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INTRODUCTION
BANKRUPTCY: THE NEED FOR BALANCE

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On October 20, 1997, the National Bankruptcy Review Commission submitted its report to the Congress, the Chief Justice, and the President, culminating a comprehensive two-year review of this country's bankruptcy system.[3] Precisely one year later, the Congress adjourned without enacting any significant bankruptcy legislation.[4] The struggle over that legislation had raged, however, until the final hours of the congressional session. It ended when the Senate failed to take up the conference report on H.R. 3150, which would have made major changes in the bankruptcy law--changes advocated primarily by the credit industry.

In the year that followed the Commission's report, the House of Representatives and the Senate each approved comprehensive bankruptcy legislation: H.R. 3150 on June 10 and S. 1301 on October 9, 1998. The bills, though dramatically different in approach, each adopted a significant number of Commission recommendations. The Commission report itself contained 172 specific recommendations for improving the bankruptcy laws, reflecting diverse ideas and suggestions from a series of national and regional hearings and more than 2,500 written submissions.[5] Many of those proposals and comments--from virtually every economic, geographic, and philosophic perspective--drew distinctions based on the differences, real or perceived, between good debtors and bad debtors, between good creditors and bad creditors. The Congressional proposals did as well.

The "honest debtor, who fails [through] . . . losses, sickness," and business setbacks, warrants different legal treatment, one commentator wrote, than the "designing, or idle, extravagant debtor who fails . . . [only] to cheat and abuse his creditors."[6] The law should treat more favorably the "moderate creditor, who . . . will hear reasonable and just arguments and proposals," than the "severe creditor," motivated by "passion and revenge," not compassion.[7] The English author, Daniel Defoe, made precisely these distinctions more than 300 years ago (before writing *Robinson Crusoe*) in his essay on bankruptcy. The debate he framed in 1697 has continued--in the Commission in 1996 and 1997, in this law review Symposium, in professional and academic debate, and, for the last year, in the Congress of the United States.

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3. NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS (1997), *also available at* http://www.nbrc.gov (hereinafter "NBRC REPORT").

4. Congress did extend Chapter 12, which had expired on October 1, 1998, for six months as part of The Omnibus Consolidation and Emergency Supplemental Appropriations Act signed into law on October 21, 1998. PUB. L. NO. 105-277.

5. NBRC REPORT, app. B-1 (1997), *available at* <http://www.nbrc.gov/report/b1.html>.

6. DANIEL DEFOE, AN ESSAY UPON PROJECTS 206 (1697).

7. *Id.*

The legislation adopted by Congress embodied many of the Commission's recommendations: the elimination of the federal district court as a mandatory stop in any appeal of a bankruptcy court's decision,[8] elimination of unlimited homestead exemptions,[9] and permanent status for Chapter 12's procedures for family farmers,[10] for example. In the area of consumer bankruptcy, however, the proposed legislation would have made fundamental changes in the Bankruptcy Code. Although the Commission itself made a number of proposals for improving the consumer bankruptcy system, it did not recommend architectural change --in part, because the Congress had directed the Commission to avoid wholesale revision.[11]

Specifically, the bill passed by the House of Representatives would have established what has been called a "needs-based system" designed, its proponents argue, to re-establish "the link between bankruptcy and the ability to pay one's debts." [12] Legislation passed by the Senate would make a debtor's "need" and "ability to pay" factors for the court to consider in deciding whether to permit a debtor to maintain a bankruptcy case.[13]

These proposals would have eliminated, for at least some debtors, the choice between Chapter 7 liquidation and a Chapter 13 payment plan, a choice that has been an integral part of the American bankruptcy system since the Chandler Act of 1938.[14] Under the legislation, some debtors would have had no choice but to use Chapter 13 or, no matter how desperate their circumstances, to try to cope with overwhelming debt outside the legal system.[15] It is not the purpose of this Note, or this law review Symposium, to analyze the wisdom of these proposals. That already has taken place in Congress and continues in other public and academic forums. However, this legislation, and much of the Commission's work in 1996 and in 1997, emphasizes the importance of the bankruptcy system in the economic life of this country and the mirror that it holds to this country's values.

No one, including Congress, anticipated the firestorm of controversy over consumer bankruptcy. Indeed, the legislative history of the Bankruptcy Reform Act of 1994, which created the Commission, emphasized that Congress was "generally satisfied with the basic framework" of the 1978 Bankruptcy Code, counseling that the Commission's recommendations "not disturb the fundamental tenets of current law."[16] That was late in 1994, just before the first sparks became the explosion of consumer bankruptcy filings that continues today. More than 1.35 million con-

8. NBRC REPORT, Recommendation 3.1.3 (1997).
9. NBRC REPORT, Recommendation 1.2.2 (1997).
10. NBRC REPORT, Recommendation 4.4.1 (1997).
11. H.R. REP. NO. 103-835 (1994); *see supra* at 285 and note 16.
12. Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998).
13. S. 1301, 105th Cong. (1997).
14. Act of June 22, 1938, 52 Stat. 893.
15. Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998).
16. H.R. REP. NO. 103-835, at 59 (1994).

sumer bankruptcy cases were filed in 1997, twenty percent more than in 1996 and seven times the number twenty years earlier.[17] This dramatic increase in consumer cases has occurred in virtually every judicial district in the country.

