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IMPACT ANALYSIS OF THE 1970 BANKRUPTCY DISCHARGE AMENDMENTS

PHILIP SHUCHMAN†

I. INTRODUCTION

Rules of accepted business practice are created from routine and repetitive economic situations because decisions cannot be made anew each time a recognized scene recurs. These rules of business practice not only respond to economic conditions, they in turn create new conditions, often resulting in an informal body of law. For example, persons dealing with sellers and lenders have been bound by unilaterally created rules of practice in the form of adhesion contracts during most of the history of American law. In this manner, the business practices of lenders and sellers have acquired the binding force of the law. Power in the market place is still power in the courts.

Attempts to change these rules of practice through changes in the law may have side-effects and unforeseen results produced by the ingenuity of lawyers responding to new case and statutory law. The subject of this article is an empirical study of the effect of the 1970 amendment to the Bankruptcy Act¹ on the rules of actual practice that had been created by the widespread and consistent actions of consumer creditors in taking advantage of a gap in the statutory framework.

I have stated my views on most of the subject matter of this article in an earlier writing,² and I have done so, for the most part, in the accepted dispassionate law review style. Students and professional commentators already have analyzed the new law of bankruptcy discharge with completeness and acumen.³ Consequently, I will review only

†Professor of Law, University of Connecticut; Deputy Director, Commission on the Bankruptcy Laws of the United States. These data were gathered, organized and tabulated by George D. Appelbaum, Mark D. Blocher, Myron A. Bloom, John C. Firmin, John L. Krajsa, and Robert J. Wheelwright. The investigations were funded by the Commission on the Bankruptcy Laws of the United States, which is not responsible for the accuracy of the findings. The analysis and conclusions are those of the writer. I am grateful to Professors Frank R. Kennedy and Walter Ray Phillips for their helpful suggestions.

¹Act of October 19, 1970, Pub. L. No. 91-467, § 7, 84 Stat. 992, *amending* 11 U.S.C. § 35 (1970).

²Shuchman, *The Fraud Exception in Consumer Bankruptcy*, 23 STAN. L. REV. 735 (1971) [hereinafter cited as Shuchman].

³See, e.g., Countryman, *The New Dischargeability Law*, 45 AM. BANKR. L.J. 1 (1971); Note, *Bankruptcy—1970 Amendments to the Bankruptcy Act—An Attempt to Remedy Discharge Abuses*, 69 MICH. L. REV. 1347 (1971); Comment, *Bankruptcy: Effect of the 1970 Bankruptcy*

enough recent history to introduce bankruptcy discharge to the reader unfamiliar with the law of personal bankruptcy. References to recent literature are provided in the footnotes.

A glossary is required. Legal terminology is wonderfully neutral, so much so as to be inadequate for description. For example, in speaking of creditor and debtor one may convert these symbols into persons. That would be a mistake, for only the debtor is a person; the creditors are corporate businesses: large and impersonal commercial establishments with codified rules of practice and with elaborate accounting and statistical analyses of losses, tax consequences, money flows, and the week-to-week cost of borrowing in the commercial money market. Debtors and creditors are inhabitants of two separate worlds, meeting for different purposes on a ground established by the corporation to facilitate a profit-making transaction. Corporations now have the same rights as natural persons,⁴ though—heaven knows—a corporation feels no joy or remorse and has no soul to be lifted or ass to be kicked. But the use of artificial language may have unfortunate consequences. The use of the word “creditor” to refer to a friend or relative as well as to a bank or finance company is an abuse of the language which tends to present a distorted and misleading picture of reality. In this article the following definitions should be assumed for most purposes.

A *creditor* is a business enterprise, usually large, always organized in the corporate form, and often doing business in a large region or in many states. These businesses are organized and operated for the sole purpose of making a specific form of investment: loans for profit. The typical creditors are banks, small loan and other finance companies, installment sellers and their financiers, and credit unions.

A *debtor* is an individual in need of small sums of money. The typical debtors here involved are married and have three children; they are about forty years old, have a high school education, and are usually employed at an unskilled manual job at an annual wage below the level of the Bureau of Labor Statistics “lower living budget” of 7,200 dollars. The debtors may be considered near-poor or lower middle class.

A *bankrupt* is a debtor who did not repay the last of several loans from a creditor and whose wages were being garnished. The debtor has filed a petition in bankruptcy that caused him to become dishonest usually because he failed to list on a “financial statement” other debts

Amendments on the Discharge That Never Was, 1971 Wis. L. Rev. 1174.

⁴See *United States v. Amedy*, 24 U.S. (11 Wheat.) 392, 411 (1826).

that were known to the creditor anyway.

Reliance is a legal doctrine that results from the debtor's bankruptcy and his failure to pay the creditor's last loan. It is derived from a *financial statement* or *loan application* that is prepared by the lawyers for the creditor. The financial statement is signed by the debtor, who often handwrites on it the magical incantation, "I have no other debts," from which ceremonial comes reliance.

A *renewal* or *resetting* is a loan which is made to pay off an earlier loan and which often provides some cash for the debtor. Most consumer loans are of this type which are encouraged by creditors because they make more profit that way.

Although nine-tenths of all bankruptcy filings in the United States (about 180,000 out of 200,000) are pitifully small estates resulting from voluntary petitions filed by individual debtors, the substantive law of bankruptcy is almost entirely based on the one-in-ten business bankruptcy. This is in part historical peradventure and in part design, for the Bankruptcy Act was created for merchants and traders⁵ and is said to operate for the benefit of those engaged in commerce. Consumer bankruptcy is a modern phenomenon whose largest growth has been since 1945, fairly well coinciding with the increase in consumer credit during the same period. Such changes in the Bankruptcy Act as have been enacted for the benefit of consumers (*i.e.*, those not engaged in a business or profession) have been incidental or with a view toward making it more feasible for defaulting consumer debtors to pay their debts.⁶ The jargon of bankruptcy law is esoteric and uses labels borrowed from the bankruptcy acts of two and three centuries ago, and many of the basic concepts stem from even earlier times.

However one views the history and purposes of bankruptcy law, it has been clear for several decades that the sole purpose of bankruptcy for most bankrupts is to be discharged from debts and free from the harassment of various execution processes. In most consumer bankruptcies there is nothing at all to distribute to creditors⁷ (at least not to

⁵C. WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 7 (1935).

⁶*See, e.g.*, Bankruptcy Act §§ 601-86, 11 U.S.C. §§ 1001-86 (1970) (Chapter XIII—Wage Earners' Plans).

⁷ADMINISTRATIVE OFFICE OF THE U.S. COURTS, *TABLES OF BANKRUPTCY STATISTICS*, Table F 4(a) (1971). These data show that of 164,000 straight bankruptcy cases concluded in fiscal year 1969, 131,000 (80%) were either nominal or no-asset cases. In addition, *see* D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 20-22 (1971), estimating that 85% of all consumer bankruptcies were nominal or no-asset cases.

general creditors⁸—secured creditors fare somewhat better)⁹, and hence there is no problem of fairness between competing creditors. What little property the bankrupt debtor has is usually exempt under state law or subject to security interests.

