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Top Twenty Issues in the History of Consumer
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Charles J. Tabb*

*University of Illinois College of Law, ctabb@law.uiuc.edu

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The Top Twenty Issues in the History of Consumer Bankruptcy

by Charles J. Tabb, Alice Curtis Campbell Professor of Law and the Associate Dean for Academic Affairs at the University of Illinois College of Law

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**THE TOP TWENTY ISSUES IN THE
HISTORY OF
CONSUMER BANKRUPTCY**

By

CHARLES J. TABB

Alice Curtis Campbell Professor of Law
Associate Dean for Academic Affairs
University of Illinois College of Law
Champaign, Illinois 61820
ctabb@law.uiuc.edu

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Consumer bankruptcy reform occupied the limelight earlier this year, when President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) on April 20, 2005. The enactment of BAPCPA marked the successful culmination of over two score years of intense, fervent, and well-funded lobbying by the consumer credit industry. The paramount aim was to force debtors with expected future income in excess of necessary expenses – supposed “can pay” debtors – out of chapter 7 and into chapter 13.

Forcing “can pay” debtors out of straight bankruptcy into payment plans is the hot topic *du jour*. However, in the past 463 years, since the first modern Anglo-American bankruptcy law was passed in England in 1542 during the reign of good old Henry VIII, many pressing issues have surfaced. Some are now settled; others are not. Following is a necessarily summary trip down memory lane in revisiting the big issues in consumer bankruptcy reform through the ages.

For those who like lists, or who are quite busy and lack the time (or interest) to read further, let me begin with an overview of some of the big issues in consumer bankruptcy history. I have identified twenty issues (not intended to be an exhaustive list), which could be grouped into rough categories, as follows:

1. Who is eligible for bankruptcy relief?
 - * Should individual debtors who are not engaged in business be eligible for “bankruptcy” relief?
 - * Should individual consumer debtors be permitted to file a voluntary petition for bankruptcy relief?
 - * What must be proven to cast a debtor into involuntary bankruptcy?
 - * Can a debtor be too poor to file for bankruptcy?

2. What assets does the debtor get to keep?
 - * What should be the proper source of exemption laws for debtors in bankruptcy? Should debtors be permitted to use (or even be limited to using) state exemption laws? Any restrictions? Should debtors have access to a uniform federal exemption system?
 - * Should any restrictions be placed on the pre-bankruptcy conversion of non-exempt to exempt assets? That is, what, if anything, should be done about exemption planning?
 - * Should debtors be able to avoid any liens that impair exemptions?
 - * At what level of comfort should a debtor be left after bankruptcy?

3. What future income is shielded?
 - * Should the debts of the debtor be discharged at all?
 - * Should creditors have to consent to the granting of a discharge of debts?
 - * Should the debtor have to pay a minimum percentage dividend on her debts in order to obtain a discharge of debts, or to receive some other benefit?
 - * What limits should be imposed on receiving discharges in successive cases?
 - * What grounds should warrant total denial of discharge?
 - * What debts should be excepted from the general discharge?
 - * Should a debtor be permitted to reaffirm her debts? If so, any limits?
 - * Should the court have the power to condition or suspend the discharge?
 - * Should a debtor be allowed to obtain an immediate discharge in a straight liquidation

case even if she has the means to make payments out of future income, or should such a “can pay” debtor be forced into (or at least be restricted to) a repayment plan?

4. Who decides and how?

- * Must a debtor raise the discharge as an affirmative defense, or is the discharge self-executing?
- * What court system should have jurisdiction over discharge litigation?
- * What are the proper roles of creditors? Trustees? United States trustee? Courts? Congress?

As a final general category, one could consider the moral aspect of consumer bankruptcy. Is bankruptcy a “wrong,” a “right,” or neither? Are bankrupts bad people? Should they be punished? Imprisoned? Executed? Applauded?

For the more patient or intrigued reader, let me now turn to a more detailed examination of these issues.

Who is eligible for bankruptcy relief?

The first and most fundamental issue concerning consumer bankruptcy is – *is there any such thing?* That is, should individual debtors who are not engaged in business be eligible for “bankruptcy” relief? Historically, the question would have been considered an oxymoron, and answered “of course not.” Definitionally, “bankruptcy” was limited to merchants – to persons engaged in trade. Indeed, the conceptual justification for having a bankruptcy law at all followed from the inescapable risks attendant on carrying on trade on credit. Separate “insolvency” laws supposedly dealt with the problems facing non-business individual debtors. The restriction of bankruptcy eligibility to merchants first appeared in the 1570 Elizabethan statute and was carried forward in the United States Bankruptcy Act of 1800. (Ch. 19, § 1, 2 Stat. 20). Having said that, in practice the courts were quite lenient in interpreting the statutory eligibility criteria. Nonetheless, it was not until the 1841 Bankruptcy Act that the merchant eligibility test was dropped and bankruptcy was made available to business and non-business debtors alike, as “all persons whatsoever owing debts.” (Ch. 9, § 1, 5 Stat. 441). Justice Joseph Story was the brains and Senator Daniel Webster the political brawn behind this landmark bill. Opponents of the 1841 legislation (such as Senator John Calhoun) argued vehemently that it was unconstitutional, as not falling within the “subject of bankruptcies” under Article I, § 8, clause 4. The Supreme Court never passed directly on that constitutional question, but Justice Catron upheld the law sitting on circuit, in *In re Klein* (notes, 42 U.S. (1 How.) 277 (1843)). Although the 1841 Act died a quick death, being repealed barely a year after enactment, it settled forever the question whether non-business debtors were eligible for bankruptcy.

