORT, PART I, at 5-6; 93-94.

14. Kennedy, *Restructuring Bankruptcy Administration: The Proposals of the Commission on Bankruptcy Laws*, 30 BUS. LAW. 399, 400-01 (1975).

15. Lee, *A Critical Comparison of the Commission Bill and the Judges' Bill for the Amendment of the Bankruptcy Act*, 49 AM. BANKR. L.J. 1, 6-7 (1975). The Commission itself had been critical of an internal survey performed at the request of the Administrative Office of the Courts. The survey had asked the bankruptcy judges what proportions of their own time were consumed by administrative and judicial tasks. REPORT: PART I, at 5, 135-36.

16. REPORT: PART I, at 85-86. For data on the insignificant size of "asset" cases, see text accompanying notes 62 to 69 *infra*.

17. REPORT: PART I, at 86-87.

18. The Uniform Probate Code's system of "flexible administration" is based upon a very similar proposal. See UNIFORM PROBATE CODE §§ 3-301 to 3-311 (1974).

19. Commission Bill § 2-201.

to delay bankruptcy proceedings by alleging that the bankruptcy court lacked jurisdiction over a particular issue would be greatly reduced.²⁰ The Commission also recommended a change in the procedure for appointment of bankruptcy judges to one requiring nominations by the President and confirmation by the Senate for terms of 15 years.²¹

The Commission's proposal also benefits petitioners by providing for broader powers for government employees. It allows agency staff to counsel debtors with regular income concerning the kinds of relief available under the statute.²² The administrator would also be authorized to serve as trustee in the proceeding unless creditors request a meeting for the purpose of electing a trustee, or unless the debtor's business is to be operated.²³ This greater use of salaried personnel should reduce the time necessary to complete the administration of a bankruptcy case.²⁴

Financing of the bankruptcy process constitutes another area ripe for structural reform. The Commission attempts to create separate financing systems for its administrative and judicial structures. The bankruptcy courts would be publicly financed from general appropriations.²⁵ To finance the agency, the Commission would shift to a more complicated formula: expenses would be paid from fees and charges, estimated at a level which would approximate costs,²⁶ earnings from funds invested in proposed Chapter VI proceedings,²⁷ and congressional appropriations.²⁸

B. *The Brookings Proposal*

Serious concern about the bankruptcy system had antedated the creation of the Presidential Commission. In the early 1960's, representatives of the federal courts had asked the Brookings Institution to consid-

20. REPORT: PART I, at 89-92.

21. Commission Bill § 2-102; REPORT: PART I, at 6, 95. The Commission recommends this change in appointment procedure because it considers its proposed Bankruptcy Court as analogous to the Tax Court. For a discussion of the inappropriateness of the analogy, see Testimony presented on September 19, 1975, before the Subcommittee on Civil and Constitutional Rights of the U.S. House Judiciary Committee by Marjorie Girth and David T. Stanley, at 9, 14-15 [hereinafter cited as *Girth & Stanley Testimony*].

22. Commission Bill § 4-203(1)(a).

23. *Id.* § 5-101.

24. REPORT: PART I, at 123-24.

25. Commission Bill § 2-107; REPORT: PART I, at 134-35.

26. Commission Bill § 3-302.

27. Chapter VI is the counterpart to the present Chapter XIII in which wage-earning bankrupts can propose to pay their debts over an extended period of time, possibly in a reduced amount. See *id.* § 3-303.

28. *Id.* § 3-301(b).

er undertaking a nationwide survey of bankruptcy operations. Funding was obtained from the Ford Foundation, and the Brookings staff selected eight federal judicial districts as representative of the various kinds of caseload which bankruptcy judges handled.

The Brookings authors interviewed approximately 600 participants in bankruptcy cases. In addition, almost 1,700 bankruptcy files were examined, 400 personal bankrupts were interviewed, and the Gallup Organization polled the public on their knowledge and attitudes about bankruptcy.²⁹

The resulting study recommended reform of the entire structure for handling bankruptcy cases. It found that bankruptcy cases had *potential* for litigation, but in the overwhelming proportion of cases, neither creditors nor debtors found it worthwhile to litigate. By the time an individual or a business decides to use the bankruptcy remedy, its assets have dwindled to a point at which successful litigation might cost more than it would yield.³⁰ Spectacular exceptions to this general rule exist,³¹ but the Brookings authors felt that a reformed bankruptcy system could be designed for the typical case without sacrificing the capacity for more complex processing in those exceptional cases in which the parties felt it worthwhile to pursue an issue.