The discharge has been routine in most bankruptcy courts. Less than a thousand discharges were denied in nearly 164,000 bankruptcies in 1969. These denials were concentrated in a few courts, and most (about two-thirds) have been based on the debtor's refusal to produce income tax returns. A tax refund will often pay the trustee's fee though rarely is it sufficient to allow for payment of a dividend to general creditors.

The effect of the discharge on particular consumer debts is what has been at issue. The usual creditors who contend that the discharge has not barred them from actions in the state courts are those in the business of consumer credit: banks, finance companies, installment sellers and their financiers, and credit unions. Although one would think that such lenders would be in the best position to anticipate losses and to prevent overreaching by their customers, who are usually uninformed and indigent, it appears to the contrary that these professional lenders with national organizations, access to computerized credit-reporting services, and staffs of able lawyers are apparently so easily bilked that their stockholders should be warned. During 1970, lenders claimed that as many as forty thousand or more bankrupt consumer-borrowers had deceived them.¹⁰ Each deception allegedly occurred when a borrower induced the lender to make a loan based on a false financial statement. Had these lenders known the truth, they never would have acted so imprudently.

But the lenders thus deceived were not without recourse. A remedy had been given them early in the history of the Bankruptcy Act, the fount from which flows a strange cornucopia of cases said to evidence the prevailing morality: Only an honest bankrupt is entitled to be discharged from his debts.¹¹

⁸ADMINISTRATIVE OFFICE OF THE U.S. COURTS, *supra* note 7, at Table F 6. In 22,000 straight asset cases concluded in fiscal year 1969, unsecured creditors received 7.8% of their allowed claims. In addition, see D. STANLEY & M. GIRTH, *supra* note 2, at 21-22. Unsecured creditors received 7% of their allowed claims in consumer bankruptcies. *Id.*

⁹D. STANLEY & M. GIRTH, *supra* note 2, at 21-22. Secured creditors received 66% of their allowed claims in consumer bankruptcies. *Id.*

¹⁰See Shuchman 762.

¹¹See, e.g., *Harris v. Zion's Sav. Bank & Trust Co.*, 317 U.S. 447, 451 (1943); *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 191 (1902).

For nearly sixty years section 14c(3) of the Bankruptcy Act of 1898 had protected consumer creditors from the dishonesty of their mischievous borrowers. This provision in the Bankruptcy Act permitted injured creditors to file objections to the discharge sought by an errant borrower on the ground that the bankrupt as borrower had obtained a loan (or an extension or resetting of a loan) by making false financial statements on the printed loan application provided by the lenders to facilitate the business of lending money for profit. The mere threat of barring the discharge, it is said, usually had the desired effect: the bankrupt would reaffirm the debt and the objection to his discharge would not be filed. This practice was of considerable benefit to those in the consumer credit business, for they alone had printed financial statements (often labelled as a loan application) upon which to rely, and they alone had the legal leverage of possible denial of the discharge that the bankrupt sought and for which he had paid his lawyer's fee and a fifty-dollar filing fee. With this legal leverage, the injured creditor could not only have a new promise to make him whole, but he could also have a new debtor without other creditors to interfere with business as usual.

If the threat of barring the discharge did not work, those in the lending business had yet another remedy to get back at their lying customers. Not all debts were effectively discharged, since section 17a(2) of the Bankruptcy Act allowed creditors who had loaned money in reliance on a false financial statement to sue the discharged bankrupt in the state court of appropriate jurisdiction, notwithstanding the discharge of scheduled and provable debts.¹²

Although the federal courts granted the discharge, the state courts had the power to interpret the effect of that discharge for many purposes, including the application of section 17a(2).¹³ A suit in a state court was often a better remedy than a proceeding to bar the discharge entirely since objections to the discharge had to be brought in the bankruptcy court before referees often hostile to creditors' objections and while the bankrupt was still represented by counsel. Also, in the bankruptcy court any creditor could object to the discharge, whether or not he had relied on the false financial statement,¹⁴ and the successfully interposed objection to discharge benefited all other creditors as well.¹⁵

¹²11 U.S.C. § 35 (a)(1)(d) (1970).

¹³See, e.g., *Hilton Credit Corp. v. Jaggli*, 366 F.2d 793 (9th Cir. 1966), and cases cited therein; *Ciavarella v. Salituri*, 153 F.2d 343 (2d Cir. 1946); Smedley, *Bankruptcy Courts as Forums for Determining the Dischargeability of Debts*, 39 MINN. L. REV. 651, 652-53 (1955).

¹⁴*In re Lepley*, 227 F. Supp. 983, 985 (W.D. Wis. 1964).

¹⁵*In re Gadansky*, 249 F. Supp. 114, 115 (E.D.N.Y. 1965).

And why give them that windfall? They hadn't worked for it.

Thus, before 1960 a creditor with a scheduled and provable claim could bar the discharge of a bankrupt who had procured a loan by means of an intentionally false financial statement upon which the creditor had relied. In addition, the aggrieved creditor could ignore the discharge and sue the bankrupt in the state courts for the debt he claimed was excepted.

There were so many complaints and so much critical comment in the law journals¹⁶ about this procedure that Congress finally took ameliorative action. Two major changes in the Bankruptcy Act were brought about by the 1960 Celler amendment.¹⁷ The injured creditor who had relied upon a false financial statement to his detriment could no longer *bar the discharge* of the consumer bankrupt under section 14c(3) because that section of the Bankruptcy Act was limited in its application to persons engaged in business who had procured loans based on false financial statements. Consumers (those nine out of ten bankrupts) were now excluded from the operation of section 14c(3). But section 17a(2), which *excepted* such debts from the effect of the discharge and allowed the dishonest debtor to be sued in state court, remained; in fact, it was expanded to include language taken from section 14c(3). As amended in 1960, the Bankruptcy Act not only allowed creditors to sue in state courts on loans made in reliance upon a materially false statement, but also allowed suit on the extension and renewal of such loans.¹⁸

The 1960 Celler amendment thus took little away from those in the consumer credit business, and it gave them something more than a minority of state courts had allowed. Some state courts had held that where a subsequent loan had been made to pay off a previous loan, with some pittance of fresh cash proceeds, and only the new loan was tainted with fraud, only the fresh cash advanced was subject to the section 17a(2) exception. Hence the creditor could recover only that smaller portion by its successful action in those state courts.¹⁹

The Celler amendment of section 17a(2) eliminated this judicial protection²⁰ for debtors by barring from discharge a fraudulently ob-

¹⁶See, e.g., Friebolin, *Re-Examination of Section 14c(3) as a Ground for Objection to Discharge*, 39 MINN. L. REV. 673 (1955); Note, *Bankruptcy Act: Abuse of Sections 14c(3) and 17a(2) by Small Loan Companies*, 32 IND. L.J. 151 (1957).

¹⁷Act of July 12, 1960, Pub. L. No. 86-621, § 2, 74 Stat. 409, amending 11 U.S.C. § 35 (1970).

¹⁸*Id.*

¹⁹See, e.g., *Household Fin. Corp. v. DeShazo*, 57 Wash. 2d 771, 359 P.2d 1044 (1961); *Household Fin. Corp. v. Christian*, 8 Wis. 2d 53, 98 N.W.2d 390 (1959).