Much the same story could be told for another first order threshold issue, which indeed goes hand in hand with the preceding one: should a debtor be permitted to file a *voluntary* petition for bankruptcy relief? Here again, as an historical matter the question was oxymoronic and flew in the face of the very definition and conception of bankruptcy, which was as a *creditor’s* remedy to be invoked against debtors; “[r]elief was not *for* debtors, but *from* debtors.” (Tabb 1995 at 8). Voluntary relief was a creature of the distinct insolvency statutes. Again, the

early English bankruptcy laws, beginning with the Statute of 34 & 35 Henry in 1542, continuing through the 1800 United States Bankruptcy Act (Ch. 19, § 2, 2 Stat. 21-22), permitted creditors only to institute bankruptcy proceedings. Note that in practice the barrier for debtors was not as inviolate as the formal law suggested, since it was a commonplace for debtors to prevail upon friendly creditors to file a bankruptcy petition. Even so, it can hardly be gainsaid that the innovation of the 1841 Act in authorizing voluntary petitions in bankruptcy (Ch. 9, § 1, 5 Stat. 441) effected a sea change in the very nature of bankruptcy relief. The constitutional question of whether voluntary bankruptcy is within the “subject of bankruptcies” was raised, and decided affirmatively by Justice Catron in *Klein*, as noted above. Indeed, some years earlier, in *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 194 (1819), Chief Justice Marshall in dictum had suggested that a voluntary bankruptcy system likely would fall within the constitutional grant.

A third initiation question of historical significance is, what must be proven to cast a debtor into involuntary bankruptcy? On this score, the historical basis (good since 1542) persisted until the enactment of the Bankruptcy Reform Act of 1978. Before 1978, petitioning creditors had to prove that a debtor committed an “act of bankruptcy” in order to have a bankruptcy commission granted. Acts of bankruptcy were various actions taken by a debtor (such as making a fraudulent conveyance) that indicated that the debtor was trying to prevent creditors from collecting on their debts. The fact that the debtor’s financial status was sufficiently distressed that a collective bankruptcy proceeding might be worthwhile was not enough; the debtor had to *do* something bad (and the petitioning creditor had to be able to prove it). The problem was that waiting for the occurrence of a provable act of bankruptcy often postponed initiation until it was too late to do any good. Finally, in one of the masterstrokes of the 1978 legislation, Congress jettisoned the centuries-old concept of acts of bankruptcy and allowed initiation of an involuntary bankruptcy case on proof that the debtor was generally not paying his debts as they came due. 11 U.S.C. § 303(h)(1).

One of my favorite teaching questions always has been, can a debtor be too poor to file for bankruptcy? Why? Because the answer is so counterintuitive – yes! Any doubts on this score were resolved against the debtor in the case of *United States v. Kras*, 409 U.S. 434 (1973), holding that the absolute fee requirement to file a bankruptcy petition does not violate a debtor’s constitutional due process rights of access to the courts. After *Kras*, Congress has considered on multiple occasions the possibility of enacting a statutory *in forma pauperis* provision that would allow the filing fee to be waived for those debtors who are too indigent to pay the filing fee (even in installments). In BAPCPA in 2005, Congress enacted a new provision, 28 U.S.C. § 1930(f), which permits (but apparently does not require) the district court or bankruptcy court to waive the filing fee for an individual debtor if that debtor has income less than 150 percent of the income official poverty line for the debtor’s size family, and the debtor is unable to pay the filing fee in installments.

What assets does the debtor get to keep?

Exemption laws have always been a critical part of bankruptcy relief. Those laws define what assets the individual debtor gets to keep for herself and her family, free from the claims of her creditors, even if those creditors are not paid in full.

One of the most contentious and persistent issues in bankruptcy exemption policy in the United States has been identifying the proper *source* of exemption laws for bankruptcy debtors. This is a federalism problem. All states have exemption laws that operate outside of bankruptcy, of course, which shield certain assets of individual debtors from creditor collection efforts. Should debtors who are the subject of a federal bankruptcy proceeding be permitted to use (or even be limited to using) those state exemption laws? If so, should there be any restrictions? Is such incorporation of state laws constitutional? Alternatively, or in addition, should debtors have access to a uniform federal exemption system? These issues have proven to be a lightning rod for legislative attention and controversy. Almost every variation has been tried: federal only (1800, 1841), state only (1898), state and federal (1867), and state or federal option (sort of) (1978).

Our first bankruptcy law, the Bankruptcy Act of 1800, offered only a limited federal exemption scheme: necessary wearing apparel and necessary bed and bedding (Ch. 19, §§ 5, 18, 2 Stat. 23, 27). The otherwise innovative 1841 Act continued in the same vein as the 1800 law, offering only slightly broader and more generous federal-only exemptions (Ch. 9, § 3, 5 Stat. 443). In neither of those acts was exemption offerings a source of contention. By the time of the 1867 Act, however, the issue of using state exemption laws had become a central point of debate. The reason was that in the middle of the 19th century states had begun using liberal exemption laws as a means of attracting debtors to their states, and legislators from those states adamantly insisted on retaining those generous exemption offerings for bankruptcy debtors. Sound familiar? The 1867 Act for the first time authorized the use of state exemption laws, in addition to federal exemptions (Ch. 176, § 14, 14 Stat. 523). Incorporating state exemptions raised a constitutional problem: was the bankruptcy law “uniform” when debtors in different states had different exemption laws available to them? The Supreme Court never ruled on the constitutionality of this part of the 1867 law.

