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BANKRUPTCY: THE LEGAL WHIPPING BOY

JOSEPH V. COSTA*

From its inception, the Constitution has given Congress the exclusive power to regulate bankruptcy.1 While federal bankruptcy laws were only operative for a total of 16 years prior to 1898,2 since that time the law has often been amended but never repealed.³ The administration of the bankruptcy laws without major criticism or scandal throughout these 75 years bears witness to the success of the present system in achieving its raison d'être—the wiping out of the debts of an overburdened debtor in order to give him a new start and thereby benefit society as a whole.

To both the legal profession and the general public, bankruptcy is a Pandora’s box which they fear to open lest they be overwhelmed in legal mumbo jumbo, red tape and a confrontation with moral principles. However, an efficient, economical administration of a viable bankruptcy law is of increasing importance to the social and economic foundations of our culture. At the height of the Depression in 1932, there were nearly 70,000 cases of bankruptcy in the United States.⁴ In 1963, approximately one of every 1000 persons in the United States filed a petition in bankruptcy.⁵ For the year ending June 30, 1974, all categories of bankruptcies rose 9.4 percent to a total of 189,513.⁶ My day-to-day experience indicates that these figures are continuing to rise at a rapid rate.

With these considerations in mind, the Commission on the Bankruptcy Laws of the United States (the Commission) was established to consider the philosophy of bankruptcy, causes of bankruptcy, possible alternatives to the present bankruptcy administration—including the

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* Bankruptcy Judge for the Eastern District of New York.
1 U.S. Const. art. I, § 8.
3 Congress has periodically amended the Bankruptcy Act. The years 1903, 1910, 1926, and 1952 saw substantial amendment but the only major revision was the Chandler Act of 1938. Minor changes were also made in 1917, 1922, 1950, 1956, and 1966. Virtually every year, Congress makes additional insubstantial amendments to meet current needs. See Bateman, Recent Developments in Bankruptcy, 32 Mo. L. Rev. 1, n.1 (1967). See also Note, The Proposed New Bankruptcy Act, 7 Ind. L. Rev. 852, n.3 (1974).
4 D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 18-20 (1971) [hereinafter cited as BROOKINGS REPORT].
5 See id. at 25.
application of advanced management techniques — and, most importantly, to analyze, evaluate and recommend changes in the existing bankruptcy laws.7

At the outset, I must note that in many respects the Commission did meet its stated goals. This is especially true where the proposed act codifies decisional law and quiets differences between the courts of appeals on matters which have not yet reached the Supreme Court. I also salute with the greatest personal appreciation the dedication and unselfish work which the members of the Commission put forth in their effort. They worked long hours and served completely without compensation. However, my friends on the Commission would be the first to criticize me, and I would lose their respect if I did not speak my piece on those points where I believe they seriously missed their objectives. Upon careful inspection of the Commission's work product, it became apparent to me that the Commission had in the proposed Bankruptcy Act of 1973 (the Commission's Act)8 lost sight of the objectives of the bankruptcy laws which had been in force in England for more than four centuries and in the United States for over 75 years. The Commission had fallen prey to the "blame-the-court" syndrome currently in vogue, and as a result bankruptcy was made the legal "whipping boy."

7Pub. L. No. 91-354 (1970). The congressional hearings, which ultimately led to the creation of the Commission, produced a series of findings. Among them were:
1) A dramatic increase in the number of bankruptcies since World War II was seriously overloading the court system.
2) Nearly half of the bankruptcy court operation funds were spent on no-asset or nominal asset cases which could be handled more economically as nonadversary summary proceedings.
3) Current practices did not effectively protect creditors, who generally found it much more practical to raise prices than to try to collect debts in bankruptcy court.
4) In light of the large numbers of nondischargeable and secured debts, debtors were also not effectively protected.
5) Bankruptcy courts generally lacked uniform procedures, thus denying equal treatment.
6) Many functions now performed by lawyers could be performed by nonlegal personnel at a lower cost.


The Commission consisted of nine members, three of them appointed by the President. Each house of Congress had two appointees to the Commission, one from each political party. The remaining two members were appointed by the Chief Justice of the Supreme Court. A report of the Commission's activities was to be submitted to the President, Chief Justice, and Congress within two years of the enactment of the bill. Pub. L. No. 91-354 (1970).

Reacting to the deficiencies of the Commission's Act, the National Conference of Bankruptcy Judges concluded that the proposal required more than piecemeal amendments. It thus set out to draft an entirely new bill to accomplish this end. A committee was formed, and a comprehensive study and analysis was made. Suggestions were solicited and received not only from Conference members, but also from the bar and from interested outside organizations. A draft was submitted to the entire Conference membership, and after a mid-year meeting, a second proposed act, the Judges' Bill, resulted. The bill was introduced in the House of Representatives on September 12, 1974.9

While a detailed analysis of the two bills is not intended, it is hoped that a discussion of some of the relative strengths and weaknesses of the two proposals will aid in the current debate facing the Congress.

THE CRY FOR REFORM

Some years ago, there began to develop a public trend in which many of the economic ills besetting the nation were blamed on the bankruptcy laws. In my opinion much of this improperly directed criticism was the result of misleading treatment given the problem by the news media. An early forerunner in this movement was an article appearing in the May 1966 issue of Reader's Digest, entitled "Planned Bankruptcy: The Racket That Cheats Us All." Highlighted in red ink read the subtitle: "Loopholes in our bankruptcy law enable swindlers to fill their pockets — and rob consumers of millions of dollars a day." The article outlined the activities of conniving thieves expert in "scam" operations.10 The article implied that these swindles continued with impunity.

