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The Changing Bankruptcy Process

By Honorable Joe Lee*

The bankruptcy process has undergone dramatic change in the 1970's. December 18, 1970 was the effective date of the new dischargeability law¹ which conferred jurisdiction upon the bankruptcy courts to determine the dischargeability of particular debts. On April 24, 1973, the Supreme Court promulgated new rules of bankruptcy procedure for straight bankruptcy and Chapter XIII cases.² These rules, after approval by Congress, became effective October 1, 1973.³ Rules governing practice under other debtor relief chapters of the Act are in the pipeline awaiting approval,⁴ and there is presently pending in Congress an omnibus bankruptcy bill entitled The Bankruptcy Act of 1978,⁵ which, if enacted into law, would effect sweeping changes in the structure of the bankruptcy system, as well as in the substantive law of bankruptcy.

These developments will have a great impact on the law of bankruptcy. In fact, the new dischargeability law has already considerably enhanced the power of the bankruptcy court to enforce an order of discharge granted individual debtors. The new rules of bankruptcy procedure have upgraded practice in bankruptcy courts by bringing it more into conformity with practice under the Federal Rules of Civil Procedure. Likewise, as will soon be seen, the new dischargeability law has had a tremendous effect upon bankruptcy proceedings.

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⁴ The Supreme Court on March 28, 1974, transmitted, to Congress, rules governing practice and procedure under Chapter XI of the Bankruptcy Act. These rules became effective July 1, 1974.
One of the primary purposes of bankruptcy proceedings is to grant relief to honest debtors. If the discharge decree is easily circumvented, the effectiveness and very stature of the bankruptcy court is called into question. Prior to enactment of the new dischargeability law, several investigations had focused attention upon the inadequacy of the discharge in bankruptcy in providing relief for oppressed debtors. The objective of this new legislation is to make more effective the discharge in bankruptcy granted to individual debtors.

The dischargeability law empowers the bankruptcy court to determine the dischargeability or nondischargeability of particular debts, upon application of any party in interest, after notice and hearing. The former rule provided that the bankruptcy court merely determined whether a discharge should be granted, while the effect of the discharge on a particular debt was to be adjudicated by the court in which the claim was sought to be enforced following bankruptcy. In theory the old rule provided for an excellent division of labor between federal and state courts, but in practice it did not function well for bankrupts who often found themselves in an exceedingly hostile legal environment following bankruptcy. The discharge constituted an affirmative defense which was waived if not properly pleaded. Bankrupts often lost the full protection of the law through failure to plead their discharge, or simply because they were not financially able to retain counsel to defend post-bankruptcy actions brought against them by creditors in the state courts.

The problem is succinctly noted in the following excerpt from the dissenting opinion of Justice Paul in Helms v. Holmes:

The average bankrupt is a layman who has been advised that a discharge in bankruptcy releases him from his debts and

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7 Hearings on S. 578 and Other Bills Before a Special Senate Subcomm. on the Judiciary, 90th Cong., 1st Sess. (1967); Joint investigation by office of United States Attorney and Federal Bureau of Investigation at Nashville, Tenn., released May 12, 1967.
10 Hearings on S. 578 and Other Bills, supra note 7, at 35.
11 See, e.g., Fed. R. Civ. P. 8(c) & 12(h).
who has faith in the dignity, the force and effect of a decree of a federal court. He has surrendered his property and has no means to defend himself against further litigation. It has become a custom of greedy creditors to take advantage of this situation by ignoring the bankruptcy proceedings and the order of discharge and suing on their debts in the state courts hoping that the bankrupt, because of this ignorance and faith in this order of discharge or because he is unable to employ counsel, will fail to appear and plead the discharge or otherwise defend. And unfortunately this frequently happens. Usually these suits are brought before inferior state courts, such as justices of the peace, many of whom are laymen; and even when the bankrupt appears and pleads his discharge these justices, without legal training or experience in the interpretation of the Bankruptcy Act, undertake to pass upon the effect of this discharge as affecting the particular debts—usually reaching erroneous conclusions and usually adverse to the bankrupt. Every court which deals with any considerable number of bankruptcy cases is familiar with the difficulties which bankrupts have in protecting themselves from rapacious creditors even after discharge.12

Hopefully the dischargeability law will correct abuses of the discharge process such as those described above.

Prior to its enactment, the dischargeability law had been pending before Congress in one form or another, for approximately fifteen years.13 As early as 1956 and 1957, bills were introduced to amend Section 2a of the Bankruptcy Act to confer jurisdiction upon the bankruptcy court to determine the dischargeability of particular debts, and to authorize the court to reopen cases for the purpose of making such a determination without additional cost to the bankrupt.14 The proposed grant of jurisdiction to enable the court to determine the dischargeability of particular debts was combined with amendments to section 14c(3) of the Act providing for elimination of the false financial statement as a ground for denial of a discharge in bankruptcy.15

The 1960 amendment to Section 14c(3) of the Act (the so-
called Celler amendment),\textsuperscript{16} which by way of compromise retained the false financial statement as a bar to the discharge of a debtor engaged in business while eliminating it as a ground for objecting to the discharge of a non-business bankrupt, was the forerunner of the dischargeability law as finally enacted by Congress in 1970. In its original form the Celler amendment would have granted to the bankruptcy court jurisdiction to determine the dischargeability or nondischargeability of particular debts.\textsuperscript{17} However, the provision authorizing the bankruptcy courts to make dischargeability determinations encountered substantial opposition in the Senate and was dropped from the bill.\textsuperscript{18}