In the Act of 1898, for the first time, *only* state exemptions could be used by bankruptcy debtors (Ch. 541, § 6, 30 Stat. 548). Now the constitutional uniformity issue was squarely presented. In *Hanover National Bank v. Moyses*, 186 U.S. 181 (1902), the Supreme Court upheld (probably incorrectly, see Koffler 1983) the constitutionality of the exemption provision, holding that all the Bankruptcy Clause requires is “that uniformity is geographical and not personal,” and such geographic uniformity obtained because “the trustee takes in each State whatever would have been available to creditors if the bankrupt law had not been passed.”

In the debates leading up to the 1978 legislation, reformers sought to give debtors the option of electing uniform federal exemptions, in addition to the state exemptions. The political football that ensued was remarkable (see Posner 1997). At the last minute, with no explanation, Congress enacted the infamous “opt out” provision of 11 U.S.C. § 522(b), whereby states could “opt out” of the federal exemptions, precluding debtors resident in that state from electing the federal exemptions of § 522(d). To date about three-fourths of the states have opted out. The Supreme Court has not addressed whether opt out is constitutional, although lower courts have upheld it. In BAPCPA, Congress tinkered with the exemption law, adding a domiciliary test in § 522(b)(3)(A); as a necessary corollary, Congress added a provision that a debtor could select the federal exemptions of § 522(d) if the debtor otherwise would not be eligible for any exemptions due to application of the domiciliary test. 11 U.S.C. § 522(b)(3).

The second huge issue in exemption law has been what to do with “exemption planning.” Should any restrictions be placed on the pre-bankruptcy conversion of non-exempt to exempt assets? Is it “fraud” simply to take advantage of what the law offers? Or must there be proof of something more, some extrinsic evidence of fraud (lying, concealing, and so forth)? Note that this issue is connected closely with the exemption “source” question, in that almost always the concern is that the debtor has taken advantage of very, very generous *state* exemptions on the eve of bankruptcy – buying a multi-million dollar house in a state with an unlimited homestead exemption (insert Florida, Texas here) or the like. If the only exemptions offered were fair, balanced, and calibrated to actual and compelling necessities of the debtor or her family, people would rarely get upset. There were not many “exemption planning” cases under the 1800 Act where the debtor went out and bought “necessary bed and bedding” the day before bankruptcy.

Until BAPCPA, the bankruptcy statutes never addressed the exemption planning question, although the problem was well-known and oft-debated (see Kennedy 1960, Resnick 1978). The only mention of the question in the 1978 legislative process was in the legislative history, which appeared to approve of the practice. Courts have long allowed eve of bankruptcy conversions if there is no extrinsic proof of fraud, apart from the mere fact of conversion. The allegedly fraudulent conversion is tested in two ways – either through denial of the exemption, or through denial of the discharge under § 727(a)(2) as a fraudulent transfer.

After the publicity associated with the infamous Enron case, though, where many top Enron executives acquired very substantial exempt homesteads in Texas or Florida, Congress took some action in 2005. First, new § 522(o) reduces the value of a homestead exemption to the extent attributable to a fraudulent conversion of non-exempt property within 10 years of the bankruptcy filing. The statute does not elaborate as to what constitutes “intent to hinder, delay, or defraud,” so presumably the old case law will remain relevant. Second, under § 522(p), even if no fraud is shown, the debtor may only exempt under state law up to \$125,000 in a homestead acquired within 1,215 days before filing, but that cap does not apply to a debtor who rolls over equity from one house to another in the same state (so no moving to Florida!). Third, a \$125,000 cap applies to debtors who have violated certain securities laws. 11 U.S.C. § 522(q). Finally, the “move to Florida” gambit is further restricted by the domiciliary requirement of § 522(b)(3)(A), which only allows a debtor to claim exemptions in a state where they have been domiciled for the 730 days prior to bankruptcy. If the debtor moved during the 730 days, the applicable state exemption law is the state where the debtor was domiciled for the majority of the 180 days before the 730-day period.

A third important exemption issue concerns the debtor’s power to avoid certain liens to the extent they impair exemptions to which the debtor otherwise would be entitled. Liens can pose a significant threat to the efficacy of exemption allowances for consumer debtors, since normally liens are enforceable against exempt property. Often, of course, the secured creditor has given meaningful value in exchange for the lien and should not be subjected to lien avoidance. Other liens, though, such as nonpossessory, nonpurchase-money security interests in household goods or wearing apparel, have little value beyond the leverage they give the creditor. A central reform of the 1978 law was to empower debtors to avoid such liens, as well as judicial liens, to the extent they impair exemptions. 11 U.S.C. § 522(f). In 1994, Congress tried to fine-tune § 522(f), carving out liens supporting domestic support obligations from the category of

avoidable judicial liens, and preventing the avoidance of liens on tools of the trade and related collateral types beyond \$5,000 in value.

A final pervasive and overarching exemption issue, which at some level is always in play whenever consumer bankruptcy reform is on the table, is, at what level of comfort should a debtor be left after bankruptcy? Hearken back to the 1800 Act exemption scheme: a debtor got to keep necessary wearing apparel, and necessary bed and bedding. That's it. Today a debtor in Texas or Florida can keep a multi-million dollar mansion. What is it that we want exemption laws to do in bankruptcy? What policy goals do they serve? Those are important questions and should shape the formulation of our bankruptcy exemption laws. Unfortunately, under current law, with the option of electing state exemption laws, and with states competing for debtors by offering increasingly generous exemptions, to speak of any coherent bankruptcy exemption "policy" is virtually meaningless.