²⁰See, e.g., *Local Indus. Fin. Co. v. McDougale*, 404 S.W.2d 789 (Ky. 1966); *First Credit*

tained renewal loan, including payment of a prior untainted loan. Consumer creditors then knew what to do when they anticipated a debtor's bankruptcy: give a new loan and be sure to get the right kind of financial statement.

Again there were complaints in the law journals²¹ and more hearings were held by Congress²² regarding the effectiveness of the discharge. The Celler amendment had foreclosed one means of coercion (the threat of barring the discharge) but had expanded another means of finessing the discharge (*i.e.*, suing in state court on the excepted debt). Further amendment to section 17a(2) was made in 1970 under the sponsorship of Senator Burdick and Congressman Edwards, but no change was made in the fraud exception. Thus the present substantive law allows an exception from the discharge of loans and renewals, resetting, and extensions of loans which were made in reliance on a materially false written financial statement made by the consumer borrower with the intent to deceive.

Their procedural amendment was enacted in September, 1970, and became effective on December 18, 1970. It left the substantive law unchanged, but required the injured creditor claiming an exception from discharge under section 17a(2) to bring his action for a "determination of dischargeability" in the bankruptcy court before the referee during the pendency of the bankruptcy proceeding or be barred thereafter from any action on his debt in any other forum.²³ This article examines the impact of the 1970 amendment on the basis of data gathered in the Federal Judicial District of Connecticut and the Eastern District of Virginia (excluding Richmond) and on the basis of data from the Superintendent of Banking in New York. In addition, widespread thinking on the problems and inequities created by the pre-1970 discharge law is examined in light of a previously published empirical study in Connecticut.²⁴ Finally, possible legislative actions are suggested to ameliorate problems that may result from present doctrine.

Corp. v. Wellnitz, 21 Wis. 2d 18, 123 N.W.2d 519 (1963). See generally Federal Fin. Co. v. Merkel, 65 Wash. 2d 379, 397 P.2d 436 (1964).

²¹See, e.g., Phillips, *Order of Discharge and Post-Bankruptcy Litigation*, 16 MERCER L. REV. 409 (1965); Smedley, *Determination of the Effect of a Discharge in Bankruptcy*, 15 VAND. L. REV. 49 (1961).

²²See S. REP. NO. 1173, 91st Cong., 2d Sess. (1970), noting the bills introduced and the hearings held for nearly four years before then.

²³Act of October 19, 1970, Pub. L. No. 91-467, § 7, 84 Stat. 992, amending 11 U.S.C. § 35 (1970).

²⁴Shuchman.

II. PRE-AMENDMENT DISCHARGE RECONSIDERED

Prior to passage of the 1970 amendment, it was possible for a creditor who claimed an exception from discharge under section 17a(2) to avoid the bankruptcy court entirely and bring an action on the debt in a state court. This procedure was criticized for a variety of reasons, and these criticisms will be examined in the light of empirical data from the earlier Connecticut study.

First there is the question of whether there was in fact a problem of many improper law suits in the state courts under the section 17a(2) exception for false financial statements. Here one can only infer from the number of such suits and from the identity of those who are accused of material misrepresentation.

The sample of bankrupts sued in the state courts of Connecticut did not appear to be part of any criminal subculture. If they were cheats, their performances were amateurish. Measured by gross demographic characteristics, the typical bankrupt sued by a creditor was a white male in his middle thirties, living with his family and employed in a blue collar manual skilled job with average annual earnings of more than six thousand dollars. These findings are consistent with several other studies.²⁵

From the earlier study in Connecticut, and a replication made in the eastern part of Virginia, it appeared that the group of bankrupts sued in state court under the pre-amendment section 17a(2) were not different from their non-sued cohorts. The differences, if any, seemed to be that the non-sued bankrupts had paid their debts to the plaintiffs in such actions, had reaffirmed their debts, or, because they were unemployed and had no assets or only exempt assets, had no property upon which execution could be had. It is the writer's opinion that many more consumer bankrupts could have been sued under section 17a(2) by small loan companies, credit unions, banks, and sales financiers using bankruptcy schedules and a loan application form *cum* financial statement. The only questions of fact to be adjudicated in such cases were the reliance by the consumer creditor and the intent to deceive by the bankrupt.

A second problem thought by some commentators to have hindered a successful discharge by a consumer bankrupt was the unfamiliarity of state trial court judges with the important case law relating to section

²⁵See Herrmann, *Families in Bankruptcy—A Survey of Recent Studies*, 28 J. MARRIAGE & FAM. 324-25 (1966) (allowing for the fact that all the studies were conducted before 1965).

17a(2).²⁶ This seems unlikely because these legal principles of the Bankruptcy Act are uncomplicated and have common law equivalents. Moreover, in the reported decisions of several state courts there is fair evidence that the judges fully appreciated the legal and social context of the usual section 17a(2) action. The elements of "reliance upon a materially false statement in writing respecting [the bankrupt's] financial condition made . . . with intent to deceive"²⁷ are simple. From the reported cases it seems evident not only that the state court judges understood this legal doctrine, but also that many of them disagreed with it.²⁸

State court judges were not as a group sympathetic with these actions. They often appear to have sought to finesse any doctrinal approach, often by a factual finding of no reliance on the false or incomplete financial statement.²⁹ This was accomplished by findings that the use of credit reports negated reliance³⁰ or that a continued course of dealings with the bankrupt showed reliance on that experience rather than on the formality of a financial statement.³¹ Sometimes they found lack of intent to deceive or innocent or negligent mistakes, thus permitting a decision in favor of the defendant.³²

Some commentators thought that bankrupts misunderstood the import of a discharge. They speculated that the bankrupt, having been discharged in bankruptcy, assumed that any suit on a scheduled debt in a state court meant nothing and could not affect him.³³ Thus it was said that bankrupts sued in state court after discharge did not seek the advice of counsel because they had been lulled into a false sense of security. The empirical data in the Connecticut study cast some doubt on these assumptions.³⁴ The section 17a(2) actions started in state courts during the pendency of the bankruptcy proceeding, presumably

²⁶See Note, 69 MICH. L. REV., *supra* note 3, at 1354, citing *Hearings on H.R. 6665 and H.R. 12259 before a Subcomm. of the House Comm. on the Judiciary*, 91st Cong., 1st Sess. 65 (1969).

²⁷Bankruptcy Act § 17(a)(2), 11 U.S.C. § 35(a)(2) (1970).

²⁸See, e.g., *First Nat'l Bank v. Haymes*, 49 Misc. 2d 939, 268 N.Y.S.2d 820 (N.Y. City Civ. Ct. 1966); *Public Fin. Corp. v. Callopy*, 164 N.E.2d 205 (Ravenna Mun. Ct., Ohio 1959).

²⁹See, e.g., *Feliciano Fin. Co. v. Bateman*, 194 So. 2d 781 (La. Ct. App. 1967).

³⁰See, e.g., *Midland Discount Co. v. Robichaux*, 184 So. 2d 93 (La. Ct. App. 1966).

³¹See, e.g., *Beneficial Fin. Co. v. Crane*, 4 Conn. Cir. 627, 239 A.2d 48 (1967); *Sales Purchase Corp. v. Barnes*, 228 So. 2d 155 (La. Ct. App. 1970); *Friendly Fin. Discount Corp. v. Hayden*, 171 So. 2d 717 (La. Ct. App. 1965).