The Celler amendment, without the proviso empowering the bankruptcy court to determine the dischargeability of debts, did not bring about any substantial change in practice. The small loan companies had already adopted the practice in consumer bankruptcy cases of foregoing general objections to discharge of the bankrupt for alleged publication of a false financial statement. Instead, they preferred to exercise the right, which survived bankruptcy, to sue on the debt in the state court and thereby seek to have the debt declared nondischargeable under the fraud exception to discharge in Section 17a(2) of the Act.\textsuperscript{19} The latter option was not materially affected by the Celler amendment. The knowledgeable creditors perceived that the law operated to their advantage when the bankrupt received a discharge from his debts generally because the bankrupt was then more capable of paying debts from which he was not released in the event it should be determined in a state court action that a debt was unaffected by the discharge. Consequently, in the era following enactment of the Celler Amendment, as formerly, most of the dischargeability determinations were made by the state courts which were ill-equipped and little inclined to deal with the problem.\textsuperscript{20} Contrary to the congressional intent, the Celler amendment further emasculated the effectiveness of the bank-

\textsuperscript{17} Hearings on May 21-22, 1958 and June 18, 1958 Before a Senate Subcomm. on the Judiciary, 85th Cong., 2d Sess. 49-50 (1958).
\textsuperscript{18} Id.
\textsuperscript{20} Lee, What Shall We Do for the Consumer Bankrupt?, 44 Ref. J. 9, 10 (1970).
ruptcy court in protecting the debtor following the issuance of the discharge in bankruptcy.

Section 17a of the Act, as newly revised by the dischargeability law, contains eight separate subsections or clauses cataloging the exceptions to the general rule that all provable debts are released by the discharge in bankruptcy. Some rearrangement of Section 17a was necessary, as part of the dischargeability law, in order to isolate the grounds most frequently invoked for excepting claims from discharge, over which the bankruptcy court has been given exclusive jurisdiction, from those over which the bankruptcy court and the state courts have concurrent jurisdiction in determining the dischargeability of debts. The exceptions which are treated differently and with respect to which the bankruptcy court has been granted exclusive jurisdiction to make dischargeability determinations are the so-called (2), (4), and (8) clauses. Specifically, these clauses pertain to: § 17a(2)—liabilities for obtaining money or property by false pretenses or false representations or by the publication of a false financial statement, or for wilful and malicious conversion of property of another; § 17a(4)—liabilities for fraud, embezzlement, misappropriation or defalcation by the bankrupt while acting as an officer or in any fiduciary capacity; and § 17a(8)—liabilities for wilful and malicious injuries to the person or property of another other than conversion. These exceptions are available only if the creditor files a timely complaint with the bankruptcy court for a determination of the dischargeability of a debt. The creditor who fails to make timely application to the bankruptcy court is thereafter foreclosed from invoking these provisions as grounds for excepting his claim from the discharge. The new law requires that the bankruptcy court fix the time within which such applications must be filed with the court, which time may not be less than thirty days nor more than ninety days from the date first set for the initial meeting of creditors. Moreover, a creditor who files a complaint with the bankruptcy court alleging

22 Countryman, supra note 15, at 24-25.
25 Id.
his debt is nondischargeable on one of these grounds has the burden of proving all the essential elements of his case.\textsuperscript{27}

Under the new law the creditor who claims that his debt is nondischargeable on one of the three grounds over which the bankruptcy court has been given exclusive jurisdiction is no longer at liberty to ignore the bankruptcy proceedings and sue on the debt in the state court. The Act provides that any judgment of any court other than the bankruptcy court is null and void as determination of the personal liability of the bankrupt with respect to debts from which the bankrupt has been released by reason of the failure of the creditor to seasonably seek a ruling on the question of dischargeability from the bankruptcy court.\textsuperscript{28}

The new dischargeability law confers concurrent jurisdiction upon the bankruptcy court and the state courts to determine the dischargeability of debts which are not released from discharge under the remaining five clauses of Section 17a of the Act. However, the creditor who sues the bankrupt in the state court contending his debt is not discharged under clauses (1), (3), (5), (6), or (7) of Section 17a of the Act (taxes enjoying priority, an unscheduled claim, wages enjoying priority, bond monies deposited by employee, or alimony or maintenance), faces the prospect of having the case removed to the bankruptcy court. The Act permits the bankrupt at any time to file an application with the bankruptcy court for a determination of the dischargeability of any debt,\textsuperscript{29} and further provides that a bankrupt may have his case reopened for this purpose without payment of an additional filing fee.\textsuperscript{30} Upon the filing of such an application, the commencement or continuation of a suit in the state court for the collection of the debt may be enjoined.\textsuperscript{31} The practical effect of the new dischargeability law is to shift the arena for trying the question of dischargeability of debts from the state court to the bankruptcy court.

Finally, a creditor seeking a determination of the question of the dischargeability of a debt in the bankruptcy court should also seek judgment for the amount of the debt because the law pro-

\textsuperscript{27} Sweet v. Ritter Finance Co., 263 F. Supp. 504, 543 (S.D. Va. 1967);
\textsuperscript{29} Id. § 17c(1), 11 U.S.C.A. § 35c(1) (Supp. 1974).
\textsuperscript{30} Id. § 17c(6), 11 U.S.C.A. § 35c(6) (Supp. 1974).
\textsuperscript{31} Id. § 17c(4), 11 U.S.C.A. § 35c(4) (Supp. 1974).
vides that, where the court determines the debt to be nondischargeable, it may render judgment for the amount of the debt.\textsuperscript{32} When docketed in the U.S. District Court Clerk's office the judgment is collectible by execution issuing out of U.S. District Court.\textsuperscript{33} This new practice obviates the problem of split jurisdiction which was one of the major objections to the dischargeability provisions of the Celler Amendment under which, after the bankruptcy court determined the debt to be nondischargeable, suit to enforce collection of the debt was to be brought in state court. Thus, under the new law, the bankruptcy court is a full service court on the question of dischargeability.