When consumer cases reached the one million mark in 1996, the news media began to pay attention to this phenomenon, coming, as it did, in the midst of remarkable economic prosperity across the country.[18] The arcane provisions of the Bankruptcy Code were no longer the exclusive province of law reviews and professional journals. They quickly became news--the subject of analysis and commentary in *USA Today* as well as *The Wall Street Journal*.[19] More members of Congress began to pay attention to the issue--even if their points of view began to shift. "The Bankruptcy Reform Act of 1978 changed the code dramatically," one influential Congressman wrote, "making the system decidedly pro-debtor. The 1978 reforms were appropriate for the times. But the times have changed . . . ."[20]

As the number of consumer bankruptcies has increased and, with it, the media's attention and that of the Congress, so has the realization of how little sound statistical information is available about bankruptcy. Why do so many families file for bankruptcy in a time of economic prosperity? Answering that question, both easily stated and fair, frustrated the Commission and continues to frustrate the Congress.

There are, no doubt, many "causes" at work: attorney advertising, unprecedented access to consumer credit, changes in health insurance, and corporate downsizing, to name only some of the more obvious. The spread of legalized gambling has also played a significant role, and this Symposium very timely addresses the dischargeability of gambling debts. Before either a cause or a "cure" can be identified, however, there has to be an understanding of even more basic facts. Who files for bankruptcy? How much debt do they discharge? What is the relationship between secured debt and unsecured debt for those who file? How many debtors reaffirm, rather than discharge, financial obligations in bankruptcy? Why do so many Chapter 13 plans fail? Notwithstanding the advent of computerized case dockets, there is relatively little reliable statistical information about the bankruptcy system's constituents--debtor or creditor.

The Commission, through its national and regional hearings, provided a remarkable forum for the public policy debate surrounding the "facts" about consumer bankruptcy, even though the Commission had neither the time nor the resources to evaluate the credibility of the factual theories presented. In particu-

17. News Release from Administrative Office of the United States Courts (Dec. 1, 1997); News Release from Administrative Office of the United States Courts (Mar. 18, 1997).

18. News Release from Administrative Office of the United States Courts (Mar. 18, 1997).

19. Fred R. Bleakley, *Creditors Seek Tougher Bankruptcy Laws: Card Industry Wants Debtors to Pay Some Money Back*, WALL ST. J., Dec. 17, 1996, at A2; Christine Dugas, *Special Report: Going Broke*, USA TODAY, June 10, 1997, at A1.

20. Press Release of Representative George W. Gekas (R-PA), U.S. House of Representatives, Statement of Chairman George W. Gekas, Judiciary Subcommittee on Commercial and Administrative Law, Bankruptcy Reform Act of 1998 (Feb. 3, 1998).

lar, the Commission heard a number of witnesses testify about a study funded by the credit card industry that concluded that some Chapter 7 debtors could pay more of their debts if they were required to use Chapter 13.[21] That research provided the principal support for the credit industry's criticism that the bankruptcy system, with its choice between Chapter 7 and Chapter 13, is fundamentally flawed, and the study triggered its own controversy.[22] After the Commission filed its report, however, the General Accounting Office completed an audit of the survey, criticizing its methodology and calling its conclusions into question.[23]

The point, for the future of the bankruptcy system, is not that one study may be flawed, but that there remains too little reliable information to help Congress answer the fundamental policy questions being presented to it, let alone to make radical changes in the system. The Commission made a series of specific recommendations to improve and coordinate data collection and dissemination, which were incorporated in the 1998 legislation.[24] Any fundamental changes to a system that involves 1.4 million debtors and their families, untold numbers of creditors in businesses, small and large, more than 300 bankruptcy courts, and thousands of lawyers will not be made in a political vacuum. Those decisions, however, should be made in neither a statistical nor an economic vacuum.

The need to know more about how bankruptcy works today, through improved data collection and analysis, transcends any one part of the system, including not only Chapters 7 and 13, but also corporate reorganization under Chapter 11, municipal reorganization under Chapter 9, and family farm bankruptcy under Chapter 12. There is one other transcendent need that must be met as the Congress continues to address the bankruptcy system. Simply and starkly put, it is the need for balance.

The legislators who drafted the 1978 Bankruptcy Code found that balance, at least for those times, through a deliberate and deliberative process. They began with a comprehensive report and series of recommendations prepared, after several years of work, by the first Bankruptcy Commission.[25] A small bipartisan group of Congressmen and Senators, supported by a skilled staff, then immersed themselves in the subject.[26] The subcommittee of the House Judiciary

21. DR. MICHAEL E. STATEN, A PROFILE OF DEBT, INCOME AND EXPENSES OF CONSUMERS IN BANKRUPTCY, Krannert Graduate School of Management, Purdue University, Dec. 17, 1996; DR. MICHAEL E. STATEN, REPAYMENT CAPACITY OF CONSUMERS IN BANKRUPTCY, Krannert Graduate School of Management, Purdue University, Jan. 23, 1997.

