Finally, three minor changes in the 1978 law are designed to clarify the consumer's options in bankruptcy. The first requires that the consumer be told which chapters of the bankruptcy code he is eligible to use. Previously, one informed of his choices, the consumer may choose whatever best serves his interests. The second change makes explicitly clear that even though a debt may be dischargeable, the consumer may voluntarily repay the debt. This condition clarifies any ambiguity about a consumer's set of possible actions. Curiously, it does not specify that the consumer actually be told about this option.

**Likely Impact of the Amendments**

On the surface, the changes adopted in 1984 appear to be serious and substantial. The costs of bankruptcy are raised, attempts are made to curtail abuses by consumers, and a greater bankruptcy relief at some time, was insolvent, or did not pay a dischargeable debt. The following discusses the major changes to the consumer bankruptcy provisions embodied in the 1978 code, the apparent problems with these changes, and the latest corrections introduced by the 1984 amendments.

13. Recall that new discharge provisions also raise the cost of bankruptcy to some consumers. The new code significantly altered the bankruptcy code was developed in 1978. Apart from redesigning the bankruptcy code, the many changes introduced by the new code attempted to correct the above failings were so great that only the bankruptcy judges strictly refer to a state court, which has the power, without appeal, to overrule the bankruptcy court. Thus, consumers may be able to obtain a more favorable settlement. If this loophole becomes a problem, creditors may seek to amend the bankruptcy code further.

**In April 1981, the Subcommittee on Courts of the Senate Judiciary Committee began hearings to examine why there was such an extraordinary increase in personal bankruptcies since passage of the Bankruptcy Reform Act of 1978, and to determine appropriate corrective action. The subcommittee rejected the wage earner's plan, which introduced the wage earner's plan, and debt restructuring plan (Chap-

**In October 1979, prompted an enormous number of personal bank-


**The views stated herein are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.
Before the 1978 code, these “gate-rushers” usually could keep the money they collected, leaving less of the bankruptcy proceeds to cover the claims of other creditors, even those who had the same legal rights to the consumer’s assets as the “gate-rushers.” Under the new law, however, other creditors can make the “gate-rushers” return these funds to the consumer’s estate for possible distribution to the other creditors.

A second change in the 1938 code essentially dropped all preconditions for eligibility under Chapter 13. Under the revised code, any consumer can file for bankruptcy, regardless of whether or not he can pay his debts out of current or past income. This was designed to protect consumers from overbearing debt collectors, and to promote that consumer’s economy over that of the creditor. The third code change lowered the cost of bankruptcy by allowing consumers to keep more of their assets and income. This was done in four ways: (1) by creating federal exemption limits, which were typically more generous than any state limits, (2) by allowing consumers to discharge a greater variety of debts, and (3) by allowing debtors to reduce their total debt by paying secured creditors the lesser of the market value of the collateral, or the creditor’s security interest, as full payment of their debt. These provisions were created to give the honest consumer more help in starting a new life after bankruptcy.

Finally, the 1978 code attempted to make Chapter 13 relatively more attractive to financially distressed consumers by raising the high income levels at which increasing losses to them. It protected creditors by requiring that a Chapter 13 plan leave them at least as well off as they would be in a Chapter 7 filing. It made Chapter 13 more attractive by permitting the redemption of any collateral, giving greater protection to co-debtors, requiring only secured creditor approval of a Chapter 13 plan, and widening the class of dischargeable debts. A final and controversial requirement for personal filings conducted by the Credit Research Center for the Coalition for Bankruptcy Reform (a group of consumer credit and associated organizations) found that between 30 percent and 40 percent of the debtors in their sample could repay at least one-half of their debts within five years. This study, and those by the General Accounting Office and by Brimmer and Co., Inc., found that the main differences between consumers who filed under the 1938 law and those who filed under the 1978 code were that the latter had greater amounts of assets, debts, and income. The reasons for filing and the demographic characteristics of the consumer bankrupts were not that different in the two groups. Thus, it appeared that the new code was encouraging unnecessary bank- ruptcy filings by more affluent consumers.

There were two minor changes that protect debtors. One is for certain cash advances that were made during the three-year period beginning the date the consumer’s obligations are expanded on the Judiciary, U.S. House of Representatives, U.S. General Accounting Office, July 20, 1983; and the references cited therein.


10. Not all of the changes favor creditors. There are two minor changes that protect debtors. One allows a consumer to retain a home even in bankruptcy and to be protected from the serving of a wage garnishment and the sale of his home if it is his primary residence. The other allows a consumer to retain personal items worth up to $7,500 and to be protected from the sale of these items if they are his primary residence. These provisions were created to give the honest consumer more help in starting a new life after bankruptcy.

11. Pre-1978 law did not permit the discharge of most taxes.
Before the 1978 code, these “gate-rushers” usually could keep the money they collected, leaving less of the total income for the claims of other creditors, even those who had the same legal rights to the consumer’s assets as the “gate-rushers.” Under the new code, other creditors can make the “gate-rushers” return these funds to the consumer’s estate for possible distribution to the other creditors. A second change in the 1938 code essentially dropped all preconditions for the discharge of personal debts. The 1938 code required the debtor to prove within a specified period that he no longer had the legal right to the goods. The 1978 code essentially dropped all preconditions other creditors can make the “gate-rushers” return these funds to the consumer’s estate for possible distribution to the other creditors.