What future income is shielded?

The focus of the debate on consumer bankruptcy reform in recent years has been on the question of what future income the debtor should be allowed to keep from her creditors. Under the scheme of the 1898 Act, a debtor could choose to file a liquidation bankruptcy case under chapter 7, receive a discharge of debts, and enjoy the full fruits of all her future income received for work performed after filing bankruptcy. In short, the debtor's human capital was protected. Many issues are – and have been for centuries – packed into the category of debt discharge and the enjoyment of future income.

The first and most basic question is also the most important: should the debts of the debtor be discharged at all? Today we take the notion of a bankruptcy discharge largely for granted, and see it as a given, but it is anything but. The original conception of bankruptcy did *not* include a discharge of debts. Indeed, the 1542 Statute of 34 & 35 Henry 8, ch. 4, § 6, plainly stated that creditors whose debts remained unpaid after the bankruptcy distribution "may have their remedy for the recovery and levying of the residue of the same debts." This approach was entirely consistent with the quasi-criminal orientation of the early bankruptcy laws, which were crafted entirely as a further remedy for creditors.

"The most important development in bankruptcy history" (McCoid 1996) was the institution of the discharge of pre-bankruptcy debts for "conforming" debtors in 1705 in the Statute of 4 Anne, ch. 17, § 7. A debtor who cooperated in the bankruptcy proceedings could obtain a "certificate of conformity" from the bankruptcy commissioners that he then could plead in defense to a later action brought to recover a discharged debt. The sort of "conformity" Parliament demanded is much the same as is expected of debtors today to receive a discharge, as evidence by the discharge denial grounds in § 727(a). Ironically, much of the motivation for the landmark statute was to help *creditors* by offering a carrot to debtors to cooperate in the bankruptcy case, so that creditors then could recover more. The "stick" in the statute was the introduction of the death penalty for debtors who did not cooperate. Parliament, fed up with over a century of egregious cases of debtor fraudulent behavior, capped by the notorious frauds of one Thomas Pitkyn in 1704, took desperate measures to stem the tide of fraud. Remember too that debtors could not voluntarily avail themselves of bankruptcy and thereby receive a

discharge, as it remained an involuntary remedy only. At the same time, historians ascribe to Parliament some small measure of concern for the plight of debtors in enacting the discharge law. Whatever the reasons, once the step of allowing discharge of debts was taken, it stuck, and has remained ever after a permanent part of the bankruptcy landscape.

The occasion for debtor celebration prompted by the 1705 Statute of 4 Anne (aside from the death penalty part) proved short-lived, as the very next year Parliament made access to discharge much more difficult in the Statute of 5 Anne. The barrier? Creditors were given the power to consent to the granting of a discharge of debts: a debtor would receive a discharge only if the certificate of conformity was signed by four-fifths in number and amount of creditors holding provable claims. (Chapter 22, § 2). The creditor consent limitation proved enduring, not being abolished entirely until 1883 in England and 1898 in the United States. The first United States act, the Bankruptcy Act of 1800, required consent of two-thirds in number and amount of creditors holding proved debts of at least \$50. (Ch. 19, § 36, 2 Stat. 31). Nor was the consent requirement a paper tiger. In practice, obtaining sufficient consents from creditors often proved to be difficult, if not impossible. Even the landmark 1841 Act, which introduced voluntary bankruptcy for non-merchant debtors, nonetheless retained creditor power over the discharge. The only differences were that the burden was shifted to creditors to file a dissent, and the approving number was dropped from two-thirds to a simple majority (Ch. 9, § 4, 5 Stat. 443-44). In the 1867 Act, creditor consent was one of the central topics for debate, and a compromise was reached. Consent was still required, but the effective date was postponed for a year, giving debtors a chance to file early and escape the limitation. Furthermore, if the debtor paid a dividend of 50% on debts, no consents were needed. (Ch. 176, § 33, 14 Stat. 533). The 1898 Act dropped the consent requirement altogether.

A related question to that of creditor consent is whether a debtor should have to pay a minimum percentage dividend on debts in the bankruptcy case in order to obtain a discharge of debts, or to obtain some other benefit. The common thread of each is the notion that a debtor should have to be found “deserving” in some manner in order to be granted a discharge; in the consent situation, the debtor’s fiscal “beauty” is in the eye of the creditor beholders, whereas in the instance of the requisite dividend, an objective measurement is used. The close linkage between the two concepts was nicely illustrated by the provisions of the 1867 Act, just discussed, which excused the need for creditor consent upon payment of a sufficient percentage dividend. Indeed, the very first bankruptcy law that provided for a discharge, the Statute of 4 Anne, contained a percentage dividend test, offering debtors a graduated monetary allowance out of the estate, up to 5% or £200 – but only if the creditors were paid at least 40% on their claims. (Ch. 17, §§ 7-8). The Bankruptcy Act of 1800 contained a similar rule, with the amount of the allowance increasing as the dividend paid to creditors increased. (Ch. 19, § 34, 2 Stat. 30). The notion that debtors who pay a certain dividend get added privileges persists in the law today, as a debtor can be excused from the 6-year bar on receiving successive discharges if she pays enough to creditors in the first case under chapter 13. 11 U.S.C. § 727(a)(9). The genesis for that rule came in the 1732 Statute of 5 George 2, which required a debtor to pay a 75% dividend in order to receive a discharge in a second bankruptcy case. (Ch. 30, § 9).