\textbf{The New Bankruptcy Rules}

The new bankruptcy rules are the product of the Advisory Committee on Bankruptcy Rules, created pursuant to the provisions of the Judicial Code\textsuperscript{34} which directs the Judicial Conference of the United States to carry on a continuous study of the operation and effect of the rules of practice and procedure adopted by the Supreme Court for the lower federal courts. When the Advisory Committee on Bankruptcy Rules was first established in 1960, its work was hampered by former Section 30 of the Bankruptcy Act,\textsuperscript{35} which authorized the Supreme Court to prescribe rules for the purpose of carrying out the provisions of the Act. However, the rules so promulgated had to be consistent with the provisions of the Act, and procedural changes were not authorized. The Committee soon recognized the desirability of providing the Supreme Court with the same general rule-making power in bankruptcy that it already had in civil, criminal, and admiralty practice. Accordingly, the Committee sought and obtained enactment of legislation repealing Section 30 of the Act and authorizing the Supreme Court to prescribe rules for the purpose of carrying out the provisions of the Act. However, the rules so promulgated had to be consistent with the provisions of the Act, and procedural changes were not authorized. The Committee soon recognized the desirability of providing the Supreme Court with the same general rule-making power in bankruptcy that it already had in civil, criminal, and admiralty practice. Accordingly, the Committee sought and obtained enactment of legislation repealing Section 30 of the Act and authorizing the Supreme Court to prescribe by general rules the forms of process, writ, pleadings, motions, and the practice and procedure under the Bankruptcy Act; the legislation provided that all laws in conflict with such rules would thereafter be of no further force and effect.\textsuperscript{36} The bankruptcy

\textsuperscript{32} Id. § 17c(3), 11 U.S.C.A. § 35c(4) (Supp. 1974).
\textsuperscript{33} Bankruptcy Rules 921 [hereinafter cited as Rules].
\textsuperscript{35} Bankruptcy Act of 1898, ch. 541, § 30, 30 Stat. 554 (repealed 1964).
\textsuperscript{36} The rule-making power in bankruptcy was transferred by this legislation to title 28 of the United States Code by the addition of a new section 2075.
rule-making power conferred upon the Supreme Court by this legislation, which became effective October 3, 1964, is substantially identical to the rule-making authority delegated to the court in other areas of practice in the federal courts.

This new dispensation of power to the Supreme Court required a complete reorientation of the Committee's work. Freed from the inhibiting effect of former Section 30, the Committee commenced the task of formulating a modern code of practice and procedure in bankruptcy to supersede the frequently archaic and outmoded procedures prescribed by the Act itself—most of which date back to the basic Act of 1898, and had not been the subject of reconsideration since the enactment of the Chandler Act in 1938. Although confronted by a task of stupendous proportions, the Committee has achieved a comprehensive and long overdue improvement in bankruptcy practice.

The enabling act provides that the rules adopted by the Supreme Court "shall not abridge, enlarge, or modify any substantive right." The Committee found, however, that it is far from clear where the process of improving procedure does begin to abridge, enlarge, and modify substantive rights, especially in the bankruptcy field where major substantive rights are so intimately bound up in procedure. In drawing lines

\[\ldots\] between substance and procedure and between procedure and jurisdiction, and between what is appropriately left to the political process and what is properly governed by rules, [there is often] an assumption that the rule-making authority should not change what is important or touch what is controversial. The committee accepted no such self-abnegating of its responsibility. \ldots

The procedure whereby new bankruptcy rules are promulgated and ultimately become effective is somewhat involved. The Advisory Committee on Bankruptcy Rules reports to the Standing Committee on Rules of Practice and Procedure, which in turn reports to the Judicial Conference of the United States. If the

\begin{footnotes}
39 Gignoux, supra note 37, at 15.
\end{footnotes}
Judicial Conference recommends promulgation of the rules, the Supreme Court may enter an order fixing the effective date of the rules and ordering that they be transmitted to Congress before the first day of May in the year in which they are to become effective. If Congress does not act adversely thereon, the rules become effective 90 days after transmittal to Congress, or on such later date as may be fixed by the court.\textsuperscript{41} Thus far, only the rules governing practice in straight bankruptcy cases and Chapter XIII proceedings have been utilized extensively. By order of the Supreme Court dated April 24, 1973 these rules were transmitted to Congress and became effective October 1, 1973.\textsuperscript{42} The Chapter XI rules were transmitted to Congress by the Supreme Court on March 18, 1974 and became effective July 1, 1974.\textsuperscript{43} The rules and forms governing practice under Chapters IX, X, and XII of the Bankruptcy Act and in railroad reorganization cases are still in transit awaiting approval. The rules governing practice under these debtor relief chapters are expected to become effective in later years.