However, the facts narrated and the cases cited attested to the efficacy of the existing procedures. Through the alertness of creditors, the power of the bankruptcy court may be invoked through the filing of an involuntary petition in bankruptcy.11 Thus, the investigatory powers

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10 Surface, Planned Bankruptcy: The Racket That Cheats Us All, Reader's Digest, May 1966, at 125. The Brookings Report describes a "scam" operation as one in which a criminal element either sets up a business or takes over an existing business with established credit ratings. Once in control, it proceeds to purchase large quantities of goods on credit, then absconds. It is not the racketeer but the creditor who then invokes the powers of the bankruptcy courts in this type of situation. Brookings Report, supra note 4, at 111-12. See Davidson, Schemes and Methods Used in Perpetrating Bankruptcy Frauds, 71 Com. L.J. 383 (1966) (discussion of the activities of the Department of Justice in this area).
11 Bankruptcy Act § 59(b), 11 U.S.C. § 95(b) (1970). The section provides where three or more creditors have a claim against the debtor exceeding $500 above the value of any collateral held by them, an involuntary petition may issue for the purpose of adjudicating
of the trustee are activated, which may result in a referral by the bankruptcy court of the alleged criminal activity to the United States Attorney. For example, frauds committed in In re Murray Packing Co.,\textsuperscript{12} cited in the article, resulted in the conviction of six individuals. Likewise, in a Philadelphia case described in the article, the defendants were ultimately convicted of conspiracy and concealing assets.\textsuperscript{13} Most of these activities are equally violative of state larceny laws. Unfortunately, local agencies are often ill-equipped to investigate and prosecute this type of crime.

The importance of this type of criminal activity on the administration of the bankruptcy laws may be somewhat overstated. As the Commission ultimately noted in its July 1973 report:

Notwithstanding the notoriety of "scam" bankruptcies, absconding and concealing debtors, and other instances of egregious conduct in, and in anticipation of, cases under the Act, the Commission has found little empirical substantiation that dishonest conduct is a cause of bankruptcy in a significant number of cases.\textsuperscript{14}

Complaints are also heard from the banking community that loan losses are due to lax bankruptcy laws which permit debtors to wipe out their obligations by a mere scheduling in bankruptcy. The increase in bankruptcy filings is attributed to a reversal in trend from the original view of bankruptcy as a means of creditor control to the current concept of relief for the honest debtor. This, the bankers complain, is the encouragement of immorality and the undermining of an important phase of the banking business. Often, however, the banking institutions themselves are to blame for the ills that beset them. In large business filings, bankruptcy judges frequently discover that loans were made without checking the financial conditions of the business. For example, the bank has failed to determine if the borrower has paid his taxes, especially withholding and social security taxes. In many cases, the hidden purpose of the loan is to pay those taxes, and when the borrower's petition is filed, the schedules indicate large tax liabilities which have priority over other debts.

One only need turn on the radio or television to learn that he can furnish his kitchen or living room or be the proud possessor of

\textsuperscript{13} Surface, Planned Bankruptcy: The Racket That Cheats Us All, Reader's Digest, May 1966, at 125, 128.
\textsuperscript{14} COMMISSION REPORT, supra note 6, pt. I, at 53-54.
a color television if he visits his friend at the nearest bank. The ease with which consumer credit is extended is, in my opinion, a contributing factor in many bankruptcies. I suggest that corrective banking legislation might better serve to alleviate unnecessary bankruptcies than some of the so-called bankruptcy reforms.

In 1965, at the suggestion of the federal judiciary, the Brookings Institution undertook a research study in the field of bankruptcy. No serious study of bankruptcy administration had been made for over twenty years. Contributions to the study were made by Vern Countryman of the Harvard Law School and other noted legal scholars. However, their degree of expertise in bankruptcy law was by no means uniform. For example, David T. Stanley, director of the study, admitted that his experience in "the field of bankruptcy is relatively new."16

One crucial finding of the Brookings Institution report (Brookings report), which to my knowledge was not and cannot be substantiated, is the alleged "accommodation" between the district court judge and

16 Brookings Report, supra note 4, at 219. The Brookings Institution is "an independent organization devoted to nonpartisan research, education, and publication in economics, government, foreign policy, and the social sciences generally." Id. at v.

The findings of the Brookings Report include:
1) Personal bankruptcies have increased greatly in number since World War II, often occurring after threats by creditors to bring legal proceedings.
2) Business bankruptcies, often resulting from poor management under unfavorable market conditions, have also increased but at a slower rate.
3) The average personal bankrupt is a blue-collar worker making more than $5,000 per year.
4) While bankruptcy is generally socially disapproved, the bankrupts, themselves, have mixed attitudes ranging from bitterness and shame to relief.
5) Notwithstanding uniform federal law, its application varies from court-to-court and state-to-state.
6) The rehabilitation chapters are rarely utilized and when employed are not effective.
7) Bankrupts have no special problems obtaining new credit.
8) The major cause underlying the rise in personal bankruptcies is increased personal indebtedness, and, to some extent, unemployment.
9) Bankruptcies have no substantial effect on the economy.
10) Creditors realize little from bankruptcy proceedings and, therefore, often do not bother to participate but instead pass the losses along in higher prices.
11) The bankrupt's attorneys typically "handle their cases routinely, unimaginatively, and often unexpertly."
12) The bankruptcy system is poorly managed without sufficient supervision or record keeping, leading to error and fraud.
13) Bankruptcy personnel are often nonqualified or under-trained.
14) Roughly 70 percent of all bankruptcy cases have no assets after exempt property has been set aside. Of the remaining 30 percent, administrative costs consume a large portion of the assets.
15) There is no justification for the bankruptcy proceeding to be self-supporting, especially since no other federal legal proceeding must meet this requirement.
16) Creditor priorities are illogical.
17) Bankrupts are often harassed into reviving discharged debts.

Id. at 2-4.

the bankruptcy judge, his appointee.\textsuperscript{17} I have spent over 30 years of my professional life in the practice of criminal law in the federal courts and now 11 years on the bench of the bankruptcy court and I have never heard even a rumor of such an accommodation. As the Honorable Edward Weinfeld noted in his separate statement accompanying the Commission's report:

The reasons advanced by the majority for the establishment of a separate bankruptcy court and for the appointment of judges by the President in lieu of the present referee system are based upon erroneous assumptions which are contrary to my experience as a United States District Court Judge for almost a quarter of a century. . . . This assumption is without factual support. The majority also accepts the view that the relationship between the referee and a reviewing district court judge tends to undermine the integrity of the judicial process; that a district court judge is unlikely to reverse an appointee and so reviews or appeals are discouraged. This premise, based upon "impression or belief," again is groundless and improperly gives credibility to an argument that a United States District Judge will render decisions on review based on his relationship to the referee whose decision is under review rather than on the merits of the issue before-him. The assumption has as little force to it as would a claim that the court of appeals would hesitate to reverse a district court judge because he was known to the members of the panel. . . .