The law just cited demonstrates another persistent concern of bankruptcy reformers, which is what limits should be imposed on a debtor receiving discharges in successive cases?

There is a lingering notion that a debtor who seeks to file bankruptcy repeatedly in order to obtain multiple discharges is somehow abusing the system and should be checked. The standard approach historically was to make the debtor pay for the second discharge, with the 75% dividend requirement imposed by the Statute of 5 George 2, and carried forward in the first American laws of 1800 (Ch. 19, § 57, 2 Stat. 35) and 1841 (Ch. 9, § 12, 5 Stat. 447). The 1867 Act slightly modified this rule, requiring a 70% dividend in case number 2 *or* the assent of three-fourths in value of the creditors in the second case, unless all of the debts from case number 1 had been paid in full or released. (Ch. 176, § 30, 14 Stat. 532). The 1898 Act contained no limitation on receiving successive discharges, but a 1903 amendment introduced the modern rule, an absolute six-year bar on receiving discharges in successive chapter 7 cases. (Ch. 487, § 4, 32 Stat. 797). In the 1978 law, the six-year bar on discharges in successive chapter 7 cases was continued, and a minimum dividend test was imposed to receive a chapter 7 discharge after a chapter 13 case, § 727(a)(8), (9), but no limits were imposed if the *second* case was under chapter 13. BAPCPA, with its obsession for “bankruptcy abuse prevention,” as the title suggests, lengthened the six-year bar to eight years *and* for the first time introduced a prohibition on receiving a chapter 13 discharge in the second case, imposing a four-year waiting period if the first case was under chapter 7, 11, or 12, and a two-year bar if the first case was under chapter 13. 11 U.S.C. § 1328(f).

Not every debtor receives a discharge. Every bankruptcy law has withheld the benefit of discharge from some debtors. Identifying what grounds warrant total denial of discharge defines in a fundamental way the “fresh start” system. So too does the explication of discharge denial grounds reveal much about the contemporary culture. In this arena as well, bankruptcy reformers have tried different approaches through the centuries. In the original discharge law, the Statute of 4 Anne, the debtor first had to “conform” to the requirements of the bankruptcy law in order to earn a discharge in the first place. The types of “conformity” required mirror the grounds in our current discharge denial statute, 11 U.S.C. § 727(a). Thus, a debtor was asked to make full disclosure, turn over assets, and so forth. In addition, certain pre-bankruptcy acts of the debtor precluded the discharge grant: incurring excessive gambling losses (£5 in a day or £100 in the year before bankruptcy), or making a marriage settlement of over £100 on the debtor’s children while insolvent. (Ch. 17, §§ 15, 12). The 1732 Statute of 5 George 2, discussed above, introduced the limitation on discharge in successive cases, a concept which continues to this day.

The United States Bankruptcy Act of 1800 had few grounds for withholding the discharge. Of course, the fact that creditors retained the power to vote on the discharge served as an effective check on debtor mischief; as later acts minimized and then dropped creditor oversight, the imperative for clear rules denying discharge increased. In 1800, the only grounds for discharge denial were failure to disclose a fictitious claim or incurring gambling losses of \$50 at one time or \$300 in the year before bankruptcy. (Ch. 19, § 37, 2 Stat. 31-32). The 1841 Act, which opened discharge up to all debtors on a voluntary basis, concomitantly expanded the grounds for discharge denial, including fraud, making a preference, willful concealment of property, willful failure to comply with court orders or to conform to the act’s requirements, admitting a false debt, applying trust funds to the debtor’s own use, or, for merchants, failing to keep proper books of account. (Ch. 9, § 4, 5 Sta. 443-44). The 1867 law, which effectively did away with creditor consent by postponing its effective date, at the same time had a very long list

of grounds for discharge denial, some quite draconian (Ch. 176, § 29, 14 Stat. 531-32), all of which resulted in only one-third of all debtors receiving a discharge.

The 1898 Act, which as originally enacted was perhaps the most debtor-friendly “fresh start” law ever, blocked a discharge only if the debtor had committed a bankruptcy crime or fraudulently concealed his true financial condition or destroyed or failed to keep financial records in contemplation of bankruptcy. (Ch. 541, § 14b, 30 Stat. 550). This swing of the pendulum in the debtors’ favor went a bit too far, and just five years later in the 1903 amendments, four new grounds were added to § 14b: obtaining credit by a materially false writing; making a fraudulent transfer within four months of bankruptcy; refusing to obey a bankruptcy court order or answer a material question; or obtaining a discharge within the prior six years. ((ch. 487, § 4, 32 Stat. 797). Little change was made in the ensuing century, and most of these grounds were continued in some form in § 727(a) of the 1978 Code. The penalty for obtaining credit by a false writing was changed to a discharge exception under § 523(a) rather than being ground for discharge denial. In BAPCPA in 2005, a debtor education rule was added as § 727(a)(11), requiring debtors to get financial counseling during bankruptcy as a condition of receiving a discharge.