³²See, e.g., *Rouge Employees Credit Union v. Wilson*, 7 Mich. App. 16, 151 N.W.2d 214 (1967); *Household Fin. Corp. v. Williams*, 66 Wash. 2d 183, 401 P.2d 876 (1965).

³³Note, 69 MICH. L. REV., *supra* note 3, at 1354.

³⁴See Shuchman 759, Table 4.

while the bankrupts were still represented by counsel, ended with judgment being rendered by default more often (38%) than the post-discharge actions in state court (29%). However, the post-discharge actions were brought far more often (128 cases as against fifty-five cases brought before discharge but after the bankruptcy petition), so the absolute number of post-discharge defaults was greater.

Commentators also supposed that once the bankrupt had turned over to the bankruptcy court his non-exempt assets, he lacked the economic ability to pay counsel to defend the action in the state court.³⁵ However, there are two additional considerations here. First, about four-fifths of all personal bankruptcies are no-asset cases,³⁶ which means that little or no property of the bankrupt was in fact turned over to the bankrupt estate, or at least not enough to pay the costs of administration. Second, although four-fifths may have no non-exempt property, most bankrupts are employed at the time they file their petitions in bankruptcy, and their incomes are well above the federally-defined poverty level (3,800 dollars gross annual income for a family of four) and in line with others' incomes in the bankrupt's general demographic category. Thus they might well be able to secure the assistance of counsel. The problem of legal fees and court costs is probably nearly as significant a factor in the bankruptcy courts under the amended section 17a(2) as it was in state courts prior to the amendment. Lawyers will still want to be paid whether the trial is before a state judge or a referee. Finally, two complaints about preamendment practices in state courts concerned the possibilities of "sewer service" (no notice to the defendant-bankrupt) and the creation of distant or otherwise inconvenient forums.³⁷ No evidence of either of these practices was found in the original Connecticut study or in the Virginia replication.

Thus, as with much law review analysis, a priori assumptions turn out to have an unknown truth value. The accepted conjectures of students and scholars are usually a mixture of guesses and half-truths. In the realm of legal discourse, persuasively stated comment in respectable law journals can pass for accepted fact. This relatively uncritical acceptance occurs because the actual impact of changes in the law is so infrequently examined; but even if such changes are investigated, often there is insufficient reliable information upon which to assay the effect of a

³⁵Note, 69 MICH. L. REV., 1347, 1354, *supra* note 3.

³⁶See ADMINISTRATIVE OFFICE OF THE U.S. COURTS, *supra* note 7, at 10.

³⁷Note, 69 MICH. L. REV., *supra* note 3, at 1353-54.

law with reasonable confidence. More often than I fear is good for us, the only cognizable effect of changes in law may be that legal scholars and lawyers perceive the world of their professional activity differently.

III. THE VIRGINIA INVESTIGATION

A replication of the study of extra-bankruptcy actions made earlier in Connecticut was conducted in Virginia, and the methods of the Connecticut study³⁸ were followed as adapted to the physical situation and the availability of records and pleadings in the Virginia courts. A consecutive sampling of personal bankrupts was taken from the bankruptcy files, and the information was used to search court records in Virginia. We attempted to determine how often scheduled creditors with provable debts had sued bankrupts in the state courts on the grounds that the bankrupt's debts were excepted under section 17a(2). This involved pairing the parties by name and address and matching the debts by date and by the amount scheduled or claimed.

We divided these extra-bankruptcy actions—termed “events”—into two categories: those started between filing and discharge and those brought after discharge. The author had found in Connecticut that about one personal bankrupt in five (not less than 17%) was sued in state court on debts scheduled and provable in bankruptcy.³⁹ One hundred and eighty-three such events were found in Connecticut in a total sampling of 1073 personal bankruptcies filed over about a thirteen month period (17%).⁴⁰ The post-discharge cases were more common, with 128 of the 183 events being brought after the discharge (nearly 70% of all the events), while fifty-five such suits were brought after the filing of the bankruptcy petition but before discharge (about 30% of all the events).⁴¹

In Connecticut, the plaintiff-creditors prevailed on the pleadings in 112 of 181 known extra-bankruptcy actions (62%); if one adds dispositions by all other means, including trial, the plaintiff-creditors received favorable verdicts or negotiated settlements in 126 of 181 known cases (70%).⁴²

In order to compare the Virginia study to the results in Connecticut, allowances must be made for differences in practice and procedure,

³⁸Shuchman 752.

³⁹*Id.* at 753.

⁴⁰*Id.* at 753-54.

⁴¹*Id.* at 757-58, Tables 1 & 2.

⁴²*Id.* at 760, Table 5.

availability of records and pleadings, periods of time investigated, and the jurisdiction of the state courts. The jurisdiction of the federal district court in Virginia did not extend over the entire state as in Connecticut. However, insofar as the Virginia files are informative and complete, the pre-amendment events in Virginia occurred in about twenty-seven percent of the personal bankruptcy cases examined (320 events out of 1195 personal bankruptcies). Using the Connecticut categories in Virginia, we found that 151 creditors' actions (13%) were brought after filing but before discharge, and 169 creditors' actions (14%)⁴³ were brought after discharge.

Allowances must also be made for differences in substantive law. Connecticut is among the few so-called "one loan" states; small loan licensees are not permitted to lend more than the statutory limit of 1800 dollars, after a deduction for amounts owed to any other licensed lender.⁴⁴ Thus the Connecticut sample of personal bankruptcies rarely showed more than one small loan licensee as a scheduled creditor. There is no such limitation in Virginia, and two or three small loan licensees were common in the schedules of the personal bankruptcies examined. This difference may explain the finding in Virginia that the 320 extra-bankruptcy actions involved 232 individuals; thus there were three extra-bankruptcy actions for every two personal bankrupts.

There were far fewer pleadings of record in the Virginia court files.⁴⁵ Also, the files were less informative regarding disposition of the pre-amendment actions. Many of the files showed that a judgment in a stated amount was entered in favor of the plaintiff. Of the 320 pre-amendment events, 174 files contained the amount of the judgment, which was then compared with the amount of the claim as scheduled in the bankruptcy. In four-fifths of these cases, the judgment amount was the same as the scheduled claim (138 out of 174, or 79%). In the remaining thirty-six cases, the difference between the claim and the judgment averaged slightly more than ten percent. Most of these judgments were for an amount less than that which had previously been scheduled in the bankruptcy petition.⁴⁶ Except for the few cases in which service could

⁴³The bankruptcy file numbers and the Virginia state court docket numbers are on file at the North Carolina Law Review, Chapel Hill, N.C.

⁴⁴CONN. GEN. STAT. ANN. § 36-233(h) (Supp. 1972). There is no such limitation in Virginia or New York.

⁴⁵Thus it is sometimes difficult to determine whether the events were conventional § 17a(2) pre-amendment actions, ordinary contract actions based on reaffirmations, or merely uninformed creditors ignoring the discharge.