. . . .

I do not believe, based on my experience in my own busy metropolitan district, which has seven full-time referees, that attorneys are supine or that any reputable attorney would forbear to file what he considered a meritorious review of a referee's order for fear of incurring a referee's displeasure. Equally groundless are the assumptions which attribute to the referees and judges lack of impartiality based on the present method of appointment. . . .

. . . .

Unquestionably the judges of the district court appoint referees on the basis of their competency, merit and fitness for the position. And while judges are aware of the competency of individual referees when reviewing their orders, this circumstance would appear to be no more than a factor in making their decisions on review than the regard for the competency of district judges by the circuit courts on appeal from decisions of district court judges.

Finally if we are to be guided by experience, appointment of the bankruptcy judge by the President, with the advice and consent of the Senate, would result in undue delay in refilling positions when vacancies occur.\textsuperscript{18}

\textsuperscript{17} Brookings Report, supra note 4, at 219.

\textsuperscript{18} Commission Report, supra note 6, pt. I, at 299-300 (footnote omitted).
Judge Weinfeld agreed with the Commission's recommendation that the administrative and judicial functions now performed by bankruptcy judges be separated and that the administrative functions be transferred to a separate agency. However, he dissented from the proposal to create a separate bankruptcy court with judges appointed by the President, with the advice and consent of the Senate, for a term of fifteen years. He further concluded in his dissent that "[t]he referee system has worked well and efficiently through the years and I find no justifiable reason for a change which would add another tier of judges to the federal judicial system."

It was the Brookings report that triggered the creation of the Commission on the Bankruptcy Laws. Prior to the publication of the report of the Commission on July 30, 1973, those of us who were interested in the progress and development of the Commission's work attended seminars on that subject. My recollection of those lectures is that we were being assured that while some of the points made by the Brookings report were valid, most were not. The Commission, we were told, would effectuate a balance. I must frankly state my personal conclusion that the Commission's proposed act, save for a very few instances, is a capitulation to Brookings.

The reason for the failure of the Commission's Act to meet current needs for adjustments in procedure may be traced to the very composition of the Commission. While two distinguished members of the judiciary were members of the body, there was not one bankruptcy judge. Of the 24 consultants listed in the Commission's report, 18 are professors, one a consumer advocate, one a computer processing expert, three lawyers but again, not one bankruptcy judge. Thus, the opinions of those who are closest to the problems were all but ignored. I am aware that members of the Commission interviewed or consulted with and received suggestions from bankruptcy judges and practitioners.

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19 Id.
20 Id.

The Commission was also condemned for not having included a practicing business bankruptcy attorney on the panel itself and for having used only one such attorney as a consultant. Phelan, The Proposed Bankruptcy Administration (The "FBA")—Bureaucratic Alphabet Soup Gets a Bigger Bowl, 48 Am. Bankr. L.J. 341, 342 (1974) [hereinafter cited as Phelan].
However, their numbers were few and those who had been consulted, with whom I have spoken, indicate that their suggestions were in the main ignored.\textsuperscript{22}

Thus, the recent proposal of the National Conference of Bankruptcy Judges, the Judges’ Bill, deserves careful consideration as a possible answer to some of the excesses of both Brookings and the Commission.

\textbf{Salient Features of the Reform Proposals}

\textit{Judicial and Administrative Structure}

Currently, the federal district courts have original jurisdiction in bankruptcy matters.\textsuperscript{23} Judicial matters are handled by the district court judges and their appointed referees, known as bankruptcy judges. Bankruptcy judges, in conjunction with receivers and trustees, handle the complex administrative matters accompanying an adjudication of bankruptcy.\textsuperscript{24}

\textsuperscript{22}Suggestions were made and papers and treatises were submitted by, among others, the Hon. John Lee, Bankruptcy Judge for the Eastern District of Kentucky, and President of the National Conference of Bankruptcy Judges, in a comprehensive study published and printed in November 1971, with an acknowledgment by Senator James O. Eastland, Chairman of the Committee on the Judiciary for the United States Senate, for the use of the Commission. Similarly available were contributions made by my confreres, Bankruptcy Judges Daniel R. Cowans and Asa Herzog. Judge Herzog suggested a well-qualified administrative assistant be appointed to aid each bankruptcy judge, functioning to narrow the matters requiring judicial determination before referring them to the judge. It was suggested that this assistant be a qualified lawyer, and that he receive a competitive salary. None of these proposals was accepted by the Commission.


\textsuperscript{24}In navigating the procedural aspects of the adjudication, the bankruptcy judge provides substantial guidance to the parties. For example, property involved in bankruptcy proceedings is often income producing and it is his duty to apportion equitably the dividends. If an appeal is sought from his determination, it is the bankruptcy judge’s function to prepare the necessary records, Bankruptcy Act § 39(a), 11 U.S.C. § 67(a) (1970). The number of judges and their territories is determined by the Conference of Circuit Judges pursuant to the recommendations of the Director of the Administrative Office of the United States Courts. \textit{Id.} at § 34(a), 11 U.S.C. § 62(a). \textit{See also} Bankruptcy Rules § 901(7) (1973).

Besides the bankruptcy judge’s administrative duties, he also renders assistance to the district court judge, and at times performs some of the functions of the district court judge. The bankruptcy judge’s jurisdiction is limited to that prescribed in the Act, and is subject to review by the court. \textit{See In re Tom Moore, Inc.,} 179 F. Supp. 285 (E.D. Tenn.), \textit{aff’d sub nom.,} Scott v. Maco Warehouse Corp., 273 F.2d 162 (6th Cir. 1959) (per curiam).

The bankruptcy judge has broad judicial powers. Petitions for relief referred to him are either adjudicated or dismissed in his discretion. During the hearing he may administer the oath to witnesses and require the production of evidence. In certain instances it is in his power to receive or release the bankrupt’s property. It is within his discretion to grant, deny or revoke discharges and confirm arrangements or wage earner plans. He may also revoke plans or reinstate bankruptcy proceedings. Bankruptcy Act § 38, 11 U.S.C. § 66 (1970).