Since the overwhelming proportion of bankruptcy cases require only administrative processing, the Brookings study recommended the establishment of an independent bankruptcy agency within the executive branch.³² Originally, all cases except corporate reorganizations were to be filed with the agency,³³ but the Commission's report was convincing in its recommendation that all cases except railroad reorganizations be filed with the agency.³⁴

The revised recommendation would require that agency personnel process all cases, unless those filed as business reorganizations were transferred to the United States District Court pursuant to an opting-out procedure.³⁵ Contested matters would be heard by administrative law

29. For details of the methodology, see D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* (1971), Apps. A-1 to A-4, B-1 [hereinafter cited as D. STANLEY & M. GIRTH].

30. *Id.* at 77; see text accompanying notes 62-71 and 87-88 *infra*.

31. Note that the percentage of business reorganization and arrangement cases did not exceed two percent of the total bankruptcy caseload in fiscal years 1970 through 1975. See text accompanying notes 59-60 *infra*.

32. D. STANLEY & M. GIRTH 199.

33. *Id.* at 212. Corporate reorganizations were to be filed with the U.S. District Courts. The study did not deal with Ch. IX or Section 77 proceedings. *Id.* at 196.

34. See note 9 *supra*.

35. Compare Commission Bill §§ 7-101 and 7-102, which allow the administrator or any party in interest to petition the court to intervene in the reorganization by ordering the administrator to add representative members to creditors' committees and by or-

judges, whose decisions could be appealed to a central appeals board within the agency and then to the appropriate Circuit Court of Appeals, before reaching the United States Supreme Court.³⁶ The proposed agency structure thus avoids the classification problems that the Commission's proposal encountered.

Agency personnel would be salaried and all except the director, deputy director, attorneys, and specialists needed on an ad hoc basis would be subject to civil service rules.³⁷ As in the Commission's proposal, trained staff would be available to counsel the debtor on the options which were available under the statute. The agency would also have financial counseling staff, who would be available to the debtor as long as the case was pending. Under these circumstances, some individual debtors might decide not to use counsel, although the option would remain open to them to do so if they wished.³⁸

The Brookings authors also decided that the entire system should be financed from general tax revenues.³⁹ This decision was based upon their perception of bankruptcy as a service to debtors in trouble, whose financial rehabilitation would benefit a broader public than the immediate parties.⁴⁰

C. *The "Judges' Bill"*

Although bankruptcy judges were not represented on the Commission itself,⁴¹ their views have not gone unheard. After reviewing the Commission's proposed statute, the National Conference of Bankruptcy Judges decided to draft its own revisions to the present Bankruptcy Act.⁴² The judges' alternative legislative proposal has focused attention

during the administrator to appoint a trustee, subject to the court's approval. See also *Girth & Stanley Testimony*, *supra* note 21, at 25-26.

36. D. STANLEY & M. GIRTH 215.

37. *Id.* at 203-04.

38. *Id.* at 204-05.

39. *Id.* at 214. Nominal filing fees would provide some revenue.

40. After considering the Commission's recommendations, the Brookings authors continue to feel that the system should be publicly financed. One possible alternative would be to publicly-finance liquidation proceedings, and then charge the costs of personal or business payout plans against creditors participating in those cases. This would extend the Commission's proposals under Commission Bill § 3-302 to their Chapter VII proceedings. The need for public funds could also be reduced by the amount of earnings from invested funds of all bankruptcy estates. See *Girth & Stanley Testimony*, *supra* note 21, at 17-18.

41. For a history of the elimination of the requirement that bankruptcy judges be included on the Commission, see Cyr, *Setting the Record Straight for a Comprehensive Revision of the Bankruptcy Act of 1898*, 49 AM. BANKR. L.J. 99, 102-07 (1975).

42. This legislation was first introduced in 1974; it was reintroduced in January, 1975 as H.R. 32 and S. 235, respectively, 94th Cong., 1st Sess. (1975) [hereinafter cited as the Judges' Bill].

on their recommendations to a greater extent than a minority position on the Commission might have achieved.