Even if a debtor receives a general discharge, some of the debtor’s individual debts may be excepted from that discharge. Bankruptcy reformers have shown a particular inability to resist toying with the list of discharge exceptions, especially in modern times. Today some debts are excepted because of the debtor’s bad acts in creating the debt (e.g., fraud, willful and malicious injury); others protect favored creditors (e.g., taxes, domestic support obligations); and others appear to be excepted only due to the influence of special interests (you know who you are). It has not always been this way. The early bankruptcy laws excepted almost no debts: for the most part, a debtor either got a discharge or not. The 1800 law excepted only debts owing to the United States or any State (Ch. 19, § 62, 2 Stat. 36); in 1841, all that was added were debts for defalcation by a public officer and fiduciary obligations (Ch. 9, § 1, 5 Stat. 441); and the 1867 law added only debts created by fraud or embezzlement ((Ch. 176, § 33, 14 Stat. 533). Section 17 of the 1898 act, the predecessor to current § 523(a), excluded debts for taxes, fraud, willful and malicious injuries, unscheduled claims, and fiduciary misconduct. (Ch. 541, § 17, 30 Stat. 550-51). In 1903 exceptions for alimony, maintenance and support, and for “seduction of an unmarried female or criminal conversation,” were added. ((Ch. 487, § 5, 32 Stat. 798).

Today, by contrast, the list of exceptions in § 523(a) continues to grow, expanding from nine excepted debts in the 1978 Code to a current total after BAPCPA of nineteen excluded debts. Another notable policy decision of the 1978 Code was to offer debtors a “superdischarge” if they filed under chapter 13, as an enticement to proceed under that chapter. Originally, many otherwise excepted debts, including those for taxes, fraud, or for willful and malicious injury, could be discharged in chapter 13. Here again, though, Congress has been steadily cutting back on the reach of the superdischarge in the quarter-century since the 1978 act became law, culminating in a full-scale frontal assault in BAPCPA, with the discharge now withheld for debts for fraud, some taxes, and for willful “or” malicious injury. 11 U.S.C. § 1328(a)(2), (4). This move by Congress is consistent with the overall orientation of BAPCPA, which is to *force* many debtors to proceed, if at all, under chapter 13, rather than trying to *persuade* them to elect to do so.

Regarding particular debt exceptions, space does not permit much discussion, but suffice it to say that an entire article could be (and has been) written about credit card debts and the fraud exception. The 1997 Commission carefully studied the problem of credit card “fraud” and made a concrete suggestion for a bright-line 30-day rule, which Congress decided not to adopt. Instead the only tweaking done to the fraud exception was to expand the reach of the presumption of nondischargeability in § 523(a)(2)(C).

One of the most important practical restrictions on the scope of the discharge occurs when debtors choose to reaffirm their otherwise dischargeable debts. Should this practice be permitted? If so, what limits, if any, should be placed on the practice? Before the reforms of the 1970s, reaffirmation agreements went largely unchecked, and often seriously eroded the debtor’s discharge. A serious effort was undertaken in the 1970s reforms to curtail drastically enforceable reaffirmations. The House of Representatives wanted to eliminate reaffirmations altogether (House Report 1977 at 164). The 1978 Code, however, did not take that tack, but instead chose to permit reaffirmations, but only if the debtor and creditor jumped through a whole series of regulatory hoops involving disclosure, warnings, cooling off periods, independent approval, and the like. The 1997 Commission again wanted to cut back on enforceable reaffirmations, but again Congress in BAPCPA took the alternative path of extensive regulation, with disclosures and warnings, this time even mandating the content and wording of reaffirmation agreements. 11 U.S.C. § 524(k).

One possible way that a debtor’s entitlement to a discharge could be policed is through more active court involvement. In England and Commonwealth countries, courts have the power to limit, suspend, or condition the debtor’s discharge, in order to tailor the appropriateness of discharge relief to the debtor’s individual circumstances. (Boshkoff 1982) For example, the court may order the debtor to make certain payments to creditors for a period of time as a condition of receiving a discharge. Is this a good approach? Should the court have the power to limit, condition or suspend the discharge? It has worked fairly well in the Commonwealth. In the United States, however, this sort of court role has never been embraced. Our bankruptcy law has been more rules oriented, with the discharge requirements laid out by Congress and enforced by the courts. Before BAPCPA, courts did have considerable discretion over some matters, such as deciding whether the debtor’s chapter 7 filing constituted a “substantial abuse” under § 707(b) or whether to confirm a chapter 13 plan. BAPCPA sought to withdraw as much discretion as possible from the bankruptcy judges, though, and impose hard and fast rules on how the fresh start provisions should be implemented.

Finally, in considering the “future income” question, the proverbial 800-pound gorilla is the final question: should debtors be allowed to obtain an immediate discharge in a straight liquidation case even if they have the means to make payments out of future income, or should such “can pay” debtors be forced into (or at least be restricted to) a repayment plan under chapter 13? Readers are probably sufficiently aware of, and weary of, these debates so that little need be said here. Note that in the rest of the world it is expected generally that debtors with excess future income are to contribute some portion of that income to payments to creditors as a quid pro quo for receiving bankruptcy relief. In the United States, though, the historical tradition has been quite to the contrary. The standard has been to allow individual debtors to elect to proceed under chapter 7 and receive an immediate discharge, even if they might have some excess future