Under the Commission’s proposed bill the office of bankruptcy judge is abolished. The United States Bankruptcy Administration would handle the administrative functions...
The Judges' Bill calls for the creation of separate bankruptcy courts. Subject matter jurisdiction of the bankruptcy courts would extend to all civil bankruptcy cases. Further, all civil actions, whether in state or federal courts, which would contain bankruptcy issues and which could have originally been brought in the bankruptcy court could be removed to the bankruptcy court by either plaintiff or defendant for determination of those issues. When proceedings are commenced in more than one bankruptcy court involving the same or related debtors, the court with the first petition will make the determination as to the court in which the action will proceed. The bankruptcy courts, however, would have no jurisdiction over criminal actions other than contempt for violation of their own orders.

The bankruptcy courts would be governed by specified portions of the Federal Rules of Civil Procedure unless inconsistent with rules promulgated by the Supreme Court. Among its procedural provisions, the Judges' Bill specifically grants standing to intervene in a bankruptcy proceeding to any person with "a direct and substantial interest." The right to a trial by jury would remain substantially the same as under current law but with one important change. Under
the current act a person against whom an involuntary petition has been filed has a specific right to a jury trial on the question of his insolveney. Under the Judges’ Bill all involuntary petition cases would be tried by the bankruptcy judge without a jury; the judge is empowered, however, to empanel a jury on motion or on his own initiative. Bankruptcy court judgments would be reviewable by the court of appeals.

The Judges’ Bill also contains provisions governing the structure of the bankruptcy courts. The number, location, and territorial boundaries of the courts would be designated by Congress pursuant to the recommendations of the Judicial Conference of the United States. The Judges’ Bill further provides that the Director of the Branch of Bankruptcy Administration shall review the number and location of bankruptcy courts at the direction of the Judicial Conference. However, a bankruptcy court’s jurisdiction would not be limited to its territorial boundaries in any matter properly before it.

Under the system of independent bankruptcy courts proposed by the Judges’ Bill, the judicial council of each circuit would appoint the bankruptcy judges. These judges would serve for terms of fifteen years with mandatory retirement at age seventy, or earlier if a judge becomes permanently incapable of future performance of his duties. During the term of office, a bankruptcy judge is removable “only for incapacity, misconduct, or neglect of duty.” Removal proceedings would be initiated by a report of possible wrongdoing from the Director of the Branch of Bankruptcy Administration to the Chief Justice of the Supreme Court who would in turn appoint a federal judge to investigate the allegations. If sufficient facts are found to warrant issuance of a complaint, the Chief Justice would then appoint a commission composed of three federal judges other than the investigating

33 Judges’ Bill, supra note 9, at § 2-206(a).
34 Id. § 2-209(a). The Commission’s Bill provides for appeals to the nearest district court, thus adding an extra and unnecessary layer to the appeal process. Commission’s Bill, supra note 8, at § 2-210(a)(3).
35 Judges’ Bill, supra note 9, at § 2-105. Under the Commission’s Bill, the Judicial Conference would determine the number, location, and territorial boundaries. Commission’s Bill, supra note 8, at § 2-105(b).
37 Judges’ Bill, supra note 9, at § 2-105(c). See also id. § 1-103, which provides that the bankruptcy courts will have jurisdiction if the debtor “resides or has a domicile, place of business, or property within the United States including its territories and possessions.”
39 Judges’ Bill, supra note 9, at § 2-103(a).
40 Id. § 2-102(d).
judge to preside over a formal hearing on the charges. If an order of termination of appointment is issued, it would be appealable in the same manner as a judgment of a federal district court.\textsuperscript{41}

Recognizing the importance of competitive salaries to attract high quality personnel, the Judges' Bill deals extensively with compensation and benefits.\textsuperscript{42} Basically, bankruptcy judges would receive the same

\textsuperscript{41}\textit{Id.} The Commission's Bill contains a similar provision. Commission's Bill, \textit{supra} note 8, at § 2-102(c).

\textsuperscript{42} Judges' Bill, \textit{supra} note 9, at § 2-102 \textit{et seq}. Recently, Congress had occasion to pass upon the recommendation of the Presidential Committee on Salaries which urged increases for the executive, legislative, and judicial branches. Bankruptcy judges would have received only a two percent increase. Through the efforts of Senator Mansfield, majority leader of the Senate, even that paltry increase was thwarted. When he was questioned about his actions, Senator Mansfield's reply was: "My heart bleeds for the U.S. Judiciary. They don't have to keep their jobs if they don't want them. They can retire, and there are hundreds to take their jobs." \textit{N.Y. Times}, Mar. 7, 1974, at 17, col. 1. In answer to these remarks this author wrote to the Senator on March 14, 1974. The letter read in part:

I state that my feeling is one of regret because the remarks are made by one who is a recognized national leader of the party to which I gave my allegiance and most of my efforts before being limited from further active participation by an Act labeled "Hatch" and the Judicial Canons of Ethics.

\ldots

I have no knowledge as to the accuracy of the quotes, and if you have been misquoted, there is an apology due you and a retraction should be published. If the quotes are correct and reflect your sentiments, then I believe you owe some explanation to the judiciary. Just to think that these are men and women appointed with the advice and consent of the Senate. \ldots I do \ldots respectfully suggest that to belittle or impugn the dedication, industry and loyalty of the judiciary and to infer a mercenary motivation to their labors neither justifies your position nor adds to the public desire of harmony among the three branches of government.

Being at the bottom of the totem pole in the echelon of importance, I don't attempt to reply in behalf of nor make the case for the judiciary. The matter of the justification of the raise, either legal or moral, is not at issue here in view of the legislative action already taken. I emphasize that not having received an increase for over five years in the face of galloping inflation is just as difficult to understand to a judge as it is to a laborer. His wife goes to the same supermarket and his children seek the same costly education. However, as an individual, I cannot help but be moved to resentment by your remarks, which must convey your inner feelings and attitude. Much to my surprise, if such is the attitude of one who knows, then what can we expect from those who are ignorant or those who are anxious to undermine and belittle our institutions?

As for your statement that they should resign, "hundreds are waiting to take their jobs," I have no doubt that there is a reservoir of incompetents who are ready to grab, but I am sure that the public is not, nor do I believe are you upon sober reflection, ready to compromise on the quality of our judges. Also, I have no doubt that a discussion with some of your colleagues will confirm the fact that because of the remuneration offered, they have been finding it more difficult to obtain competent and highly-respected members of the legal profession successful in their private practice to accept appointment to the federal bench. I cannot equate quantity with quality in an office as sensitive as a federal judgeship.