The Judges' Bill includes a number of the substantive reforms which the Commission proposed. The judges' structural recommendations, however, only complete the process of enhancing the status of the former bankruptcy referee.⁴³ They now recommend creation of a "one-stop, full-service bankruptcy court,"⁴⁴ with law clerks, criers, and bailiffs, among other subsidiary personnel.⁴⁵ Appeals from such courts would go directly to the appropriate Circuit Court of Appeals and then to the United States Supreme Court.⁴⁶

The concept of the full-service court avoids the Commission's classification problems. All bankruptcy petitions, including distinct petitions for business "arrangement" and "reorganization" proceedings, would be filed with the court.⁴⁷ The bankruptcy court would have the enlarged jurisdiction recommended by the Commission.⁴⁸ The bankruptcy judges would have 15-year terms, as in the Commission Bill, but appointing authority would be lodged in the Judicial Council of the appropriate circuit.⁴⁹

The Judges' Bill also includes a proposal to establish the Branch of Bankruptcy Administration within the Administrative Office of the United States Courts.⁵⁰ However, the role foreseen for the Branch is much more limited than that proposed by the Commission for the bankruptcy agency.⁵¹ For example, the Branch could help a person who is considering bankruptcy prepare a petition and statement of affairs,⁵² but no counseling facilities would be available within the Administrative Office. Instead, the judges' proposal provides for the Director to maintain a list of attorneys for individual referrals.⁵³

The judges' proposals for financing the bankruptcy system provide more systematic reform than do the Commission's. Financing from

43. In 1973 bankruptcy referees attained the title of "bankruptcy judges." BANKRUPTCY RULES § 901(7) (1973) (effective October 1, 1973).

44. Lee, *A Critical Comparison of the Commission Bill and the Judges' Bill for the Amendment of the Bankruptcy Act*, 49 AM. BANKR. L.J. 1, 6 (1975); Judges' Bill §§ 2-101 *et seq.*

45. Judges' Bill § 2-106.

46. *Id.* § 2-209.

47. *Id.* §§ 4-202(b) and 4-207(b). For the Commission's proposal, see note 9 *supra*. The "arrangement" and "reorganization" procedures are found in Chapters VIII and VII, respectively, of the Judges' Bill.

48. Judges' Bill § 2-201.

49. *Id.* § 2-102.

50. *Id.* § 1-102(5). The funding provision is section 3-101. For an analysis of the origins and limited powers of the Administrative Office, see P. FISH, *THE POLITICS OF FEDERAL JUDICIAL ADMINISTRATION*, Chs. 4-6 (1973).

51. Lee, *supra* note 44, at 9-12.

52. Judges' Bill § 4-203(a).

53. *Id.* § 4-203(b) and (c).

general appropriations is recommended for the bankruptcy courts and their supporting personnel,⁵⁴ a much more significant recommendation than the Commission's because it covers virtually the entire system. Congressional appropriations are also authorized for the Branch of Bankruptcy Administration.⁵⁵ In addition, the Director of the Administrative Office is authorized to establish filing fees and charges, based upon a standard of "reasonable and equitable" levels,⁵⁶ not the estimated actual cost standard proposed by the Commission. The judges also adopt the Commission's proposal that earnings from investments of Chapter VI estates be forwarded to the federal treasury.⁵⁷

II

CASELOAD WHICH A REVISED BANKRUPTCY STRUCTURE WOULD HANDLE

Neither the Presidential Commission nor the bankruptcy judges made an independent factual assessment of the activity within the current bankruptcy caseload. Neither they nor anyone else disputed the Brookings factual findings on the personal and financial profiles of the petitioners and on the kinds of activity which occurred as the cases were processed.

The experience of the last 5 years, which is summarized in the table following, shows that personal bankruptcy cases continue to constitute an overwhelming proportion of the bankruptcy caseload, although the percentage of business cases has increased slightly.⁵⁸

Bankruptcy Filings

<u>Fiscal Year</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
Personal Filings	178,202	182,249	164,737	155,707	168,706	224,354
Percent of total	91.7%	90.5%	90.0%	89.9%	89.0%	88.2%
Business Filings	16,197	19,103	18,132	17,490	20,807	30,130
Percent of total	8.3%	9.5%	10.8%	10.1%	11.0%	11.8%
Total Filings	194,399	201,352	182,869	173,197	189,513	254,484

Source: DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES — (1975).

During the same period, Chapter XI filings for business arrangements

54. *Id.* § 2-107.

55. *Id.* § 3-101.

56. *Id.* § 3-102.

57. *Id.* § 3-103(b).