Some salient features of the new rules and forms are: (1) a simplification of the schedules and statement of affairs,\textsuperscript{44} (2) an automatic stay of most actions to enforce claims against the bankrupt or to enforce liens upon property of the estate,\textsuperscript{45} and (3) the wholesale adoption of the Federal Rules of Civil Procedure governing discovery.\textsuperscript{46} In addition, the new rules conform pleadings in bankruptcy cases to those under the Federal Rules of Civil Procedure.\textsuperscript{47}

The rules governing practice and procedure in straight bankruptcy cases are divided into nine parts. Part I specifies the contents of the three permissible types of petitions—voluntary, involuntary, and partnership—and governs matters relating to adjudication. Part II prescribes the procedure for the selection of receivers, trustees, and the employment of attorneys and accountants to assist the trustee in the administration of the estate. Part III governs the proof of, and objections to, claims and the

\textsuperscript{41} Gignoux, supra note 37, at 16.
\textsuperscript{42} See note 2 supra.
\textsuperscript{43} See note 4 supra.
\textsuperscript{44} Official Forms 6 and 7.
\textsuperscript{45} RULES 401 and 601.
\textsuperscript{46} RULES 726-737.
\textsuperscript{47} RULES 707-725.
payment of dividends thereon. Part IV provides for the protec-
tion of the bankrupt by an automatic stay of certain actions
on unsecured debts, for preservation of his exemptions, and for
procedural protections in matters respecting objections to dis-
charge or to the dischargeability of any debt. Part IV also im-
poses on the bankrupt a duty to cooperate with the court in mat-
ters affecting the liquidation of the estate or relating to his right
to a discharge or to the dischargeability of debts. Part V is a set
of in-house rules primarily concerned with prescribing the types
of records which must be kept by the court, and providing for
the delegation of ministerial functions by the bankruptcy judge.
Part VI provides for an automatic stay of enforcement of liens
against the property of the bankrupt and spells out the procedure
to be followed in the recovery or abandonment of property by
the trustee in connection with liquidation of the estate. Part VII
specifies the procedure for commencement of adversary proceed-
ings between the trustee and the bankrupt or third parties re-
specting property of the estate, or between third parties and the
bankrupt in regard to the bankrupt’s right to a discharge in
general or with respect to particular debts. Part VIII provides
the manner for perfecting appeals to the district court, while
Part IX is a conglomeration of rules relating to the verification of
pleadings and other papers, objections to jurisdiction of the bank-
ruptcy court, contempt proceedings, and various other matters.

Examining the highlights of Part I in more detail, it will first
be seen that this section of the rules accomplishes a change in
terminology. A bankruptcy “case” rather than a bankruptcy
“proceeding” is commenced by filing a petition. The word “pro-
ceeding” as used in the rules refers to a “... litigated matter
arising within a case during the course of administration of an
estate.”

Filing fees may still be paid in installments under the new
rules but they must be paid in full before the bankrupt may pay
his attorney for services in connection with the case. Dismissal
of a case for non-payment of the filing fees is without prejudice,
thus enabling the bankrupt to refile at a later date.

\[48 \text{ RULE 101, Advisory Committee's note.}
\[49 \text{ RULE 107.}
\[50 \text{ RULE 120.} \]
A voluntary petition may be filed with the clerk if accompanied by a list of all the bankrupt's creditors and their addresses as long as the schedules and statement of affairs are forthcoming within ten days thereafter. This rule is designed to permit expeditious filing on behalf of a bankrupt who may need to take advantage of the automatic stay against the commencement or continuation of suits on unsecured debts or against the enforcement of liens against his property. Additional time for filing the schedules and statement of affairs may be obtained on appropriate application to the court.

A joint petition on behalf of a partnership and the general partners is no longer permitted. Separate petitions must be filed on behalf of the partnership and any of the general partners filing for bankruptcy, although the cases may be consolidated for purposes of administration. If only the partnership entity files bankruptcy, the unadjudicated general partners must nevertheless file a statement of their assets and liabilities with the trustee of the partnership since their individual assets are subject to liquidation for payment of partnership debts.

Bankrupts who inherit property within six months after bankruptcy are required to file supplemental schedules describing the property inherited. The duty to file such supplemental schedules continues notwithstanding the fact the case may have been closed.

In order to facilitate the liquidation of assets the concept of venue has been expanded to permit petitions to be filed by or against related entities in the court which first obtains jurisdiction of one of the parties. For example, if a petition by or against a parent corporation is pending in the district, a petition may be filed by or against an affiliate corporation even though it may not do business in the district, it has no property in the district, and its principal office is located elsewhere. A petition by or against a general partner may be filed in a district where a petition by or against the partnership is pending, even though the general partner may not be a resident of the district. Likewise, a partnership

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51 Rule 108(b).
52 Rule 105.
53 Rule 108(c).
54 Rule 108(e).
55 Rule 116(a)(4).
doing business elsewhere may be adjudged a bankrupt in the district where a petition by or against one of the general partners is pending.\textsuperscript{66}

The right of trial by jury on the issues raised by an involuntary petition in bankruptcy is preserved. However, the jury trial may be conducted by the bankruptcy judge unless the bankrupt specifically demands such a trial before the district judge.\textsuperscript{67}

One notable reform accomplished by the new rules eliminates the multiplicity of signatures required of the bankrupt on the petition and statement of affairs. Only one signature is now required for the petition, and only one for each of the schedules and statements of affairs.\textsuperscript{58} Rule 911(c) allows the filing of photo-copies or similarly conformed copies of the petition. Under Rule 911(b) verification is excused for all pleadings except the petition, schedules, and statement of affairs which must still be verified under Rule 109.