As to their mercenary proclivities, I have the pleasure and the honor of working with, and therefore being able to attest to the competence and ability of many members of the judiciary. All of these men and women would be able to earn, if not double, then quadruple their present salary if engaged in private practice. Of particular notice should be the service of the judges who take senior status upon retirement.

compensation as the judges of the tax courts, and would be entitled to the same benefits as persons covered by the civil service retirement laws.

The Commission's proposal also calls for the establishment of separate bankruptcy courts, not equal in status to the district courts as the Judges' Bill has proposed, but rather on a lower level. Appeals would be made to the district courts, thereby giving the unsatisfied party three levels of appeal. It has been suggested that the Bankruptcy Administration would divide the judicial and administrative functions in a manner similar to the system now employed by the Internal Revenue Service and the tax courts.

The Commission's proposed act envisions the establishment of an entirely new layer of civil servants to administer bankruptcy proceedings, usurping much of the role now given to bankruptcy judges. To a substantial degree, this would transfer bankruptcy proceedings from interested creditor control to administrative control. Under the Commission's system, bankruptcy matters would be handled by an independent agency, the United States Bankruptcy Administration, under the auspices of the executive branch. Under the Commission's plan


See Commission's Bill, supra note 8, at § 3-101 et seq. The Administrator would have total authority over nonlitigated cases and nonlitigated issues, including many of the functions now performed not only by referees but also by "trustees, auctioneers, appraisers, receivers, accountants, and attorneys." Editorial Comment, Report of the Commission on the Bankruptcy Laws of the United States, 29 Bus. Law. 75, 91 (1973) [hereinafter cited as Editorial Comment]. Under the Commission's Bill, the Administrator would generally act as trustee except in certain cases where the creditors would have the right to elect a trustee. Commission's Bill, supra note 8, at § 4-301.

Commission's Bill, supra note 8, at §§ 3-101, 3-102. The comment following § 3-102 states that the section provides for the appointment of a single executive to manage and direct the Administration. To afford the administrator security of position conducive to sound management of an independent government agency, he is to serve a term of seven years, subject to removal by the President only for the causes indicated.

Commission Reports, supra note 6, pt. II, at 52. See generally Hertzberg & Weingarten, The Powers of the Administrator Under the Proposed Bankruptcy Act, 79 Com. L.J. 82 (1974); Weintraub & Levin, Chapter VII (Reorganizations) as Proposed by the Bankruptcy Act
the Administrator of the Bankruptcy Administration would serve a term of seven years and would be removable only by the President and only for "neglect of duty or malfeasance but for no other cause." The Administrator at his discretion would then appoint other officers who would "serve at his pleasure."

Thus, the Commission wishes to add a new federal agency as well as a new level of courts, resulting in the removal of a basically judicial proceeding from judicial control. There is simply no valid reason for such a radical and expensive change. An innovation of this nature would be justified only if the current procedure were a total failure. This is not the case. The court system now in effect is a basically sound and well-functioning process flexible enough to allow for necessary change via amendments. In fact, there has been no demonstration by the Commission or any other authority, that the existing inadequacies in the bankruptcy procedure "are either inherently in, or irreparable within, the judicial system."

It is unquestioned that significant portions of bankruptcy proceedings are administrative in nature and that the administrative and judicial functions could be better segregated than they are at the present time. Nevertheless, the administrative aspects of the procedure are not of such overriding importance that the judicial aspects should be subordinated to them. Rather, the administrative functions are merely aids to the primary responsibilities of the resolution of adverse interests. The underlying assumptions of the Commission's proposal to create an independent administrative agency are in error, and the conclusion that the proposed act would eliminate many of the problems it seeks to correct must be met with great skepticism. Although the


50 Commission's Bill, supra note 8, at § 3-102(a).

51 Id. § 3-102(b).

52 The Board of Governors of the American Bar Association approved a resolution on behalf of its members that stated emphatically that while there was a need to improve the administrative aspects of bankruptcy proceedings, the process was primarily adversary in nature and "should be retained within a judicial framework." Twinem, Bankruptcy Report: Some Limitations on Creditors' Rights, 29 Bus. Law. 353, 355 n.6 (1974).


55 A survey by the Administrative Office of the United States Courts showed that referees spent about 22 percent of their time doing administrative work. Editorial Comment, supra note 48, at 89.

Judges' Bill also contemplates a separate administrative agency, it more carefully preserves judicial functions within the judicial sphere.

The Commission would grant sweeping and unchecked discretion to the Bankruptcy Administration. As Bankruptcy Judge Conrad K. Cyr remarked:

I believe it is a mistake to bet on the jockey instead of the horse. I would prefer to have the operational structure and the procedural rules laid out in advance for all to evaluate, rather than gamble that the "right" Administrator will be "in the saddle" to assure that all of the "right" steps are taken. On this point, as on many others, the Commission itself most eloquently refutes the stance it assumes in the Bankruptcy Act of 1973.

Initial Proceedings

One criticism of the current procedure is that it is so complex that individual debtors are often totally cut off from effective relief, unless aided at substantial cost by counsel. Under the Judges' Bill the Director of the Branch of Bankruptcy Administration would be available to assist the debtor and make referrals to attorneys when necessary so that the debtor would pay attorneys' fees only for the performance of legal services and not bookkeeping chores. This service would be offered to any non-self-employed person with a regular income or a natural person who "has income or assets which are inadequate to enable him to pay normal charges for legal assistance" necessary to commence a proceeding. The Director's assistance would extend to the "preparation of the petition, schedules of assets and liabilities, a proposed budget, and a statement of affairs." Under no circumstances may the Director inquire about transfer of assets, repayment of loans and other matters which would tend to affect the legal rights of the trustee to recover assets or the right of the debtor to obtain discharge. These would be left to the debtor's attorney.

After the initial documents are completed, the debtor would be referred to an attorney, drawn from a court list of qualified persons, for counseling on the types of relief available. The attorney would

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58 Id. at 68.
60 Judges' Bill, supra note 9, at § 4-203(a), (b).
61 Id. § 4-203(a).
62 Id.
63 Id. §§ 4-203(b), (c).
also prepare the debtor's disclosure statement. The action would then be commenced by filing the petition with the bankruptcy court.