22. Letter from Ian Domowitz, Professor, Department of Economics and Institute for Policy Research, Northwestern University, to Brady Williamson, Chairman, National Bankruptcy Review Commission (June 9, 1997); Letter from Marianne Culhane and Michaela White, Professors, Creighton University School of Law, to Brady Williamson, Chairman, National Bankruptcy Review Commission (June 11, 1997); Statement of Professor William Whitford before the National Bankruptcy Review Commission (Jan. 23, 1997).

23. Letter (No. B278972) from Richard M. Stana, Associate Director, Administration of Justice Issues, General Accounting Office, to the Honorable Charles E. Grassley (R-IA), Richard J. Durbin (R-IL), Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, United States Senate (Feb. 9, 1998).

24. NBRC REPORT, Ch. 4, Recommendation 4.1.1, *et seq.* (1997).

25. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES (1973).

26. *Id.* at Preface.

Committee, for example, held thirty-five days of hearings on proposed legislation and spent twenty-two days "marking-up" the legislation.[27]

Some of the proposals ultimately developed into law, with strong bipartisan majorities, five years after the Commission had finished its work.[28] The Code had the earmarks of legislative compromise, to be sure. Some of the controversies left unresolved--the Article I status and power of bankruptcy judges and the indefensible differences in state exemptions, for example--remain controversial today. In a general sense, however, the 1978 Bankruptcy Code provided balance by recognizing and accommodating the interests of secured creditors, debtors, unsecured creditors, priority creditors, and, not the least, the public that pays for and uses the system.

The recommendations from this Commission, and even the legislation recently passed by Congress to amend the consumer bankruptcy law, do not parallel the comprehensive changes enacted in the 1978 Code. They are no less significant, however. Indeed, in some respects--the non-dischargeability provisions of the proposed legislation, for example--the changes would have had more widespread practical effect on debtors and creditors. It remains to be seen whether the Congress elected this fall can replicate the success of the 1978 Congress in conducting a deliberate and deliberative process to maintain procedural and substantive balance in the bankruptcy system. The 105th Congress did not, however, holding relatively few hearings on the merits of the legislation and meeting only once in conference to try to reconcile the major differences between the House and Senate bills.

Balance is essential. For example, in proposing changes to the bankruptcy law of his time, Daniel Defoe described the balance necessary for an efficient system: "That a due care be taken of [creditors], that men's estates may, as far as can be, secur'd to them. And due limits set to the last, that no man may have an unlimited power over his fellow-subjects, to the ruin of both life and estate."[29]

Without balance, the American bankruptcy system can be neither equitable nor efficient. The laws enacted over the past 100 years have had balance as their goal and their common theme, spoken or unspoken, trying to provide both fair treatment for reasonable creditors and a fresh start for honest debtors, while attempting to minimize abuses by both. To be sure, these objectives, while readily embraced, are often in conflict with each other. The interests of debtors inevitably collide with the interests of creditors. The interests of secured creditors often diverge from those of unsecured creditors and, in turn, from the interests of government taxing authorities.

The need for balance is not simply a legal imperative--it is an economic requirement as well. The Bankruptcy Code imposes a set of rules on debtors and creditors alike. It provides a single forum for the resolution of their disputes and, of no less importance, the law, by its mere presence, influences the relationships between creditors and between debtors and creditors, whether or not the debtor,

27. Bankruptcy Law Revision, Report of the Subcommittee on the Judiciary of the House of Representatives, H.R. REP. No. 95-595, Sept. 8, 1977.

28. Act of November 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549.

29. DEFOE, *supra* note 6, at 206-08.

corporate or individual, eventually files for bankruptcy protection. The system has to maintain balance to ensure that neither creditors nor debtors overreach--either by permitting bankruptcy to become too easy or by becoming a taxpayer-financed debt collection service.

The Commission's recommendations and report have been criticized by advocates for debtors as "too pro-creditor" and by advocates for creditors as being "too pro-debtor." The Commission did address abuse by both debtors and creditors, and its recommendations do attempt to improve fairness and efficiency for both. In an area of law and economics where balance is so essential, criticism from both sides is the ultimate compliment.

The American bankruptcy system is as much about economic progress and stability as it is about economic failure. Since 1978, when Congress adopted the Bankruptcy Code, the law has helped families, farms, and businesses, saving countless jobs while providing creditors with a fair opportunity for payment and recovery. The fresh start that concludes the consumer bankruptcy process helps debtors, but, no less, it helps the economy. Bankruptcy is, however, an unavoidably imperfect and adversarial system. Credit extended in good faith is not repaid. There are abuses, at times substantial and widespread, by some debtors and some creditors. The consequences of poor economic judgment or misfortune, whether individual or business, are borne in part by those who were neither wrong nor unfortunate.

As more financially-distressed families turn to the bankruptcy system, as more people become aware of its importance to the economy, and as the advantages and disadvantages of the system come into sharper focus, the need for balance in the system grows. A bankruptcy system that does not balance the interests of creditors and the interests of debtors will have neither their confidence nor, of even greater importance, the confidence of the American people.