Part II of the rules effects changes which expedite the processing of no-asset cases. In those cases in which it appears likely that there are no assets which can be used to pay a dividend, the court may give the creditors notice to that effect and inform them that they need not file claims. The notice may advise creditors that if sufficient assets become available for the payment of dividends the "... court will give further notice of the opportunity to file claims and the time allowed therefore."\textsuperscript{59} The purpose of this rule is to relieve the court of the administrative burden of processing claims in those cases in which there is no likelihood that the creditors will receive a dividend. In the smaller asset cases a final meeting of creditors is dispensed with if the net proceeds realized do not exceed $250.00.\textsuperscript{60} Also, in no-asset cases, the court may in its discretion order that no trustee be appointed.\textsuperscript{61}

In the smaller asset cases, in order to save the expense of a bond premium, the trustee may be excused from filing a bond and may qualify by filing an acceptance.\textsuperscript{62} Additionally, in such

\textsuperscript{56} Rule 116(a)(3).
\textsuperscript{57} Rule 115.
\textsuperscript{58} Official Forms 1, 6 and 7.
\textsuperscript{59} Rule 203(b).
\textsuperscript{60} Rule 204(c).
\textsuperscript{61} Rule 211.
\textsuperscript{62} Rule 212(d).
cases the court may authorize the trustee or receiver to act as his own attorney or accountant and award him additional compensation therefor, on the theory that combining these offices in one person may result in a savings in the cost of administration.\textsuperscript{63}

The hand of the court in controlling the activities of officers, including the attorney for the bankrupt, involved in the administration of the estate is strengthened by the new rules. Every attorney for the bankrupt, whether or not he applies for compensation, must file with the court on or before the first date set for the first meeting of creditors, unless the court otherwise directs, a statement disclosing the compensation, paid or promised, for services rendered or to be rendered in the case, the source of compensation, and whether the attorney has shared or agreed to share such compensation with any other person.\textsuperscript{64} The disclosure statement provided for by this rule is designed to assist the court in policing the requirement of Rule 107(3), which postpones payment of attorney fees until the filing fees are paid in full. It also enables the court to fulfill its duty to examine any payment of money or transfer of property from the bankrupt to his attorney which may appear to be excessive, and to order the amount of any excess paid to the trustee for the benefit of the estate or refunded to the bankrupt. An attorney who seeks and is awarded compensation from the estate is precluded from sharing the compensation with a forwarding attorney unless the attorney sharing in the compensation has actually contributed to the services for which the compensation is allowed.\textsuperscript{65}

An innovative provision in Part III of the rules dealing with claims and distribution to creditors permits the bankrupt to execute and file a proof of claim in the name of a creditor having a provable claim for taxes or wages if the creditor fails to file his claim on or before the first date set for the initial meeting of creditors. The court must give notice of the filing of such a claim to the creditor and to the trustee. Thereafter, the creditor may file a proof of claim which supersedes the proof filed by the bankrupt.\textsuperscript{66} This rule is designed primarily to protect the bankrupt against the consequence of the failure of taxing authorities

\textsuperscript{63} Rule 215(e).
\textsuperscript{64} Rule 219(b).
\textsuperscript{65} Rule 219(d).
\textsuperscript{66} Rule 303.
to timely file proofs of claim. Generally speaking, tax claims are entitled to priority in payment out of the assets of the estate and are non-dischargeable in bankruptcy. To the extent that the claim is paid out of the estate, the bankrupt is relieved from payment of the claim following bankruptcy. Where nonpayment of the claim out of the assets of the estate results from the failure of the taxing authority to timely file its proof of claim, the bankrupt suffers the consequence of this failure through no fault of his own and will ordinarily remain obligated for payment of the claim because tax claims are excepted from discharge in bankruptcy.

A parallel rule permits a co-debtor with the bankrupt to file a claim on behalf of the creditor which they jointly owe, but only if the creditor fails to file his claim on or before the first date set for the first meeting of creditors. The purpose of this rule is to relieve the co-debtor of the obligation to pay the debt to the extent that it may be paid out of the estate. However, no distribution may be made on such a claim except upon satisfactory proof that the original debt will be diminished by the amount of the distribution. The proof of claim filed by the co-debtor is superseded by a claim subsequently filed by the creditor.67

Claims must still be filed within six months after the date first set for the first meeting of creditors, subject to the power of the court to grant a reasonable fixed extension of time for the filing of a claim by the United States, a state or subdivision thereof, or on behalf of an infant or incompetent person without a guardian. Also, in those cases in which creditors were given notice not to file claims because a dividend appeared unlikely, but the payment of a dividend subsequently appears possible, creditors may file proofs of claim within sixty days after the mailing of a notice to file claims even though the six-month period for filing claims may have expired.68

Rule 306 relieves the court of the burden of making orders allowing each individual claim by providing that claims shall be deemed allowed for the purpose of distribution unless objection is made by a party in interest. The trustee is under a duty to examine proofs of claim and object to the allowance of im-

67 Rule 304.
68 Rule 302(e).
proper claims unless no purpose would be served thereby. An objection to the allowance of a claim must be in writing and the creditor must be given notice of the hearing on the objection. If a secured creditor files a proof of claim, the value of the secured interest held by him as collateral for his claim must be determined by the court, and the claim may be allowed only to the extent it is enforceable for any excess of the claim over such value.\footnote{69} In order to reduce the administrative burden of issuing checks for minuscule amounts, the court may order that no dividend of less than $1.00 shall be distributed by the trustee to any creditor.\footnote{70}

The rules in Part IV do not impose any new duties\footnote{71} upon the bankrupt, but they do confer new benefits. One such benefit is the automatic stay provided for by Rule 401. Under this rule the filing of a petition operates as a stay of the commencement or continuation of any action against the bankrupt founded on unsecured provable debts, except debts for taxes, wages, bond monies due employees, or for alimony or maintenance. The stay remains in effect perpetually unless the bankruptcy case is dismissed or the bankrupt waives or otherwise loses his right to a discharge. Provision is made for a creditor to obtain relief from the stay by filing a complaint with the bankruptcy court and showing cause therefor.\footnote{72}