58. For earlier years, see D. STANLEY & M. GIRTH, *supra* note 29, at 107.

did not exceed 1.4 percent of the total bankruptcy caseload,⁵⁹ and the total of all other business reorganizations and arrangements did not exceed 0.2 percent of the total bankruptcy caseload.⁶⁰ These statistics emphasize how inappropriate it would be to force 98 percent of the petitioners into a *structure* emphasizing the needs of less than 2 percent of the caseload.⁶¹

Although the Brookings data should have destroyed some myths about the asset values of business bankruptcy liquidations, some preconceptions linger. After the Commission's report was completed, Professor Kennedy wrote that "[b]usiness bankruptcies are typically asset bankruptcies"⁶² This ignores the fact that 31 percent of the business liquidation cases in the Brookings sample had no assets and an additional 13 percent paid only administrative expenses. Consequently, only 56 percent of the business liquidations were "asset cases," and the median size of such estates was a mere \$3190.⁶³ Costs of administration averaged 29.3 percent in the Brookings asset cases,⁶⁴ and would total \$935 in the median business asset case. If no creditors were entitled to priority of payment under the present statute,⁶⁵ unsecured creditors would share \$2255, an amount which would not be likely to encourage litigation.

Readers should recall that business asset liquidations would total only 5 to 6 percent of the total bankruptcy caseload.⁶⁶ If the new structure emphasized business asset liquidations, arrangements, and reorganizations,⁶⁷ the reformed structure would be designed for only ap-

59. 0.6 percent in Fiscal Year 1970; 0.9 percent in Fiscal Year 1971; 0.7 percent in Fiscal Year 1972; 0.8 percent in Fiscal Year 1973; 1.2 percent in Fiscal Year 1974; and 1.4 percent in Fiscal Year 1975. DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES — (1975).

60. 0.09 percent in Fiscal Year 1970; 0.1 percent in Fiscal Years 1971 through 1973; and 0.2 percent in Fiscal Years 1974 and 1975. *Id.*

61. This article does not attempt to deal extensively with the substantive or procedural issues involving reorganizations. That aspect of the debate is pursued in Weintraub & Levin, *Chapter VII (Reorganizations) as Proposed By The Bankruptcy Commission: The Widening Gap Between Theory And Reality*, 47 AM. BANKR. L.J. 323 (1973); Trost, *Corporate Reorganizations Under Chapter VII of the "Bankruptcy Act of 1973": Another View*, 48 AM. BANKR. L.J. 111 (1974); and Brudney, *The Bankruptcy Commission's Proposed "Modification" of the Absolute Priority Rule*, 48 AM. BANKR. L.J. 305 (1974).

62. Kennedy, *The Report of the Bankruptcy Commission: The First Five Chapters of the Proposed New Bankruptcy Act*, 49 IND. L.J. 422, 430 (1974).

63. D. STANLEY & M. GIRTH, *supra* note 29, at 127. The Administrative Office does not maintain data on the asset status of business and personal bankruptcy cases, so this information cannot be updated from published information.

64. *Id.* at 177.

65. Bankruptcy Act § 64, 11 U.S.C. § 104 (1970).

66. This is 56 percent of the percentage of business filings for each year. See the table following text at note 58 *supra*.

67. One commentator does suggest that the structure for bankruptcy cases divide

proximately 8 percent of its total volume. Once again, the Brookings authors felt that the reformed structure should not be designed specifically for such a small portion of the overall bankruptcy caseload.

The frequency and size of asset cases in the personal bankruptcy liquidation sample were even lower than the corresponding figures for business liquidations. Sixty-four percent of the personal bankruptcy liquidation cases had no assets. Another 20 percent paid only administrative expenses. The 16 percent which were asset cases had a median size of \$311. Subtracting the 29.3 percent average administrative cost of \$91 left creditors with only \$220.⁶⁸ The median size of non-business arrangement cases under Chapter XIII was \$600.⁶⁹

Not surprisingly, a caseload reflecting these low asset values did not generate much litigation. For example, objections to claims were filed in less than 10 percent of the cases.⁷⁰ Such objections usually only require that the creditor substantiate its claims, normally through accounting records. Objections to discharge, also very infrequent, were filed in only 4 percent of each of the non-business and non-corporate business samples. Only one business bankrupt and less than 1 percent of the personal bankrupts actually had their discharges denied.⁷¹

The precise impact that major substantive reforms may have on the size and composition of the caseload cannot be accurately predicted. One can, however, point to specific provisions which would affect the caseload. Those likely to decrease litigation include the following:

(1) The proposal to expand the jurisdiction of the bankruptcy courts.⁷² As indicated above, this provision will reduce litigation concerning the propriety of the bankruptcy courts' jurisdiction.

(2) Uniform federal exemptions, recommended by the Commission.⁷³ This proposal combines uniformity and higher valuations for

consumer from business cases, reserving the bankruptcy courts for the latter. Phelan, *The Proposed Bankruptcy Administration (The "FBA")—Bureaucratic Alphabet Soup Gets A Bigger Bowl*, 48 AM. BANKR. L.J. 341, 342-45 (1974).