The Commission's Bill, however, merely provides that the Administrator shall counsel individuals with regular income as to the types of relief available. This seemingly innocuous provision actually involves a radical change from the present structure by totally eliminating private attorneys in some cases. As the Commission report notes:

The petitioner would not of course be precluded or discouraged from consulting an attorney before filing. . . . It is contemplated that he should be free to consult his private attorney before making a choice after he has been counseled by the administrator. On the other hand, it is not contemplated that he should be required to have private counsel. He would in any event be entitled to receive such counseling assistance from the administrator as might be necessary to enable him to understand the practical implications of opting for a plan of composition or extension or straight bankruptcy.

The dangers of the Commission's proposal become obvious when it is remembered that the Administrator would, in effect, be acting as referee. In preparing and presenting his case the debtor needs the shield of attorney-client privilege as provided by the Judges' Bill. The Commission would have the individual debtor's case prepared by the same staff that would then administer the claim after action is commenced by filing the petition with the Administrator. "Attorneyless" bankruptcy would not only endanger the rights of the debtor but also would be detrimental to society as a whole. One commentator has noted:

By encouraging a debtor to proceed in bankruptcy and without the assistance and guidance of a lawyer, a bankruptcy explosion could result. The filing of a bankruptcy petition would become like filing an income tax return. Debtors could be solicited for bankruptcy and do-it-yourself bankruptcy kits could be sold.

Exemption Provisions

The current system of exemptions is basically a total federal abdication to conflicting and outdated state exemption laws. It has led

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64 Id. § 4-203(b).
65 Commission's Bill, supra note 8, at § 4-203.
66 COMMISSION REPORT, supra note 6, pt. I, at 160 (emphasis added).
67 Editorial Comment, supra note 48, at 91.
68 See Commission's Bill, supra note 8, at § 4-301 which provides that the Administrator will also perform the duties presently assigned to the trustee.
70 Bankruptcy Act § 6, 11 U.S.C. § 24 (1970) provides:
to inconsistent and inequitable results.\textsuperscript{71} A too liberal exemption policy may encourage irresponsible spending habits. Furthermore, the honest debtor turned bankrupt is only entitled to a "fresh start" and never a "head start."\textsuperscript{72} Both legislative proposals are too generous in this respect, but the Judges' Bill is the more liberal of the two.

The Judges' Bill takes into account the differing needs of each region of the country and attempts to allow for local variations of exemptions. Under this bill the individual debtor, whether voluntary or involuntary, may elect between the greater of a federal set of exemptions or the exemption plan of the state of the debtor's domicile.\textsuperscript{73} The bill limits the total property exemptions under the federal plan to a maximum of $25,000 but no ceiling is placed on the state plan.\textsuperscript{74}

The alternate federal plan gives a partial exemption for burial plots and property used as the residence for the debtor or his dependents.\textsuperscript{75} The residence exemption is limited to $6,000 with an additional $600 for each of the debtor's dependents. The debtor may exempt life insurance policies that have a cash surrender value, except where payable to himself, to the extent his aggregate exemptions are not in excess of the residence limit.\textsuperscript{76} Life insurance policies with a cash sur-

\begin{footnotesize}
\textsuperscript{71} The exemption policies of the individual states are diverse and often the result of nineteenth century needs. Note, \textit{Bankruptcy Exemptions: Critique and Suggestions}, 68 \textsc{Yale L.J.} 1459, 1463 (1959). Typically, they are designed to favor special interest groups. \textit{Id.} at 1466. See, e.g., \textit{Wis. Stat. Ann. § 272.18(11) (1974) (printing presses)}; \textit{Miss. Code Ann. § 85-3-1(o) (1972) (molasses mill and equipment)}.


There are very few federal exemptions now in existence. Among them are proceeds of libel and slander actions and life insurance policy cash surrender values. Bankruptcy Act § 70, 11 U.S.C. § 110 (1970).\textsuperscript{77}

\textsuperscript{73} Judges' Bill, \textit{supra} note 9, at § 4-503(a).

\textsuperscript{74} \textit{Id.} § 4-503(b).

\textsuperscript{75} \textit{Id.} § 4-503(d).

\textsuperscript{76} Moreover, if the debtor takes no exemption for residence and insurance or the aggregate value of the exemptions is less than the residence ceiling provided in § 4-503(b), he may exempt such items as jewelry, clothes, furniture and cars as provided in § 4-503(e)(1) up to such residence ceiling. \textit{Id.} § 4-503(d). This would be over and above the § 4-503(e)(1) exemption for these same items.

This interpretation is premised on the author's belief that within § 4-503(d), pertaining to the exemptions in lieu of homestead and insurance, there is a typographical error. It is assumed where the statute reads "if no property is allowed as exempt under subsections (a) or (b) of this section . . . .", it should read "(b) or (c)." As is, the reference to subsections (a) or (b) would be meaningless since subsection (a) merely sets the bounds
\end{footnotesize}
render value in excess of the residence ceiling may be protected from creditors by paying the trustee an amount equal to the excess.\textsuperscript{77} The homestead, burial plot and life insurance exemptions are, in any event, subject to the $25,000 ceiling. The Judges’ Bill provides for additional property exemptions up to the $25,000 limit for:\textsuperscript{78}

(1) Livestock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles, to an aggregate value of not more than $3,000.
(2) Cash, securities, and receivables, including unpaid personal earnings, accrued vacation pay, and income tax refunds, to the aggregate value of not more than $500.
(3) Payments of alimony, support, and separate maintenance.
(4) The identifiable proceeds or benefits from any life insurance policy . . . .
(5) . . . [S]uch rights as the debtor may have under a pension, annuity, or similar plan . . . .
(6) Disability benefits.
(7) Proceeds, benefits, or other rights to which the debtor is entitled as a result of any personal injury or unemployment.
(8) Health aids reasonably necessary to enable the debtor to work or to sustain his health.\textsuperscript{79}

Where the debtor dies after filing, a separate exemption would entitle the surviving spouse and dependent children to an allowance of one thousand dollars each out of estate property not yet distributed, reduced only by life insurance benefits received by that person in excess of $10,000.\textsuperscript{80}

Under the Judges’ Bill no exemption may be taken under either federal or state plans for “concealed or voluntarily transferred” property which is subsequently recovered by the trustee unless the transfer was made to secure a debt. In such a case, only the excess of value of the transferred property over the debt so secured is eligible for exemption.\textsuperscript{81} The conversion of nonexempt property into an exempt form of the exemptions and provides no specific property exemption per se. Furthermore, subsection (d) is entitled “[e]xemption in lieu of homestead and insurance,” to which subsections (b) and (c) specifically address themselves.