Unless objected to by a creditor within the 15-day period provided for by the rules, the trustee's report of exempt property becomes final without the necessity of a formal order of approval by the court.\footnote{73} If a bankrupt fails to claim his exemptions, provision is made for his spouse or dependent children to claim them in order that they may not be prejudiced by the bankrupt's failure to make timely application for the exemptions in the schedules to his petition.\footnote{74}

The rules permit the time for objecting to the discharge of the bankrupt or to the dischargeability of a particular debt to

\footnotesize{\begin{itemize}
  \item \footnote{69} Rule 306.
  \item \footnote{70} Rule 309.
  \item Under Rule 402 the bankrupt remains under a duty to attend hearings and to cooperate with and make full disclosures to the trustee in connection with the administration of the estate.
  \item \footnote{72} Rule 401.
  \item \footnote{73} Rule 403.
  \item \footnote{74} Rule 403(f).
\end{itemize}}
be shortened to as little as ten days if it appears there will be no dividend to creditors. The time for filing a complaint objecting to discharge or to the dischargeability of a debt may be fixed as early as the first meeting of creditors, which can be set on ten days notice. Ordinarily, however, the time for filing a complaint objecting to discharge or to the dischargeability of a debt will not be fixed at less than thirty nor more than ninety days after the date first set for the first meeting of creditors. The provision in Section 14c(8) of the Act which shifts the burden of proof to the bankrupt in a trial upon objections to discharge, if the objecting creditor makes out a prima facie case, has been superseded. Rule 407 provides that at the trial on a complaint objecting to the discharge, the plaintiff has the burden of proof. If no complaint objecting to the discharge has been filed and the bankrupt has submitted himself to examination at the first meeting of creditors and has paid the filing fee, the court must grant him a discharge. A new requirement imposes on the court a duty to mail a copy of the order of discharge to all creditors. Additional protection is provided by a rule which permits the discharge to be registered in the office of the clerk of any district court of the United States and when so registered the order has the effect of an order of the court of that district, and may be enforced by orders issuing from that court. This rule is intended to protect the bankrupt in the event that he moves to a foreign district and is subject to suit in that district by a creditor whose debt was discharged in bankruptcy.

Some of the in-house rules in Part V are designed to centralize administration in the office of the bankruptcy judge and to permit him greater leeway in delegating ministerial functions. A petition commencing a bankruptcy case must be filed in the office of the clerk of the district court; however, after reference, all amendments, complaints, and other types of pleadings must be filed in the office of the bankruptcy judge. All papers filed in a bankruptcy case, the bankruptcy judge’s docket, and the list of claims,

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75 Rules 404 and 409.
76 Rule 404(d).
77 Rule 404(b).
78 Rule 404(g).
79 Rule 509.
if any, are public records. The bankruptcy judge may delegate most ministerial functions—for example the issuance of a summons and notice of trial—to an assistant employed in his office. The requirement of a public examination of the bankrupt is retained. A new requirement is that whenever practicable the court must make a record, by sound recording or by a reporter, of all proceedings in bankruptcy cases.

Part VI of the rules relating to the collection and liquidation of the estate provides for an automatic stay of enforcement of liens upon the bankrupt's property which is in the custody of the bankruptcy court. The stay continues in effect until the case is dismissed or closed, or until the property subject to the lien is, with approval of the court, set apart as exempt, abandoned, or transferred. However, the court may, for cause shown, terminate, annul, modify, or condition the stay on a complaint by a creditor seeking relief therefrom.

If the bankrupt owns real property the rules provide for a filing of a certified copy of the bankruptcy petition, without the schedules, in the office of the county court clerk to notify the public that the debtor's property is involved in a bankruptcy proceeding. With respect to personal property, the trustee is under a duty to give notice of the bankruptcy to every person known to be holding money or property subject to withdrawal or order of the bankrupt, including every bank, building and loan association, public utility company, landlord with whom the bankrupt has a deposit, and every insurance company which has issued a policy having a cash surrender value payable to the bankrupt. However, failure to give such notice does not validate post-bankruptcy transfers of property of the bankrupt.

A state court receiver or trustee or assignee for the benefit of creditors who has custody of property of the debtor when bankruptcy intervenes must promptly file a written report and account with the bankruptcy court for the property of the estate

80 Rule 503.
81 Rule 506.
82 Rule 501(b).
83 Rule 511.
84 Rule 601(c).
85 Rule 602(a).
86 Rule 602(b).
and its administration. The propriety of such administration, including the reasonableness of all disbursements made before the intervention of bankruptcy, are subject to review by the bankruptcy court.\textsuperscript{87}

The provision that sales in bankruptcy proceedings must be by public auction, unless otherwise ordered by the court upon application to the court and for good cause shown, is retained, as well as the provision for selling encumbered property free of liens where the holder of an interest in the property can be compelled to take a money satisfaction.\textsuperscript{88} The trustee is authorized to abandon property of inconsequential value; he is likewise authorized to redeem property from a lien or from a sale to enforce a lien to preserve the equity value of the property for the estate.\textsuperscript{89} Moreover, the trustee or receiver may, with or without court approval, prosecute or enter an appearance and defend any action or proceeding on behalf of the estate, before any tribunal.\textsuperscript{90} Control of disbursement of monies of the estate has been relaxed so as to permit the trustee to withdraw funds by check without the countersignature of the bankruptcy judge.\textsuperscript{91} The purpose of this rule is to relieve the bankruptcy judge of the ministerial function of countersigning checks.