The third code lowered the cost of bankruptcy by allowing consumers to keep more of their assets and reduce their debt by paying secured creditors the lesser of the market value of the collateral, or the creditors’ security interest, as full payment of their debts. These provisions were created to give the honest consumer more help in starting a new life after bankruptcy.

Finally, the 1978 code attempted to make Chapter 13 relatively more attractive to financially distressed consumers with high income and sizable debt, but increasing losses to them. It protected creditors by requiring that a Chapter 13 plan leave them at least as well off in their ability to collect debts as in their pre-bankruptcy filing. It made Chapter 13 more attractive by permitting the redemption of any collateral, giving greater protection to co-debtors, requiring only a secured creditor approval of a Chapter 13 plan, and widening the class of dischargeable debts. A final and controversial requirement of the personal filings conducted by the Credit Research Center for the Coalition for Bankruptcy Reform (a group of consumer credit and associated organizations) found that between 30 percent and 40 percent of the debtors in their sample could repay at least one-half of their debts within five years. This study, and those by the General Accounting Office and by Brimmer and Co., Inc., found that the main differences between consumers who filed under the 1938 law and those who filed under the new 1978 code applied to different types of debts, and greater amounts of assets, debts, and incomes. The reasons for filing and the demographic characteristics of the consumer bankrupts were not significantly different in the two groups. Thus, it appeared that the new code was encouraging unnecessary bankruptcy filings by more affluent consumers.

Moreover, casual evidence submitted in Congressional testimony showed that the percentage of unemployed debtors agreed to be repaid in Chapter 13 plans varied considerably across the nation. In some circuit court districts, the fraction was generally greater than 50 percent, while in other districts it was less than 10 percent. A November 1981 study conducted by the Credit Research Center for the Coalition for Bankruptcy Reform (a group of consumer credit and associated organizations) found that between 30 percent and 40 percent of the debtors in their sample could repay at least one-half of their debts within five years. This study, and those by the General Accounting Office and by Brimmer and Co., Inc., found that the main differences between consumers who filed under the 1938 law and those who filed under the new 1978 code applied to different types of debts, and greater amounts of assets, debts, and incomes.

The 1978 code also was designed to give the consumer more help in starting a new life after bankruptcy. It made Chapter 13 more attractive by allowing consumers to keep more of their assets and reduce their debt by paying secured creditors the lesser of the market value of the collateral, or the creditors’ security interest, as full payment of their debts. These provisions were created to give the honest consumer more help in starting a new life after bankruptcy.

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finally, three minor changes in the 1978 law are designed to clarify the consumer's options in bankruptcy. the first requires that the consumer be told which chapters of the bank-ruptcy code he is eligible to use. presumably, once informed of his choices, the consumer may choose whatever best serves his interests. the sec-ond change gives the debtor an extra 30 days (60 days in total) to rescind discharge agreements. the third change makes explicitly clear that even though a debt may be discharge-able, the consumer may voluntarily repay the debt. this condition clarifies any ambiguity about a consumer's set of possible actions. curiously, it does not specify that the consumer actually be told about this option.

likely impact of the amendments

on the surface, the changes adopted in 1984 appear to be serious and sub-stantial. the costs of bankruptcy are raised, attempts are made to cur-tail abuses by consumers, and an impression is indirectly given that bankruptcy is a serious matter. in-deed, consumer creditors are pleased with the changes, and say that be-cause they are better protected, they will be less reluctant to lend to lower-income consumers.

However, it is likely that the suc-cess of these changes in lowering either the total number of personal bankruptcy filings, or in lowering creditor loan losses, will be minor unless the bankruptcy judges strictly enforce the main anti-abuse provi-sion and obtain the cooperation of state courts. there are several rea-sons for this: first, there are no solid statistical data on the number of consumer abusers, or on the dollar loss they represent. the amendments were designed with only anecdotal evidence of abuse provided by con-sumers. if abuse is truly minor, then the preference for discharge-provision changes will have only marginal effects.

second, the 1978 code allowed states to prevent their consumers from using the relatively more gen-erous federal exemption limits. by september 1982, 33 states substituted their own less generous exemption limits. the lower federal exemption limits thus already are inoperable in these states. they also may have little impact in the other 17 states and in the district of columbia. two studies comparing the number of bank-ruptcy filings in states that opted out of the federal exemptions with those in the other states found that lower exemption limits had a minor impact on personal bankruptcy filings.

finally, the changes unquestionably raise the cost of a chapter 13 filing, thus giving consumers the incentive to use chapter 7. the bankruptcy court can dismiss a chapter 7 case if it feels that the case would be an abuse of the law. however, in certain circumstances, the amendments let any party demand that the case be referred to a state court, which has the power, without appeal, to over-rule the bankruptcy court. thus, consumers may be able to obtain a more favorable settlement. if this loophole becomes a problem, creditors may seek to amend the bankruptcy code further.

In April 1981, the Subcommittee on Courts of the Senate Judiciary Commit-tee began hearings on a bill which was not considered until early 1984. the bill was signed by Presi-dent Reagan on July 10, 1984.

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