\textsuperscript{77}Id. § 4-503(c). There is an existing federal exemption for life insurance policies. Bankruptcy Act § 70(a)(5), 11 U.S.C. § 110(a)(5) (1970) provides in part:

[\textit{W}hen any bankrupt . . . shall have any insurance policy which has a cash surrender value payable to himself . . . he may, within thirty days after the cash surrender value has been ascertained . . . pay or secure to the trustee the sum . . . and continue to hold, own, and carry such policy free from the claims of the creditors, otherwise the policy shall pass to the trustee as assets . . . .

\textsuperscript{78}Judges’ Bill, supra note 9, at § 4-503(e). Value for exemptions would be fair market value at the time of filing less all indefeasible liens. Id. § 4-503(f).

\textsuperscript{79}Id. § 4-503(e).

\textsuperscript{80}Id. § 4-503(g).

\textsuperscript{81}Id. § 4-503(f).
prior to filing of a petition would not affect the debtor's right to an exemption unless the conversion amounted to an actual fraud.\textsuperscript{82}

The Commission's Act sets forth a similar scheme of exemptions, but makes no provision for regional variation. Under the Commission's plan, the state exemptions would be wholly abrogated and the federal plan would uniformly apply regardless of regional differences and needs.\textsuperscript{83} The Commission justified its provision with the following comment:

The reference to nonbankruptcy law to determine the exemptions is abandoned to eliminate diversity . . . and because state exemption laws seem generally archaic and unduly generous in some states and exceedingly niggardly, . . . in others.\textsuperscript{84}

The Commission's stated goal is uniformity but what is needed is uniformity of result, which can only be achieved by allowing for some form of regional differences. Individuals in high cost of living regions would suffer a great hardship under dollar limits which are designed for nationwide application.\textsuperscript{85} A better system would allow for regional adjustment of all dollar limitations. Likewise, fixed dollar amounts cause inequities in a fluctuating economy. In present times, the inflation rate is such that a dollar amount fixed at an equitable sum while a bill is drafted could be obsolete by the time the bill is enacted.\textsuperscript{86} At minimum, regular review of the sufficiency of dollar amounts must be required. A preferable system would be one which automatically ties any dollar amounts into economic changes\textsuperscript{87} as measured by recognized economic indicators. The technology exists to implement a sophisticated and regionalized system of economic indices which could eliminate these inequitable results.\textsuperscript{88}

The Judges' Bill has made at least some provisions to offset the effects of fixed dollar amounts. Under the Judges' Bill the Director of the Board of Bankruptcy Administration would make an adjustment

\textsuperscript{82}Id. \textsection 4-503(f).
\textsuperscript{83} See Commission's Bill, supra note 8, at \textsection 4-503(b)(1).
\textsuperscript{84} COMMISSION REPORT, supra note 6, pt. II, at 127.
\textsuperscript{88} Such a provision would strike a balance between the proposed uniform exemptions and the state exemptions as they now stand, resulting in a freely equitable system, allowing for the differences in the economics of the many geographic localities.
of the dollar amounts every two years on the basis of statutorily defined economic indices. It does not, however, provide for regional cost of living differences. Hopefully, whatever statute is finally enacted will contain such a provision.

The specific exemptions suggested by the Commission are similar in type to the exemptions provided by the Judges' Bill. Under the Commission's Act, the homestead exemption is limited to $5,000 plus $500 per dependent. The Commission gives a separate exemption for life insurance with a cash surrender value of up to $1,500 and allows for total exemption of life insurance policies if the debtor pays to the trustee an amount equal to the excess in value over $1,500. The Commission also provides limited exemptions for certain personal property items, as well as the debtor's burial plot.

89 Judges' Bill, supra note 8, at § 1-105(b).
90 Id. § 1-105(a) provides:
The dollar amounts designated in this title shall be adjusted as provided in this section according to and to the extent of changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers: United States City Average, All Items, 1967 = 100, compiled by the Bureau of Labor Statistics, United States Department of Labor, and hereafter referred to as the index. The index for December 197 is the Reference Base Index. If the index is revised after December 197, the adjustment pursuant to this section shall be calculated on the basis of the revised index. If the index is superseded, the index referred to in this section is one represented by the Bureau of Labor Statistics as reflecting most accurately the changes in the purchasing power of the dollar for consumers.
91 Commission's Bill, supra note 8, at § 4-503(d).
92 Id. § 4-503. Subsection (c) provides:
The following property shall be allowed as exempt in addition to any property allowed as exempt under subdivision (b):
(1) livestock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles, to the aggregate value of not more than $1,000;
(2) a burial plot to the value of $2,500;
(3) cash, securities, and receivables, including unpaid personal earnings, accrued vacation pay, and income tax refund, to the aggregate value of not more than $500;
(4) payments for alimony, support, and separate maintenance;
(5) the identifiable proceeds or benefits from any life insurance policy if the debtor is the spouse or a dependent of the insured, to the extent the proceeds or benefits are reasonably necessary for the support of the debtor and his dependents;
(6) before or after retirement, such rights as the debtor may have under a profit sharing, pension, stock bonus, annuity, or similar plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health, or length of service, and which is either (A) qualified under section 401(a) of the Internal Revenue Code, or any successor thereto, or (B) established by federal or state statute, to the extent in either case the debtor's interest therein is reasonably necessary for the support of the debtor and his dependents;
(7) disability benefits;
(8) proceeds, benefits, or other rights to which the debtor is entitled as a result of any personal injury or unemployment; and
(9) health aids reasonably necessary to enable the debtor to work or to sustain his health.