The numbering of the rules in Part VII governing adversary proceedings is correlated with the numbering of the Federal Rules of Civil Procedure. An adversary proceeding to recover money or property, determine the validity of a lien, sell property free of a lien or other interest, object to or seek revocation of a discharge, obtain an injunction or relief from the automatic stay provided in Rule 401 or 601, or determine the dischargeability of a debt is commenced by filing a complaint with the court in the bankruptcy case.\textsuperscript{92} The summons and notice of trial issued by the court upon the filing of such a complaint retains the feature of the show cause order which permits not only the time for answer but also the date of the trial to be fixed by the summons. The summons, complaint, and notice of trial may be served

\textsuperscript{87} Rule 604.
\textsuperscript{88} Rule 606.
\textsuperscript{89} Rules 608 and 609.
\textsuperscript{90} Rule 610.
\textsuperscript{91} Rule 605.
\textsuperscript{92} Rules 701 and 703.
personally upon the defendant as provided by Rule 4(d) of the Federal Rules of Civil Procedure. However, it is contemplated that the innovative alternative method which allows service by any form of mail requiring a signed receipt will be the principal form of service used.\textsuperscript{93}

A most important change\textsuperscript{94} from prior practice authorized by the rules is the provision for nationwide service of process, thereby eliminating any doubt as to the validity of extraterritorial service of process in bankruptcy proceedings.\textsuperscript{95} The procedure for service of process by mail is as follows. The court issues a summons and notice of trial and causes it to be delivered, either personally or by mail, to the attorney for the complainant, who in turn is responsible for mailing the summons, complaint, and notice of trial by mail in a form which requires a signed receipt within three days after issuance of the summons.\textsuperscript{96} When the signed receipt accompanying the registered or certified letter is returned to the attorney, he must file with the court an affidavit of service with the receipt attached thereto as proof that service of process was accomplished.\textsuperscript{97}

The 25-day period allowed for filing an answer to the complaint is computed from the date of issuance of the summons and notice of trial, as opposed to the Federal Rules of Civil Procedure, which allow 20 days from the date of service.\textsuperscript{98} Generally, this time frame enables the court to set a date for trial no more than 30 days after the filing of the complaint and the issuance of the summons. The 25-day period is, however, subject to extension or reduction by the court for cause shown as provided in Rule 906, and the date for trial may be advanced or postponed accordingly.

The Federal Rules of Civil Procedure governing counterclaims and cross-claims, third-party practice, amended and supplemental pleadings, pretrial procedure, joinder of claims and remedies, joinder of persons needed for a just determination, permissive joinder of parties, interpleader, intervention, and substitution of

\textsuperscript{93} Rule 704(e).
\textsuperscript{94} Rule 704(f).
\textsuperscript{95} Id.
\textsuperscript{96} Rule 704(e).
\textsuperscript{97} Rule 704(e).
\textsuperscript{98} Rule 712.
parties are made applicable to adversary proceedings. Likewise, the Federal Rules of Civil Procedure governing discovery are incorporated into adversary bankruptcy proceedings. Adaptations of the Federal Rules of Civil Procedure governing dismissal of adversary proceedings, entry of and relief from default judgments, summary judgments, stay of proceedings to enforce judgments, seizure of personal property, and injunctions also appear in the bankruptcy rules governing adversary proceedings. Finally, the bankruptcy judge is required to state separately his findings of fact and conclusions of law and to enter the judgment in the form of a separate document, as is the case under the Federal Rules of Civil Procedure.

The manner of taking appeals is governed by Part VIII of the Rules. The petition for review provided for by Section 39c of the Act has been abolished and replaced by a procedure whereunder the appellant must file a notice of appeal with the bankruptcy judge within ten days after the date of the entry of the judgment or order appealed from. The running of the time for filing a notice of appeal is tolled as to all parties by the filing of a timely motion for a new trial or to alter or amend the judgment. The time to appeal commences to run, and is computed, from entry or an order granting or denying such a motion. The bankruptcy judge may extend the time for filing a notice of appeal for a period not to exceed 20 days beyond the initial ten-day period, provided the request for the extension is made before the expiration of the initial period. A request for an extension of time for filing a notice of appeal made after expiration of the ten-day period may be granted only upon a showing of excusable neglect. Within ten days after filing the notice of appeal the appellant must file with the bankruptcy judge and serve on the appellee a designation of the contents of the bankruptcy proceeding record for inclusion in the record on appeal and a statement of the issues he intends to raise on the appeal. The time for filing briefs is fixed by Rule 808, and Rule 809 authorizes the dis-

99 Rules 713, 714, 715, 724, and 725.
100 Rules 726, 728, 729, 732, 733, 734, 735, 736, and 737.
101 Rules 741, 755, 756, 762, 764, and 765.
102 Rules 752 and 921(a).
103 Rule 802.
104 Rule 806.
strict judge to afford the parties an opportunity to be heard on oral argument.

In the general provisions appearing in Part IX the "referee" is given the new title "Bankruptcy Judge", which explains the use of the term throughout this article.\textsuperscript{105} To help insure orderly proceedings in bankruptcy court, he is empowered to summarily punish for a contempt committed in his presence by imposing a fine of not more than $250.00 and may similarly punish for contempt committed out of the presence of the court after hearing on notice.\textsuperscript{106}

The bankruptcy judge is not required to preside at examinations of the bankrupt other than at the first meeting of creditors. It is contemplated that subsequent examinations of the bankrupt and other persons concerning transactions with the bankrupt will be by way of deposition or through use of other discovery devices.\textsuperscript{107}

\textbf{CHAPTER XIII RULES}

For the most part, the Chapter XIII rules (those relating to wage earner's plan cases) conform to the straight bankruptcy rules. For example, the rules governing adversary proceedings and appeals in Chapter XIII cases are essentially the same as those applicable to straight bankruptcy. There are, however, some special features of the Chapter XIII rules which should be noted. It is permissible for a husband and wife to file one petition under Chapter XIII;\textsuperscript{108} whereas, a joint petition by the husband and wife is not permitted in straight bankruptcy cases. The concept of venue has been expanded to permit a debtor to file his petition either in the district in which he has his principal place of employment or in the district where he has his residence or domicile.\textsuperscript{109} The Chapter XIII statement of affairs has been changed so as to elicit information for which a biographical profile as well as a debt profile of the debtor can be drawn.\textsuperscript{110} This new information may be pertinent for consideration by the court in making a determination as to whether the plan should be confirmed.