income. Payments out of future income form no part of chapter 7 (except informally through reaffirmation agreements). Repayment out of future income is allowed only in a distinct chapter 13 case, which is totally voluntary with the debtor. Again, in the rest of the world, this artificial divide between liquidation and repayment proceedings is unknown and indeed viewed as an oddity. Our policy has been to encourage debtors to maximize the fruits of their human capital through the immediate chapter 7 discharge. Creditor discontent with the immediate-discharge scheme has been longstanding, dating back at least to the early 1930s, and vigorous efforts to compel “can-pay” debtors to proceed under chapter 13 have been pursued since at least 1964. Congress in 1967 and again in the 1970s reforms flatly rejected the idea of a mandatory chapter 13 system, or anything like it, insisting instead that debtors were free to choose of their own volition whether to proceed under chapter 13. Some inroads on this free choice were effected in the 1984 amendments, which added the “substantial abuse” test as § 707(b), with at least some indication that a factor in assessing abuse is the debtor’s potential repayment capacity. Not content with that change, the consumer credit industry continued to lobby hard for a stricter “means test” that would force “can pay” debtors out of chapter 7. Perhaps the most hotly contested policy issue that the 1997 Commission confronted was whether to institute a stricter “means test.” By a razor-thin 5 to 4 margin, the Commission rejected that approach. Congress, however, embraced it, and, after over 7 years of near misses and false starts, succeeded in BAPCPA to get the new amendments to § 707(b) enacted, with the entire wish list of the consumer credit industry made into law, effective for cases filed on or after October 17, 2005. Now debtors with family income above the state median income are subject to the means test and face a presumption of abuse if they can pay \$100 (or perhaps as much as \$166.67) a month over five years. 11 U.S.C. § 727(b)(2). BAPCPA also extended the standard time for chapter 13 cases to five years.

Who decides and how?

It is sometimes tempting to become too enamored of substantive legal questions, at the expense of questions of process and systems analysis; indeed, I have largely succumbed to that temptation in this paper. Before I end, however, I must do at least some penance and raise a few process questions. Often the most important issues are not what the law is, but who administers it, and how. To see the truth in that assertion, one need look no further than the first question following, which has proven over the centuries to be one of the most fundamental in defining the significance of the fresh start: must the debtor raise the discharge as an affirmative defense, or is the discharge self-executing? For the first 265 years in the life of the discharge in Anglo-American jurisprudence, the answer (unfortunately for debtors) was that they had to raise the discharge as an affirmative defense. This practice was established by the watershed Statute of 4 Anne in 1705, which introduced the discharge of debts for conforming debtors. The debtor had to obtain a “certificate of conformity.” If later sued on a discharged debt, the debtor had to appear in court and introduce the certificate of conformity in defense. Failure to do so could lead to the entry of an enforceable judgment for the creditor. The debtor also had to use the certificate of conformity to obtain his release from prison.

The first United States bankruptcy law, the 1800 Act, required a debtor to obtain a “certificate of discharge” in order to enforce the discharge in subsequent litigation on discharged debts or to obtain his release from prison. (Ch. 19, § 36, 2 Stat. 31). This document was actually

signed by the consenting creditors and was issued by the district judge, following certification by the bankruptcy commissioners to the district court that the debtor had conformed to the requirements of the bankruptcy law. The 1841 law slightly changed the process by which the certificate was obtained (debtor made application for discharge, and the entitlement to discharge then was considered at a noticed court hearing, rather than via commissioner certification as in 1800 law), but the enforcement mechanism was unchanged. So too the 1867 law retained the provision that the debtor had the burden of pleading the certificate of discharge as an affirmative defense (Ch. 176, § 34, 14 Stat. 533). The 1898 Act was silent as to the means of enforcement, but in practice the debtor continued to be required to plead the bankruptcy discharge as an affirmative defense.

This unbroken tradition of over a quarter of a millennium was changed by the bankruptcy amendments passed by Congress in 1970. Empirical studies showed convincingly that many debtors lost the benefit of their discharge through the entry of default judgments on otherwise discharged debts, due to ignorance, lack of money for legal fees, and dubious service of process. In the 1970 law, Congress amended § 14f and eliminated the need for a debtor to plead the discharge as an affirmative defense. Instead, the entry of the discharge order (1) automatically voided any judgment obtained at any time on a discharged debt, and (2) permanently enjoined creditors from taking any formal action to collect a discharged debt as a personal liability of the debtor. Thus, if a creditor did sue on a discharged debt, the creditor could be sanctioned for violating the discharge injunction, and any judgment the creditor might obtain would be null and void. In the 1978 law, Congress in 11 U.S.C. § 524(a) continued the approach of the 1970 law. This dramatic shift in the means of enforcing the discharge has proven to be one of the most significant benefits to debtors in the history of consumer bankruptcy reform.

Another process question of great practical importance is what court system – state or federal – should have jurisdiction over discharge litigation? The concern is that the state courts might not have sufficient expertise in the nuances of the bankruptcy law, or adequate appreciation of the importance of the “fresh start” policy. It has long been the law that challenges to the debtor’s discharge must be heard in the federal (district or bankruptcy) court. The granting or withholding of a discharge is considered a core part of the bankruptcy process. Today a discharge objection must be litigated in an adversary proceeding in the federal bankruptcy court. Federal Bankruptcy Rule 4004(a). However, the story has been much different for litigation over the *exceptions* to discharge. Here, jurisdiction to litigate the exceptions has traditionally been considered to be concurrent in the federal courts and in the state courts. Thus, a creditor could bring suit in the state court after a discharge had been granted and argue that its debt was excepted from discharge by § 17 (1898 Act) or § 523(a) (1978 Code). Here again, the 1970 amendments made an important shift, requiring certain critical and commonly litigated discharge exceptions (most notably the exception for fraud) to be brought exclusively in the bankruptcy court, and within a limited time. The 1978 Code continued this practice in 11 U.S.C. § 523(c).