⁴⁶The average amount of the scheduled claims for which a state court action was brought is \$578; the median is \$448.

not be made or the suggestion of bankruptcy was raised as a defense, nearly all the extra-bankruptcy actions in Virginia appeared to result in judgment by default or in some settlement in favor of the plaintiff. But because of varying notations and the almost complete absence of pleadings, the disposition of the events cannot be reliably specified.⁴⁷

IV. NEW YORK INFORMATION ON SECTION 17A(2) ACTIONS

Since the completion of the pre-amendment studies of extra-bankruptcy actions in Connecticut and Virginia, we have obtained nearly equivalent data on small loan licensees in the state of New York, as reported to its Superintendent of Banking.⁴⁸ These data have been placed on the adjacent table.

TABLE 1. REPORTS FROM SMALL LOAN LICENSEES

Year	A	B	C	D	E
1963	2561	540(21%)	927	1634	540(33%)
1964	4029	707(18%)	1302	2727	707(26%)
1965	4545	790(17%)	1638	2907	790(27%)
1966	4936	670(14%)	1835	3101	670(22%)
1967	4771	762(16%)	1639	3132	672(24%)
1968	4009	613(15%)	1416	2593	613(24%)
1969	3463	399(12%)	1303	2160	399(18%)
1970	4127	485(12%)	1306	2812	485(17%)

- A. Total number of borrowers who filed for personal bankruptcy.
- B. Section 17a(2) actions brought by creditors on the basis of fraud or misrepresentation by the debtor.
- C. Debtors who reaffirmed the debt following discharge in bankruptcy.
- D. Debtors who did not reaffirm (A minus C).
- E. Debtors sued in 17a(2) actions expressed as a percentage of debtors who had not reaffirmed (B divided by C).

⁴⁷The remaining files either contained no information (most of the files contained only motions for judgment and judgments) or used different notations; the notations themselves varied from county to county and from court to court. For example, many events were marked "dismissal," which is a means of marking a case settled and is to be distinguished from a dismissal by the judge or by the court. In other courts, the notation "nonsuit" was used to record the fact of settlement, and dismissals were otherwise specified.

⁴⁸1963-1970 N.Y. SUPERINTENDENT OF BANKS ANN. REPS.

In 1969 there were 2160 bankrupt debtors of small loan licensees who did not reaffirm their debts; 399 of those 2160 (18%) were sued in the state courts under section 17a(2). In 1970, there were 2821 bankrupt debtors of small loan licensees in New York who did not reaffirm; 485 (17%) were defendants in the usual extra-bankruptcy action based on a section 17a(2) misrepresentation. Over the eight years represented by the available New York data, the frequency of section 17a(2) actions declined steadily, from thirty-three percent of the bankrupt debtors who did not reaffirm in 1963 to seventeen percent in 1970. That reduction of about two percent a year poses problems in the interpretation of data gathered in the Connecticut and Virginia studies. These problems—the possible instability of the process and the existence of a trend which would affect our data—are discussed below.⁴⁹

In both the Connecticut and Virginia samples, eighty percent of the plaintiffs in the extra-bankruptcy actions were licensees.⁵⁰ Since the New York figures are restricted to small loan licensees, it can reasonably be assumed that they probably account for an equal percentage, or about four-fifths of all the extra-bankruptcy actions. On that assumption we allowed for an increase in the total frequency of section 17a(2) actions of one-fourth more, or twenty-three percent in 1969 and twenty-two percent in 1970. The New York information may be more accurate benchmark data against which to assay the impact of the 1970 Burdick-Edwards Amendment than the Connecticut and Virginia data because the exact number of reaffirmations is known. The frequency of reaffirmations may be an inverse variable that rises as the number of applications for non-dischargeability declines. (This assumes the equivalence of section 17a(2) actions in the state courts and the present applications for determination of non-dischargeability.)

The wage-garnishment exemption of about ninety percent in New York⁵¹ is in effect fairly close to the Connecticut sixty-five dollar take-out,⁵² since wage garnishment of more than five or ten dollars a week is infrequent in Connecticut. The pre-amendment frequency of section 17a(2) extra-bankruptcy actions in New York and Connecticut was also very similar. Hence one can surmise from the fact that the data were gathered from different sources that each independent study reinforces

⁴⁹See text following note 71, *infra*.

⁵⁰Shuchman 760.

⁵¹N.Y. CIV. PRAC. LAW § 5231(b) (McKinney Supp. 1970).

⁵²CONN. GEN. STAT. ANN. § 52-316(b) (Supp. 1972).

the conclusions of the other. And if the amount of the debtor's wages that can be garnished is accepted as a major determinant in the decision of a creditor to institute a section 17a(2) extra-bankruptcy action, the Virginia figure of about twenty-seven percent frequency falls into place because of the then thirty-five dollar maximum exemption from wage garnishment.⁵³

V. IMPACT OF THE 1970 AMENDMENT

Possible Intervening Variables

The impact of the amended dischargeability provisions⁵⁴ may be evident. The pre-amendment extra-bankruptcy cases in Virginia state courts used in the study dated from January, 1968, to September, 1970; in Connecticut they dated from November, 1965, to the summer of 1969. The post-amendment cases (all of which are in the bankruptcy court except as otherwise indicated) dated from after December 18, 1970, and there were no applications filed until February, 1971. The lag in filing applications may be due to creditors' lawyers who delayed using the new procedure for determination of dischargeability of debts.

An intervening change in the substantive law may also have affected the economic incentive to avoid the discharge of a debt. The enactment of the Federal Consumer Credit Protection Act with its forty-eight dollar limit on wage garnishment⁵⁵ (effective July 1, 1970) could have made a considerable difference in Virginia, since Virginia law had previously permitted all wages in excess of thirty-five dollars to be garnished.⁵⁶

In Connecticut, the federal exemption made no difference, since there was already a sixty-five dollar exemption from wage garnishment.⁵⁷ In Virginia, we were unable to determine the effect of the intervening wage garnishment limitation on the reduction of applications for determination of dischargeability after the amendment. There have been

⁵³Act of March 31, 1960, ch. 498, [1960] Va. Acts 773 (amended 1970 to conform with Federal Consumer Credit Protection Act § 303(a), 15 U.S.C. § 1673(a) (1970)) (now VA. CODE. ANN. § 34-29 (1970)).

⁵⁴Act of October 19, 1970, Pub. L. No. 91-467, § 7, 84 Stat. 992, *amending* 11 U.S.C. § 35 (1970).

⁵⁵Act of May 29, 1968, Pub. L. No. 90-321, § 303(a), 82 Stat. 146 (codified at 15 U.S.C. § 1673(a) (1970)).

⁵⁶See note 53 *supra*.

⁵⁷See note 52 *supra*.

no other important substantive changes in Connecticut and Virginia law regulating creditors' remedies since the pre-amendment studies. However, there have been minor changes, the impact of which can only be conjectured.⁵⁸

Post-Amendment Frequency of Applications

Our null hypothesis is that mere changes in practice and procedure should not effect the incidence and outcomes of applications for determination of dischargeability, the equivalent to the previous extra-bankruptcy actions in the state courts. We think rejection of the null hypothesis is prudent.

The results of the investigations in Connecticut and in Virginia are surprisingly similar regarding the post-amendment applications for determination of dischargeability: they both dropped to about the same incidence of such actions. In Virginia a sample of 892 personal bankruptcy files were examined. All filings were from January, 1971, to September, 1971.⁵⁹ The effective date of the Burdick amendment was December 18, 1970. Notices to scheduled creditors of the final date for filing applications had expired in nearly all of the 892 cases. In the entire sample 105 applications (12%) were filed against ninety persons (11%) or less than half of the pre-amendment twenty-seven percent frequency of extra-bankruptcy actions in the Virginia state courts.