68. D. STANLEY & M. GIRTH, *supra* note 29, at 88.

69. *Id.* at 102.

70. These cases included three percent of the personal bankruptcy liquidations, and 31 percent of the business bankruptcy liquidations. For arrangement proceedings creditors' stakes and the incidence of objections was understandably higher, involving 9 percent of Chapter XIII's and three-quarters of the Chapter XI's. D. STANLEY & M. GIRTH, *supra* note 29, at 89, 98, 128, 137.

71. *Id.* at 91, 129. Other details on litigation activity can be found at 77-91, 94-103, 121-29, 134-41.

72. Section 2-201 of both the Commission Bill and the Judges' Bill, discussed at text accompanying notes 19-20 and note 48 *supra*, respectively. The Brookings authors also favor the comprehensive grant of jurisdiction, but they would have Congress make that grant to their proposed agency. See *Girth & Stanley, Testimony, supra* note 21, at 13-14.

73. Commission Bill § 4-503.

exempt property compared to most current state laws. The latter factor should deter debtors from understating the value of their property and reduce creditors' incentives to challenge the stated values.⁷⁴ The Judges' Bill would establish uniform minimum federal exemptions, but would allow the states to be more generous.⁷⁵

(3) The removal of the alleged false financial statement as an exception to dischargeability in non-business cases.⁷⁶ Citing a creditor's enormous "leverage" when it had obtained a financial statement from a consumer, the Commission decided that "exploitation" via settlements or reaffirmations could be eliminated only by removing this exception to dischargeability.⁷⁷ The Brookings study goes even further in recommending the elimination of all exceptions to dischargeability other than alimony, support, and unsecured debts of creditors who did not have notice of the bankruptcy proceedings.⁷⁸

(4) Removal of the necessity of proving that a creditor who received an alleged "preference"⁷⁹ within 3 months of the filing of the petition had "reasonable cause to believe that the debtor is insolvent."⁸⁰ "Reasonable cause to believe" is measured as of the time the transfer or payment was made,⁸¹ and is very difficult to prove.

Examples of proposed revisions which might increase litigation include the following:

(1) The provision that one creditor with a \$2500 unsecured claim may file an involuntary petition against an alleged bankrupt.⁸² Since the creditor could now act on its own, more "nuisance" filings may occur, resulting in more contested hearings.

74. Allowed exemptions varied from those which had been claimed in 29 percent of the cases in the Brookings study. D. STANLEY & M. GIRTH, *supra* note 29, at 83.

75. Judges' Bill § 4-503. The Brookings authors prefer that an aggregate minimum dollar value be set for all property other than realty, rather than minima for particular types of property. See Girth & Stanley, *Testimony, supra* note 21, at 22-23.

76. Commission Bill § 4-507(a).

77. Kennedy, *supra* note 62, at 429 n.55.

78. D. STANLEY & M. GIRTH, *supra* note 29, at 208.

79. A "preference" is a transfer or payment on account of an antecedent debt, received by a creditor whose position *vis à vis* the other creditors who share its status would thereby be improved. Bankruptcy Act § 60(a), 11 U.S.C. § 96(a) (1970) (makes such transfers within four months of bankruptcy vulnerable to attack).

80. Bankruptcy Act § 60(b), 11 U.S.C. § 96(b) (1970). Section 4-607 of both the Commission Bill and the Judges' Bill require such proof only if the creditor is personally related to the petitioner or if the creditor was "a partner, an affiliate, a director, an officer, or a managing agent of or for the debtor" and payments to the creditor had occurred between 3 months and 1 year before the filing.

81. *Id.*

82. Commission Bill § 4-205(a); Judges' Bill § 4-205(a). A counterpart provision for filing involuntary corporate reorganizations appears in § 4-205(b) of both bills. Compare Bankruptcy Act § 59(b), 11 U.S.C. § 95(b) (1970), which requires three or more creditors with unsecured claims totalling \$500 before an involuntary petition can be filed.

(2) The proposal that an "unconscionable consumer claim" would be disallowed.⁸³

(3) The addition of a category of claims arising within 90 days of the filing of the bankruptcy petition to those which would be excepted from discharge if the petitioner incurred the debt "without the intention, at the time it was incurred, to pay the debt and in contemplation of the filing of a petition under this title."⁸⁴ If this section were enacted, problems of proof would be comparable to those eliminated in the preference section.