It is worth noting that indirectly, at least, state courts effectively *can* determine the dischargeability of debts seemingly committed to the exclusive jurisdiction of the federal bankruptcy court system. How? Through the magic of collateral estoppel. If a state court necessarily determines an issue of fraud in the creditor’s favor, and the debtor later files

bankruptcy, can the creditor plead the prior state court judgment in the bankruptcy case and insist that it be given collateral estoppel effect? In *Grogan v. Garner*, 498 U.S. 279 (1991), the Supreme Court held that it could.

A final area of great importance, and complexity, is divining the proper roles of the many parties with a hand in the bankruptcy system: creditors, trustees, the United States trustee, the courts (and here one must consider the divide between district courts and bankruptcy judges), and last but surely not least, Congress. An added overlay on this whole area is to consider whether bankruptcy should be essentially an administrative or a judicial proceeding. For a very long time in bankruptcy history, up until almost the twentieth century, the dominant actors in the bankruptcy game were the creditors. They petitioned to put the debtor in bankruptcy, they elected the bankruptcy trustee, and they voted on whether the debtor should be given a certificate of discharge. Courts still made decisions on contested matters involving discharge and exemptions. The trustee (or assignee) acted primarily as the representative of the creditors.

The first big inroad into creditor control came with the advent of voluntary bankruptcy in the 1841 United States law. Now debtors were given much more power than they ever had before. Creditors still could vote against the discharge, though. Then in the 1867 law the creditor consent power was greatly weakened by the postponement of the effective date of that provision. However, most debtors still did not get a discharge because of the numerous strict grounds for discharge denial. In England in 1883, power over the discharge was taken from creditors and given to the court, which could limit, condition, or suspend discharges. (46 & 47 Vict., ch. 52). In the States, the 1898 Act largely completed the defanging of creditor control, completely eliminating any requirement of creditor consent to the discharge. Then, as now, all a creditor could do is file an objection to the general discharge or to the dischargeability of their own debt, and the court then would decide that question in a judicial proceeding. Creditors also could (and still may) elect a trustee, who can investigate the debtor and file an objection to the discharge.

With power taken from creditors, was it given to the courts? In England, yes. But not so much in the United States. In this country, courts have never had the sort of discretion over the discharge that English courts enjoy. Congress has spelled out fairly clear rules that govern the playing of the discharge game. Courts are there only to decide judicial questions brought before them. Most of the discharge denial grounds and the discharge exception grounds are clear rules, with little room for the exercise of discretion. The “undue hardship” provision in the student loan exception (11 U.S.C. § 523(a)(8)) is about the only significant counter-example. To be sure, at times courts have assumed a modicum of power, a prominent example being the ill-fated “substantial abuse” test enacted in 1984. The bankruptcy court on its own motion, or on the motion of the United States trustee – but not at the request or even “the suggestion”(!) of parties in interest (such as creditors) could bring a substantial abuse motion. Congress certainly did not like what courts did with that delegation of power, though: a dominant theme of BAPCPA was to withdraw as much discretion as possible from the bankruptcy courts. One wonders, though, whether in practice that system will really work. Nature, and judicial systems, abhor a vacuum, and from necessity the courts may well step in and exercise considerable *de facto* control over the processing of the means test. But perhaps not. Perhaps the real players will be the attorneys, and the creditors, and the United States trustee – an official of the Executive Branch, whose own

role has been enhanced by the 2005 amendments.

Is bankruptcy relief a wrong, a right, or neither?

As a final general category, one could consider the moral aspect of consumer bankruptcy. Is bankruptcy a “wrong,” a “right,” or neither? Are bankrupts bad people? Should they be punished? Imprisoned? Executed? Applauded? The original conception of bankruptcy was that debtors were in fact bad people, quasi-criminals. The early acts suggested as much in their language: the 1542 law declared that it was “An Act against such persons as do make bankrupts” and called debtors “offenders.” Imprisonment for debt was a commonplace. By 1705 fraudulent bankrupts faced the death penalty. In the late eighteenth and early nineteenth century, a substantial shift in sentiment occurred. Debtors were not seen as necessarily evil, but perhaps just as the unfortunate but inevitable losers in the game of commerce, the playing of which was good for the economic health of the nation. In that time period, imprisonment for debt was largely abolished, voluntary bankruptcy was made available to merchant and non-merchant alike, and exemption laws were made substantially more generous; in many tangible ways, the plight of and perception of impoverished debtors took a marked turn for the better. The apogee of the expression of this sentiment was the 1898 Act, with much of the twentieth century a paean to the needs of debtors. The 1978 reform even dropped the use of the term “bankrupt” and replaced it with “debtor,” which was thought to be less pejorative.

But the worm has turned in the quarter century since the enactment of the 1978 Code. Never before in our history has such a well-organized, well-orchestrated, and well-financed campaign been run to change the balance of power between creditors and debtors, and on April 20, 2005, those efforts paid off with the enactment of BAPCPA. Notably, the rhetoric in recent years has painted debtors as “abusers” – indeed, the very title of the new law speaks of “abuse prevention.” This is not a good time in our nation’s history to be a debtor. An overwhelming majority of the United States Congress rejected the recommendations of the 1997 Commission and embraced instead the draconian pro-creditor changes put forward by the consumer credit industry. In time, though, the pendulum is likely to shift again. For now, as the Chinese say, we appear to be consigned to “live in interesting times.”

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