In Connecticut our investigation covered a sample of about 603 personal bankruptcies (again eliminating professionals and persons in business, except for a few formerly in business). In this sample we found seventy-five applications, a frequency of about twelve percent,⁶⁰ as com-

⁵⁸The rate of consumer bankruptcies has fluctuated as shown in the following table. The figures are taken from ADMINISTRATIVE OFFICE OF THE U.S. COURTS, *supra* note 7, and refer to fiscal years (July 1 to June 31).

	1968	1969	1970
United States	181,266	169,440	178,137
Connecticut	1,239	1,122	1,116
Virginia	4,571	4,101	4,355

The rate of loss for small loan lenders has risen nationally from 1.99% in 1968 to 2.06% in 1969, and to 2.30% in 1970. We have no equivalent separate data available for the two states. The cost of money for small loan lenders has probably increased since 1968.

⁵⁹The period for investigation of the impact of the dischargeability amendment was limited to about the first eight months of 1971. During most of that time there was no referee in Richmond, and other referees helped to fill the gap. Consequently, the Richmond post-amendment information was not gathered and is not part of the overall Virginia data.

⁶⁰Separate petitions by husband and wife are counted as one bankruptcy. Separate applications

pared with the pre-amendment figure of seventeen percent frequency of extra-bankruptcy actions in the state courts. Thus, assuming nothing other than the changes in forum and the applicable practice and procedure were causal factors, the impact of the 1970 dischargeability legislation in Connecticut has been to reduce such contests to about seventy percent of their previous number. Although one can only conjecture from the data of two states which, although different, were selected for geographical convenience, the impact of the 1970 dischargeability amendment will be to reduce substantially the frequency of section 17a(2) actions of record.

It may be that because of the now more nearly uniform exemption from wage garnishment,⁶¹ the rates of personal bankruptcies in the several states will fall within a narrower range than heretofore. Commentators have contended that the correlation between personal bankruptcies and the severity of wage garnishment provisions under state law bespeaks a causal relationship.⁶² Not only does that seem a justified commonplace expectancy, but at the extremes the correlation is so striking that one can reasonably infer causation. Yet there may be other operative factors at work that show themselves only in the large middle range of states that have neither very severe wage garnishment nor an almost entire prohibition of wage garnishment. It may also be true that the much closer frequency in percentages of post-amendment applications for non-dischargeability of debts found in Connecticut (17% to 12%) and Virginia (27% to 12%) is a reflection of holding relatively more constant the economic incentive for consumer creditors to take the time, trouble, and expense of making such applications.

Post-Amendment Practice

In Virginia, the 105 post-amendment applications for determination of non-dischargeability had resulted in thirty-nine hearings before referees as of October, 1971. Twenty-five of the thirty-nine adjudications were in favor of the bankrupt: the debt was ruled dischargeable. The applications for non-dischargeability were granted in fourteen hearings. Another sixty applications were settled before hearing. Twenty-

by the same creditor against husband and wife are counted as one application for the determination of non-dischargeability.

⁶¹Consumer Credit Protection Act § 303(a), 15 U.S.C. § 1673(a) (1970).

⁶²See, e.g., *Hearings on Wage Earner Plans Under the Bankruptcy Act Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Cong., 1st Sess. 107-08 (1967); D. STANLEY & M. GIRTH, *supra* note 7, at 28-31; Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214, 1234-38 (1965).

two of sixty cases whose history could be traced through the lawyers involved were settled for amounts ranging from forty percent of the scheduled claim to reaffirmation of the full amount claimed. The average claim was 1,021 dollars, and the average settlement was 550 dollars, or fifty-two percent of the claim. The median settlement was about fifty-one percent of the claim.

In Connecticut the situation was similar. The average claim in Connecticut was greater, 1,400 dollars, and the median was 1,505 dollars; the average settlement was 760 dollars and the median was 505 dollars. The average and median settlements of fifty-four percent and fifty-two percent of the scheduled debts are nearly the same as in Virginia and experienced practitioners and referees think that settlement for about half of the scheduled debt is and will remain the common practice. The Connecticut and Virginia data have been placed on the table below.

TABLE 2. POST-AMENDMENT APPLICATIONS FOR
NON-DISCHARGEABILITY

	Virginia	Connecticut
Debt Discharged (Hearing)	25	15
Debt Non-Dischargeable (Hearing)	14	0
Settled	60	18
Pending	2	40
Miscellaneous Dispositions	4	2
Total Applications Filed	105	75
Total Sample Cases	892	603
Application Frequency	12%	12%

The most conspicuous and important difference between pre- and post-amendment practice in Connecticut and Virginia is that there appeared to be no dispositions by reason of the bankrupt's default under the new practice. In the Connecticut sample of seventy-five applications there were no defaults. In the Virginia sample of 105 applications there was one default, and that was entered against a creditor applicant. Thus, although the referees may be seriously burdened with applications and hearings and are apt to encourage settlements, the present situation is conducive to far more appearances and defenses interposed by bankrupts. The total of fifty-four hearings held in Virginia and Connecticut

as the result of 180 applications (about 39%, omitting the 42 pending cases) is in sharp contrast with the very low pre-amendment frequency of trials in the state courts of Connecticut and Virginia.⁶³

Limited court time and busy referees may become increasingly significant since the rate of applications seems to be increasing slightly. A further complication arises from the possibility that creditors may be entitled to trial by jury in the bankruptcy court.⁶⁴ Also, the bankruptcy referees observed in Virginia and Connecticut took more than an hour to hear each of several routinely contested applications—an experience other referees have confirmed.⁶⁵ Thus if applications were filed in only ten percent of all personal bankruptcies, some seventeen to eighteen thousand court hours (not including pretrial preparation and findings for review when appeals are taken) would be spent by some 190 referees. The problem could be made worse by an authoritative ruling that applicants and bankrupts have a right to trial by jury upon request. Pressures on the parties, their counsel, and the referees are similar to those in the state courts. The expected result of these pressures can be confirmed: most of the contested applications are settled.

Conclusions

Significant jurisprudential and socio-legal questions are posed by differences in results that are apparently due only to a shift in the forum, a shorter time, and the revised practice. The changes brought about by the 1970 amendments to the Bankruptcy Act are of considerable benefit to the consumer debtor as well as a most interesting bit of evidence to support the contention that simple changes in adjective law often pro-

⁶³There were fifteen bench or jury verdicts found in the Connecticut study, which is about eight percent of all the 181 extra bankruptcy actions found. Shuchman 760, Table 5. We found no trials in the Virginia pre-amendment sample. We are told that more claims are settled without the filing of applications for non-dischargeability, and our inquiries tended to confirm this. However, we could not determine the frequency of such settlements.