(4) The proposal that changes in the values of collateral under "blanket" security interests be used to determine whether a preference had occurred.⁸⁵ A trustee under the proposed revision could argue that a preference had occurred if the value of the collateral at the time of the bankruptcy filing was higher than it had been at the beginning of preference period.⁸⁶

Nothing about any of these proposed substantive changes would produce an increase in the *asset* values of estates which are being administered under the bankruptcy system, and increased exemptions might even decrease such values.⁸⁷ Creditors will continue to ask "is it worth it?" before deciding to litigate. Without increased asset values, their answer will usually be negative.⁸⁸

The proposed structural revisions may be assessed more generally from varying perspectives:

(1) Value of litigation. This factor would probably be independent of the bankruptcy system's structural setting. Such a lack of potential impact may be used as an argument for maintaining the status quo. But it makes an irrelevant comparison between levels of litigation under the present and proposed structures in a system in which most cases involve no litigation at all.

83. Commission Bill § 4-403(b)(8). Section 4-403(b)(8) of the Judges' Bill does not limit unconscionability to consumer claims. The Brookings authors would also add a category of "improvident" claims to those which might be disallowed. See *Girth & Stanley Testimony*, *supra* note 21, at 23-24.

84. Commission Bill § 4-506(a)(3); Judges' Bill § 4-506(a)(3). The Brookings authors oppose the enactment of this section. See *Girth & Stanley Testimony*, *supra* note 21, at 21-22.

85. UNIFORM COMMERCIAL CODE § 9-204(3) (1962 version) authorizes the creation of the so-called "floating lien."

86. Commission Bill § 4-607(d)(1); Judges' Bill § 4-607(d)(1).

87. Even if more consumer filings resulted because of a combination of increased exemptions and decreased exceptions to dischargeability, the Commission agreed with the Brookings study that there would be no threat to the economy. Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 W. VA. L. REV. 427, 436-37 (1974); D. STANLEY & M. GIRTH, *supra* note 29, at 39-40.

88. Evidence of creditor disinterest permeated the findings of the Brookings study. See, e.g., D. STANLEY & M. GIRTH, *supra* note 29, at 76-77, 121-22.

(2) Frequency of rehabilitation. The structural alternatives' impact on the frequency of rehabilitation would provide a more relevant standard for comparison. The present structure does nothing in bankruptcy liquidations beyond the possibility that obtaining a discharge gives the debtor "a fresh start." The judges' proposed system also claims to do nothing more about rehabilitation in liquidation cases than to maintain a referral list of attorneys to whom potential bankrupts could be sent.⁸⁹

The Brookings study had found that the attorneys' and judges' attitudes toward personal bankruptcy options seriously limited the effective choices of non-business bankrupts.⁹⁰ To alleviate this problem, the Commission Bill provides for agency counseling of the petitioner as to options under the statute.⁹¹ The Brookings proposal also would add financial counseling for the petitioners. Agency staff would provide such counseling as long as the bankruptcy case was pending.⁹²

(3) Dislocation of bankruptcy personnel. The proposed structural revisions should also be assessed in terms of their ability to protect the present participants in the system. The Judges' Bill would not only protect the current bankruptcy judges, but would enhance their status.⁹³ The Commission Bill would preserve the status of the "judicial" activity which remains under its classifications. But by requiring that all cases be filed with the agency, the Commission's proposal provides the opportunity for the overwhelming proportion of the caseload to be processed in a non-adversary setting.

The Brookings proposal constitutes the most serious threat to the present managers of the bankruptcy system. Since there would be no bankruptcy court, the jobs of the present bankruptcy judges would be eliminated, although some of them could become administrative law judges within the proposed agency.⁹⁴ The proposal also explicitly notes the possibility that some non-business bankrupts might decide not to use attorneys.⁹⁵ Moreover, attorneys who are presently serving as receivers and trustees would be replaced by salaried personnel.

CONCLUSION

Several factors have combined to slow congressional progress on structural bankruptcy reform. First, bankruptcy reform has not become

89. Judges' Bill § 4-203(c). If a debtor with regular income elects to proceed under Chapter VI, the trustee is also required to "counsel the debtor in the performance of the plan." *Id.* § 6-101(c)(5).