Compare text accompanying note 79, supra.
Discharge and Reaffirmation

Under current law, a discharge “releases” the debt, thus leaving open the possibility of revival or reaffirmation. Both the Commission’s Act and the Judges’ Bill provide that discharge “extinguishes” debts. The Judges’ Bill states specifically:

[N]otwithstanding any ... law to the contrary, a debt extinguished by discharge ... shall not be revived or reaffirmed or be all or part of any bargain creating a new debt. Any judgment, whenever obtained, that a debtor is personally liable to pay a debt extinguished by discharge is null and void.

The purpose behind extinguishment is to prevent creditors from coercing a bankrupt into reaffirmance by threatening to refuse to extend new credit. The purpose of the bankruptcy laws, namely, to give the debtor a “fresh start,” would be subverted by such behavior. Upon initial consideration, such a change might seem beneficial to discharged debtors; however, in practice the opposite may well result.

While a bankrupt may need protection against coercion, prohibiting the debtor from legally binding himself to a reaffirmation would limit his available options. In the absence of a method whereby a discharged debt can be reaffirmed, a creditor may, for valid reasons, refuse to deal with the debtor again. Of course, it is no surprise that the Brookings study found that one-third of the bankrupts interviewed had a more difficult time obtaining credit after bankruptcy. However, two-thirds apparently did not experience this difficulty. The study also found that one-third of all bankrupts had revived all or part of their debts. A hypothesis worthy of testing is that there exists a substantial overlap between the latter two groups. Without the capacity to reaffirm, the bankrupt may be effectively restrained from reestab-

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93 Bankruptcy Act § 17(a), 11 U.S.C. § 35(a) (1970). Formerly, a creditor could collect an unsecured debt after discharge of the debtor by bringing suit in a state court, alleging fraud as a basis for exclusion of the debt from the discharge. Assertion of the discharge was an affirmative defense, absent which judgment would be entered for the plaintiff-creditor despite the bankruptcy. BROOKINGS REPORT, supra note 4, at 61. Remedy was found through legislation. Bankruptcy Act § 17(c)(4), 11 U.S.C. § 35(c)(4) (1970). The bankruptcy courts may now rule on the question of dischargeability in the event of such a suit. Id. “If the claim is dischargeable, the creditor will be barred from pursuing the debtor further unless the creditor is able to induce the discharged bankrupt to revive the obligation by a new promise to pay.” BROOKINGS REPORT, supra note 4, at 62 (emphasis added). See Countryman, The New Dischargeability Law, 45 AM. BANKR. L.J. pt. I, 1 (1971).

94 Judges’ Bill, supra note 9, at § 4-507(a).

95 COMMISSION REPORT, supra note 6, at 174-78.

96 BROOKINGS REPORT, supra note 4, at 63. See also H. JACOB, DEBTORS IN COURT 109-10 (1969), wherein over half the bankrupts surveyed had revived their debts.
lishing himself in the economic community. In other words, instead of a fresh start he would get no start. Moreover, payment of liabilities incurred, whether or not legally enforceable, is a matter of social policy to be encouraged, not restrained.

A better approach would be to combine the "release" provision of the current law with a provision proscribing discrimination against or coercion of bankrupts. The Judges' Bill contains an antidiscrimination provision which states:

A person shall not be subjected to discriminatory treatment because he, or any person with whom he is or has been associated, is or has been a debtor or has failed to pay a debt discharged in a case under this title. This action does not preclude consideration, where relevant, of factors other than those specified in the preceding sentence, such as present and prospective financial condition or managerial ability.

Archaic as it may seem, some states still allow for imprisonment of debtors. The Judges' Bill protects "[a] debtor by or against whom a petition has been filed . . . from arrest" and further provides that such person shall be "released from imprisonment on process issued in any civil action to enforce collection of a debt that is or will be provided for in a confirmed plan . . . or that is dischargeable . . . ." The Judges' Bill extinguishes all debts of an individual debtor with specific exceptions parallel to the exceptions to discharge found in the existing law. The exceptions include state and federal tax liabilities which are given a priority and those tax liabilities arising from failure to file a return, or for which a false or fraudulent return has been filed, civil liabilities for larceny and embezzlement, alimony and child support, liability for intentional torts, and debts respecting certain educational loans. Discharge is denied only if the debtor engaged in certain wrongful conduct, such as fraudulent transfer of property or if he has obtained a discharge within five years prior to filing.

98 Judges' Bill, supra note 9, at § 4-508.
100 Judges' Bill, supra note 9, at § 4-509.
102 This provision is also generally similar to the existing law, with the exception that Bankruptcy Act § 14(c)(5), 11 U.S.C. § 32(c)(5) (1970) provides for a minimum of six years between discharges.
Admittedly, the periodic amendments to the Bankruptcy Act over some 75 years have been a bandage attempt to keep abreast of changes in attitude by the courts in expanding the jurisdiction of the Bankruptcy Court, by the bar through its use of the Act as a professional tool, and by the public in its approach to bankruptcy as a vehicle for relief and protection. Still the major surgery attempted by the Commission, because of its capitulation to Brookings, resulted in the patient being taken to the brink of oblivion. The injection of fresh blood is necessary and, therefore, the many proposals for amendments to the Commission's proposed Act, as well as the Judges' Bill, should be carefully examined.

However, I have argued and lectured against a separate administrative branch primarily because of the czarist powers, of both an administrative and judicial nature, which would be assigned to the Administrator. More significantly, the exorbitant cost of implementing the Commission's Act makes this proposal particularly impracticable. I am constantly told that a separate administrative agency is inevitable, but I cannot agree. I believe, as others do, that a less costly procedure must be pursued. The Administrative Office of the United States Courts has done an exemplary job in monitoring and guiding the bankruptcy judges and their staffs in their administrative responsibilities. This has all been possible within the budgetary allowances made by Congress. Provisions should be made for additions to the present staffs of the bankruptcy judges to enable them to render full assistance to persons filing petitions, especially in consumer bankruptcies.

Codify the differences among the courts of appeals in matters of substance. Give the Administrative Office whatever jurisdiction and powers are deemed necessary to supervise the present system. Through these modest reforms, the court will be made responsive to the needs of the public. Oversimplistic? Perhaps. But essential reforms can be achieved with little confusion or bureaucratic chaos and most importantly, in these unprecedented times of a recession-inflation, at a cost much less than the 30 to 90 million dollars a year estimated as necessary to administer the Commission's proposal.  