⁶⁴*In re Palfy*, 336 F. Supp. 1268 (N.D. Ohio 1972), held that there is no constitutional or statutory right to jury trial on the issue of dischargeability of debts, although "The Referee's Certificate of Transmittal, indicated no delineation of issues requested to be submitted to the jury." *Id.* at 1269. *In re Swope*, Civil No. 71-107 (S.D. Ill., filed Feb. 10, 1971), presently pending before the Court of Appeals for the Seventh Circuit, affirmed the denial of jury trial sought by the bankrupt. See Herzog, *The Case for Jury Trials on the Issue of Dischargeability*, 46 AM. BANKR. L.J. 235 (1972). *Contra, In re Law Research Serv., Inc.*, No. 71-B-598 (S.D.N.Y., filed Dec. 9, 1971), in which the referee granted a creditor's request for jury trial on an application for determination of dischargeability. The case was not appealed.

⁶⁵See H. Bonney, *The Dischargeability Amendments: How Are They Functioning?* 18, Oct. 1971 (unpublished paper on file at the North Carolina Law Review, Chapel Hill, N.C.).

cure unexpected substantive results for the parties involved.

The sole reason for the decline in the frequency of actions filed by creditors seems to be the 1970 amendment. We know of no other operative intervening variables except the limitation on wage garnishment brought about by the Federal Consumer Credit Protection Action on July 1, 1970. Yet that limitation had no effect in Connecticut, and it seems unlikely that increasing the wage garnishment takeout from thirty-five dollars to forty-eight dollars (or 75% of the debtor's weekly wage) could account for a decrease in the frequency of section 17a(2) actions from twenty-seven percent to twelve percent. There have been no significant changes in the frequency of personal bankruptcy filings as a result of changes in state wage garnishment laws. In Virginia, where the enactment of a federal wage garnishment law made a considerable difference because of the severity of prior state law, there was no significant reduction in the rate of personal bankruptcy filings.⁶⁶ Of course, in the filing of these voluntary bankruptcy petitions one is observing the behavior of debtors, while in section 17a(2) actions the creditor (who is presumably more aware of and sensitive to changes in his legal position) is the moving party.

The time limitation for filing an application for determination of non-dischargeability (thirty to ninety days after the first meeting of creditors)⁶⁷ does not appear to be of significance. About one-third of the pre-amendment section 17a(2) events in Connecticut and nearly one-half of these events in Virginia were started during the pendency of the bankruptcy proceedings, usually within a few months of the petition.⁶⁸ The change in the name of the action, which is now called an application for determination of dischargeability, should have had no effect on frequency of filings.⁶⁹

There may be some other reservations regarding possible impediments in method.⁷⁰ What has been termed the problem of matura-

⁶⁶The rate of personal bankruptcies per 100,000 population in Virginia rose less than one percent from the year ending July 1, 1970 to July 1, 1971. The national rate rose about 2.3 percent during the same time. See H. Bonney, *supra* note 65.

⁶⁷Bankruptcy Act § 14b(1), 11 U.S.C. § 32(b)(1) (1970), requires the referee to fix a time for filing applications concerning the dischargeability of debts "not less than thirty days nor more than ninety days after the first date set for the first meeting of creditors." Although the referee can extend the time limits, none had done so in any bankruptcy file we examined.

⁶⁸See text at notes 41 & 43 *supra*.

⁶⁹The name may change. See COMM. ON RULES OF PRACTICE AND PROCEDURE, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES, Rule 409 (1970) which labels such pleadings as complaint and answer.

⁷⁰See D. CAMPBELL & J. STANLEY, EXPERIMENTAL AND QUASI-EXPERIMENTAL DESIGNS FOR

tion—that the observed change may have been in the making or in process before the impact of the changed law was investigated—could be present in Connecticut and Virginia. But that does not seem too likely a possibility for two reasons: the New York data covering the eight years from 1963 to 1970 show a steady decline but not the dramatic reduction in the frequency of section 17a(2) actions that was found in Connecticut and Virginia;⁷¹ and such considerable measures of decrease (about 70% and 44% of previous section 17a(2) actions) could not have been occurring for more than two or three years unless the rate of change had been much slower.

Also, the Connecticut and Virginia studies did not cover the same span of time. The Connecticut pre-amendment bankruptcies cover about a year of filings beginning in November, 1965; the Virginia bankruptcies had filing dates spanning six months beginning in January, 1968. The post-amendment events were all collected within the same eight-month period. It would have been better to match the times and to do so for a longer period of time, but administrative difficulties and the attendant expense made that unfeasible.

Another possible explanation of the results of the studies is that of instability, that variations as great as those found might have occurred absent the changes due to the 1970 amendments. The New York data might support that speculation but we have no reason to believe that the process is generally as variable as the Virginia findings revealed.

Perhaps the decrease in number of actions filed by creditors may be attributable to the fact that those in the consumer credit businesses anticipate greater resistance to the common default judgment and more active hostility from referees in bankruptcy court and are less willing to pursue a section 17a(2) action. Referees have been given a new responsibility and we think they are anxious to demonstrate that they can and will protect the consumer bankrupt. There are far fewer referees than state court judges, and each referee will have many more applications for determination than state court judges had contract actions on a debt. In addition, the referees will be better able to identify the nature and basis of the action.⁷² In the usual pre-amendment complaint, the

RESEARCH (1963).

⁷¹However, the decrease in 1964 was to eighty percent of the 1963 frequency. In 1969 it was to seventy-five percent of the 1968 frequency.

⁷²Perhaps one cannot accurately view these applications as discrete events subject to the usual fact adjudication by the conventional forms of judicial process. What may appear as fraudulent misrepresentation in the first few applications is not apt to be so perceived the hundredth time a

action resembled a garden variety debt action, and state court judges ordinarily would not have known that the action involved bankruptcy.⁷³ The referees also may have less pressing concerns and smaller case loads than most state court judges.

Yet none of these considerations is mentioned in the legislative history of the 1970 amendment.⁷⁴ One knowledgeable witness did predict that the frequency of section 17a(2) actions in bankruptcy court would diminish,⁷⁵ but other than that comment, the legislative history does not reveal any Congressional intent to reduce the frequency of such actions by changes in forum, time, and pleading. Rather, the stated intent of Congress was to provide a better forum for more prompt adjudication and to insure knowledge by bankrupts of challenges to the discharge of a scheduled debt.⁷⁶

It is the bankruptcy referee adjudicating the applications that seems to me to be the most important factor. The referees are aware that their activities and dispositions of section 17a(2) applications will be carefully observed and analyzed. One can only conjecture on the effect of that awareness. They are probably more familiar with creditor practices by reason of specialization as referees; in any event each will see many more applications than state court judges and hence will better and more quickly discern patterns of creditor action.

VI. LEGISLATIVE RECOMMENDATIONS

On the basis of the pre-amendment Connecticut study and the high

creditor presents a prima facie case based on facts largely indistinguishable from previous applications. This is not to assert (at least not without more information) that FED. R. CIV. P. 23 should apply and that class actions are appropriate although that seems at least probable. Rather, it is a recognition of the similar behavior of consumer creditors; there is little discretion in the method of arranging loans or in the actions to be taken in the event of the borrower's bankruptcy. Similar, if not identical, patterns of behavior are nearly as common as standardized printed forms. The realities of individual cases can be seen only by the observation of the mass, a task that becomes easier for referees, who will have all of these cases foisted upon them.

⁷³See Shuchman 759, Table 3.