90. D. STANLEY & M. GIRTH, *supra* note 29, at 75-76.

91. Commission Bill § 4-203(a).

92. D. STANLEY & M. GIRTH, *supra* note 29, at 204-05.

93. See text accompanying notes 41-49 *supra*.

94. D. STANLEY & M. GIRTH, *supra* note 29, at 216.

95. See note 38 *supra* and the accompanying text.

a broad-based public issue. Bankrupts are not a well-organized or vocal constituency. Nor does the general public evince as much concern about bankruptcy as it does about other legal issues which affect larger groups of the populace. Such issues include probate procedures, the possibility of injury or property damage from an automobile accident, and divorce.⁹⁶ Although bankruptcies exceeded 250,000 case filings for fiscal year 1975,⁹⁷ debtors' family members would only total approximately one million if each individual bankrupt had four dependents.⁹⁸

A second factor contributing to congressional lethargy is the fact that creditors have not demanded structural bankruptcy reform. In calendar year 1974, consumers repaid \$157.1 billion in installment debt.⁹⁹ By comparison, discharged debts in bankruptcy proceedings seem insignificant. For fiscal 1968, the Brookings authors estimated that the total debt discharged was roughly \$2 billion.¹⁰⁰ Increasing that figure by 41 percent, the rise in the Consumer Price Index between 1968 and June, 1974,¹⁰¹ brings the total of discharged debt to approximately \$3 billion, or less than 2 percent of the total consumer debt repaid in 1974. In addition, creditors spread the cost of their bad debt losses through credit insurance, tax deductions, and the higher costs of goods or credit to those who do pay promptly.¹⁰²

The alternative proposals for revision also fail to provide legislators with the appealing argument that enactment would produce obvious governmental economies. The Judges' Bill and the Brookings proposal would finance almost all of the revised system out of general appropriations. The Brookings Report in 1971 estimated the net cost of its proposed system at \$30.5 million, compared with an estimated cost of the present system of \$34.8 million, almost all of which was paid by

96. Bankruptcy reform proposals are most similar to the Uniform Probate Code's system of informal probate administration, which allows estates to be distributed without court intervention unless an interested party requests "supervised administration." See UNIFORM PROBATE CODE §§ 3-301 to -311 and 3-501 (1974). But no fault divorce and insurance reforms also reflect the public's lack of interest in litigating the issue of who was at fault in creating the problem. See Zuckman, *The ABA Family Law Section v. The NCCUSL: Alienation, Separation and Forced Reconciliation over the Uniform Marriage and Divorce Act*, 24 CATH. L. REV. 61 (1974); Hart, *National No-Fault Auto Insurance: The People Need It Now*, 21 CATH. L. REV. 259 (1972). The field of bankruptcy reform is analogous to these other proposals for reform because most bankruptcy cases do not involve litigation.

97. Filings for the fiscal year totaled 254,484, of which 224,354 were non-business petitions. Data furnished by H. Kent Pressou, Assistant Chief of the Bankruptcy Division of the Administrative Office of the U.S. Courts, September 5, 1975.

98. See D. STANLEY & M. GIRTH, *supra* note 29, at 42, for a profile of the typical personal bankrupt.

99. ECONOMIC REPORT OF THE PRESIDENT, Table C-60, at 320 (1975).

100. D. STANLEY & M. GIRTH, *supra* note 29, App. B-2, at 232-33.

101. ECONOMIC REPORT OF THE PRESIDENT, Table C-44, at 300 (1975).

102. See D. STANLEY & M. GIRTH, *supra* note 29, at 37-39.

the parties to the proceedings.¹⁰³ The judges have not estimated a cost figure for their proposed system, but it would obviously be at least as expensive as the present system because of the recommended supporting staff and facilities.¹⁰⁴ Bankrupts and their creditors, on the other hand, would find the proceedings less costly if general appropriations were to provide the basic funding for the system. However, the Commission's financing proposal would require the parties to pay increased levels of administrative costs if the agency were financed on a self-supporting basis.¹⁰⁵

Finally, opponents of structural reform are much more effectively organized than are its proponents. To date, the National Conference of Bankruptcy Judges has been the most outspoken opponent, although it claims reformist goals.¹⁰⁶ Before the Brookings Report was published, some judges attempted to gain the initiative in the legislative debate by making their own proposals. These included adding examiners to the Administrative Office staff,¹⁰⁷ adding social workers to the United States District Courts' probation offices for counseling purposes,¹⁰⁸ and expanding the jurisdiction of the bankruptcy courts and providing more adequate facilities, including courtroom space and libraries.¹⁰⁹

Only Judge Lee acknowledged that a more significant administrative structure might emerge. He suggested the institution of an Official Trustee within the judicial branch of government. This suggestion included an option for creditors to elect a private trustee if they preferred to do so.¹¹⁰

After the Brookings Report was published, the strategy shifted to personal attacks on its authors, coupled with applause for the newly-promulgated bankruptcy rules.¹¹¹ The rules did improve the present

103. *Id.* at 188-90; App. B-6, at 242-43; App. C-22 at 259.