⁷⁴Neither the Senate nor the House Reports on the 1970 dischargeability amendment indicates that reduction in the number of § 17a(2) actions was a congressional purpose. See S. REP. NO. 1173, 91st Cong., 2d Sess. (1970); H.R. REP. NO. 1502, 91st Cong., 2d Sess. (1970).

⁷⁵See *Hearings on S.J. Res. 88 Before Sub-comm. No. 4 of the House Comm. on the Judiciary*, 91st Cong., 1st Sess. 26 (1969) (testimony of Hon. Edward Weinfeld): "When it becomes generally understood that the bankruptcy courts have the jurisdiction to determine the effect of a discharge as well as the right to it and that the courts intend to use it, the litigation most likely will dwindle away." Judge Weinfeld's view probably was the unstated legislative purpose, to reduce the frequency of § 17a(2) actions, and the 1970 amendment appears to have accomplished that end.

⁷⁶See, e.g., *id.* at 34-36 (testimony of Referee Daniel R. Cowans).

incidence of defaults revealed therein, I felt that the false financial statement exception of section 17a(2) should be eliminated entirely in non-business cases or at least limited to debt balances in excess of 2,500 dollars, which would cover most consumer loans. Certainly the exception should not be permitted for renewals and resettlements except for actual fresh cash advanced.⁷⁷ These resolutions still seem appropriate, and they are simple and self-executing.

However, since so few defaults have appeared under the new practice, it may be sufficient to retain the fraud exception, but with a better definition. The exception from discharge for material misrepresentation in writing should be changed to fraudulent misrepresentation in writing, and that exception should be construed to require not an intent to deceive, but an intent to conceal the fact that the borrower had no present intention to repay the debt at the time it was incurred.⁷⁸ Proof of that intent should require a substantial preponderance of the evidence. However, even the added burden of proof may not prevent creditors from overloading the system (even without the right to a jury trial), thus giving them leverage to bring about settlements.

In Virginia we found two categories of post-amendment, post-discharge cases that seem to thwart the purposes of bankruptcy discharge and in which the legal rationale of the cases seems questionable. These cases suggest the need for more stringent protective measures, possibly by way of broadening the effect of the bankruptcy discharge.

One apparently common situation uncovered in Virginia is an action by a creditor whose debt is based on a promissory note that includes a waiver of the state homestead exemption. In Virginia the homestead exemption can cover property up to the value of two thousand dollars.⁷⁹ The debtor can claim his exemption in the bankruptcy proceedings and that property is then set aside. After discharge, the scheduled creditor can bring suit in the state court, even though he has filed no application for determination of dischargeability, and can obtain a judgment restricted in scope of execution to the exempt property. The legal doctrine used to justify this practice⁸⁰ is that the exempt property was not part of the bankrupt estate and therefore was not affected by the discharge.⁸¹

⁷⁷See Lee, *Fraud Exception to Discharge—Loan Renewal Granted in Release on False Financial Statement—Recovery Limited to Fresh Cash Advanced*, 46 AM. BANKR. L.J. 245 (1972).

⁷⁸Shuchman 771.

⁷⁹VA. CODE ANN. §§ 34-4 to -26 (1970).

⁸⁰Dockery v. Flanary, 194 Va. 318, 73 S.E.2d 375 (1952).

⁸¹See Kennedy, *Limitations of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 462-69 (1960), for a critique of this doctrine.

Hence execution can be had on the property set aside as exempt in favor of the creditor holding a waiver-of-homestead exemption.⁸²

Virtually every promissory note examined in Virginia contained such a waiver. Of course, these commonplace adhesion contracts benefit only the professionals, those in the business of consumer loans, with their printed form notes in which the debtor waives every right that applicable law permits.

Waiver of the right to the homestead exemption should be prohibited.⁸³ That could likely be accomplished only through a federally enacted uniform exemption that is not waivable or through a minimum exemption, which would allow states to create a greater exemption. Of course there would be problems with any such law, since a very liberal national exemption in bankruptcy might encourage bankruptcy, and an exemption smaller than that of many states might discourage the use of the unique remedies that bankruptcy provides. The national exemption should apply to all execution and insolvency processes, and should not be waivable—at least not below a specified value or income, or in extraordinary circumstances.

The second conspicuous avoidance of the bankruptcy discharge revealed in Virginia concerned property held by husband and wife as tenants by the entirety. Although the entirety property is usually the bankrupt's home, the majority of states which have passed on the question permit personal property to be owned by husband and wife as tenants by the entirety; such property is not severable by the creditors of either spouse under Virginia law⁸⁴ and is therefore not part of the bankrupt estate of either spouse.⁸⁵ If, for example, the husband alone is adjudicated a bankrupt and is discharged, the creditor holding a note signed by both husband and wife can proceed against their property held by the entirety. The judgment is limited in its scope of execution to the bankrupt's interest in the property held by the entirety, but the supposedly protective doctrine of ownership by the entirety is still avoided.

A somewhat different theory seems to be operating in this situation: "if one spouse goes into bankruptcy no part of the property held

⁸²*Dockery v. Flanary*, 194 Va. 318, 323, 73 S.E.2d 375, 378 (1952).

⁸³Six states (Alabama, Georgia, Louisiana, Pennsylvania, Maryland, and Virginia), representing nearly one-sixth of the nation's population, permit the statutory exemption to be waived in favor of creditors. Those states allow judgments based on notes containing waivers to be executed against exempt property. *See* Annot., 94 A.L.R.2d 967 (1964).

⁸⁴*Vasilion v. Vasilion*, 192 Va. 735, 66 S.E.2d 599 (1951).

⁸⁵*In re Reid*, 198 F. Supp. 689, 690-91 (W.D. Va. 1961); *see* 61 MICH. L. REV. 1351, 1352-53 (1963), 19 WASH. & LEE L. REV. 297 (1962).

in the tenancy by the entirety passes to the bankrupt trustee and the bankrupt comes out of bankruptcy with his interest in the property unaffected."⁸⁶ Also, only personal debts can be discharged in bankruptcy, and since the debt enforceable against the property held by the entirety is joint, it cannot be barred by discharge that is personal to the bankrupt.⁸⁷ Although the debt is not discharged, the judgment is limited in its enforceability to the bankrupt's interest in the property held by the entirety.⁸⁸

These formalisms, which lead to the loss of the bankrupt's property held by the entirety, can be thwarted by another formalism adopted in some states: that the interest of the bankrupt in the property held by the entirety becomes part of the bankrupt estate to be sold free and clear of any debt of the bankrupt, personal or otherwise. Readers of this article may have better suggestions.

⁸⁶*In re Reid*, 198 F. Supp. 689, 691 (W.D. Va. 1961).

⁸⁷Some pleadings examined indicate that the Virginia courts may also rely on § 14(f) of the Bankruptcy Act: "An order of discharge shall—(1) declare that any judgment . . . is null and void as a determination of the *personal liability* of the bankrupt . . ." 11 U.S.C. § 32(f) (1970) (emphasis added). 1A COLLIER ON BANKRUPTCY ¶ 14.69 (14th ed. 1971) lends some support to the narrow interpretation that joint debts are not affected by bankruptcy where only one of the joint debtors is discharged.

⁸⁸*Cf. United States v. Fetter*, 163 F. Supp. 10 (E.D. Mich. 1958).