104. See notes 45-46 *supra* and the accompanying text.

105. REPORT: PART I, at 150-53.

106. Cyr, *Setting the Record Straight for a Comprehensive Revision of the Bankruptcy Act of 1898*, 49 AM. BANKR. L.J. 99, 99-101 (1975).

107. See Lee, *Possible Alternatives to the Present System of Bankruptcy Administration*, 45 AM. BANKR. L.J. 149, 168-69 (1971). Effective in July, 1975, examiners for the federal court system were added to the staff of the Administrative Office of the U.S. Courts. This change in budgetary appropriations was approved by both the United States Judicial Conference and the Department of Justice, which will retain the examining function for the U.S. Attorneys' offices. Data furnished by William E. Foley, Deputy Director, Administrative Office of the U.S. Courts, November 3, 1975.

108. Lee, *The Counseling of Debtors in Bankruptcy Proceedings*, 45 AM. BANKR. L.J. 387, 399 (1971).

109. Cyr, *Bankruptcy Courts in Transition Toward Debtor Rehabilitation*, 22 MAINE L. REV. 333, 339, 358 (1970).

110. Lee, *supra* note 108, at 401. The creditors' option to elect a trustee now appears in § 5-101 of both the Commission Bill and the Judges' Bill.

111. See Cyr, *The Abandonment of Judicial Administration of Insolvency Proceedings: A Commitment to Consumer Disservice*, 78 COM. L.J. 37, 38 (1973).

system,¹¹² but they were not designed to preempt future congressional judgments about the appropriate structure for administering the bankruptcy caseload.

An effort was also made to characterize the Brookings Report as an anti-consumer document,¹¹³ both in its structure and in its suggestion that non-business bankrupts might decide not to use attorneys.¹¹⁴ Another suggestion for the supplemental staffing of the present system also emerged, namely that administrative assistants assigned to the present bankruptcy judges could solve the system's problems.¹¹⁵

Once the Commission's Report was issued, the judges rapidly shifted their attention from the Brookings authors to the Commissioners and their staff.¹¹⁶ This time the opposition was combined with a more positive strategy, that of drafting the Judges' Bill. In addition, the judges provided a detailed comparison of their legislation and the Commission's.¹¹⁷

Other professional associations have so far played a limited role in the bankruptcy reform process. At the American Bar Association's annual convention in 1972, the Corporation, Business, and Banking Law Section passed two resolutions for forwarding to the Presidential Commission. One endorsed the concept of uniform federal exemptions. The other urged that bankruptcy administration be retained in the federal judicial system, but that it be reorganized to free the judges from administrative tasks.¹¹⁸ The Bankruptcy Committee of the Commercial Law League has also had the Commission Bill and the Judges' Bill under extensive study and basically supports the Judges' Bill.¹¹⁹ The National Bankruptcy Conference is now completing its study of the pending legislation and expects to present a report including legislative amendments to the House and Senate Judiciary Committees within the next few months.¹²⁰

112. See Laven, *Water a Myth and Watch It Grow!*, 79 COM. L.J. 116, 118 (1974).

113. Cyr, *supra* note 111, at 40.

114. Levitt, *Bankruptcy Administration and the Brookings Report—A Critical Analysis*, 77 COM. L.J. 179, 181 (1972).

115. Seidman, *The Proposed New Bankruptcy Act—A Projection*, 78 COM. L.J. 254, 256 (1973). This Article is an edited version of a speech which Judge Seidman gave before the Bankruptcy Commission's Report was issued.

116. Cyr, *The Bankruptcy Act of 1973: Back to the Drafting Board*, 48 AM. BANKR. L.J. 45 (1974).

117. See Lee, *supra* note 44.

118. Mimeo copies of the Resolutions, in the author's possession.

119. See Levit, *Report of the Bankruptcy Committee of the Commercial Law League of America on Proposed Revisions of the Bankruptcy Act*, 80 COM. L.J. 188 (1975). The report also included specific suggestions for improvements in the Judges' Bill. The Committee report has been approved by the Board of Governors of the Commercial Law League.

120. Telephone conversation with Professor Vern Countryman, Vice-Chairman of the National Bankruptcy Conference, September 5, 1975.

It is difficult to predict whether any of the current structural proposals will survive the legislative process. Structural reform of the bankruptcy system may not occur unless Congress perceives strong public support. As congressional deliberations continue, observers will be able to assess whether bankruptcy procedures are insulated from the apparent public interest in less adversary settings for probate, accident, and family law cases. If they are, the resulting structure will be a significant exception to other legislative trends in the past 10 years.