\textsuperscript{105} \textit{Rule 901(7)}.
\textsuperscript{106} \textit{Rule 920}.
\textsuperscript{107} \textit{Rule 205}.
\textsuperscript{108} \textit{Rule 18-111}.
\textsuperscript{109} \textit{Rule 18-110}.
\textsuperscript{110} \textit{Rule 18-107}; \textit{Official Form 13-5}.
Under prior practice the plan could be filed as late as the first meeting of creditors, and there was no requirement that a copy of the plan be served upon creditors. Under the new Chapter XIII rules the plan must accompany the petition or be filed within ten days thereafter, or within such further time as may be granted by the court for cause shown. Either a copy or summary of the plan must accompany the notice of the first meeting of creditors.\textsuperscript{111}

There are pitfalls in the new Chapter XIII rules for the unwary secured creditor. The rules provide that a claim not properly filed by the secured creditor on or before the date first set for the first meeting of creditors shall not be treated as a secured claim for purposes of voting and distribution in a Chapter XIII case.\textsuperscript{112} This means that claims of secured creditors filed after the first meeting can be paid only as unsecured claims. A question left unanswered by the rules is whether some provision must be made to protect the secured creditor against depreciation of the security during the period of consumation of the plan. If a secured creditor seasonably files a claim, the value of the security held by him as collateral must be determined by the court. The claim can be allowed as a secured claim only to the extent of the value of the security as determined by the court and must be allowed as an unsecured claim with regard to the balance.\textsuperscript{113} A creditor whose claim is allowed in part as a secured and in part as an unsecured claim is entitled to accept or reject a plan in both capacities unless the secured claim is not dealt with by the plan, in which event he is entitled to accept or reject only as an unsecured creditor.\textsuperscript{114}

The usual six-month period for filing claims remains applicable for creditors whose claims are treated as unsecured.\textsuperscript{115} However, post-petition claims for taxes and for property or services needed to assure proper performance under the plan by the debtor are now allowable in a Chapter XIII case.\textsuperscript{116}

One new feature in the Chapter XIII rules must have gone

\textsuperscript{111} Rule 13-201.
\textsuperscript{112} Rule 13-302(e)(1).
\textsuperscript{113} Rule 13-307(d).
\textsuperscript{114} Rule 13-202(c).
\textsuperscript{115} Rule 13-302(e)(2).
\textsuperscript{116} Rule 13-305.
unnoticed by the taxing authorities. It permits the debtor to include in the plan a provision to the effect that creditors entitled to priority shall be deemed to have waived such priority upon their failure to reject the plan prior to the first meeting of creditors. Delinquent and accrued taxes, otherwise entitled to priority, could easily lose their preferred status under this rule.

If a creditor fails to file his claim on or before the date first set for the first meeting of creditors, either the debtor or trustee may file a proof of claim in the name of the creditor. This rule does not authorize the debtor or trustee to vote the claim; it merely assures the creditor of a distribution under the plan. The creditor may later file a claim which supersedes the claim filed on his behalf by the debtor or trustee. Likewise, a person who is a co-debtor with the debtor on an obligation for which the creditor fails to file his proof of claim on or before the first date set for the first meeting of creditors may file a proof of claim in the name of the creditor. The co-debtor can even vote the claim in behalf of the creditor. But, the rules provide that no distribution shall be made on the claim except upon satisfactory proof that the original debt will be diminished by the amount of the distribution. Here, too, the creditor may later file a proof of claim which supersedes the claim filed by the co-debtor.

The provision in the Chapter XIII rules for automatic stay of actions against the debtor and of the enforcement of liens against his property is broader in scope than the automatic stay provided for in straight bankruptcy cases. This is so because nondischargeable debts are not excluded from the force and effect of the automatic stay provided for in Chapter XIII cases. Ordinarily, the purpose of Chapter XIII is to enable the debtor to pay his debts in full. Consequently, the question of the dischargeability of a particular debt will not often arise in the context of a Chapter XIII proceeding. The rules, however, do authorize any creditor to file a complaint with the court to obtain a determination of the dischargeability of any debt. On or before the completion of the plan by the debtor the court must make

117 Rule 13-309(a)(3).
118 Rule 13-303.
119 Rule 13-304.
120 Rule 13-401.
an order fixing the time for filing such dischargeability complaints.\textsuperscript{121}

THE PROPOSED BANKRUPTCY ACT OF 1973

In 1970 Congress provided for the creation of the Commission on Bankruptcy Laws for the United States.\textsuperscript{122} The congressional charge to the Commission was to study, analyze, and evaluate the present bankruptcy laws, and to consider the philosophy and causes of bankruptcy, possible alternatives to the present system of bankruptcy administration, the applicability of advanced management techniques for better efficiency in the administration of the Act, and all other matters which the Commission might deem relevant.\textsuperscript{123} On July 30, 1973, the Commission filed its report with the President, Congress, and the Chief Justice of the Supreme Court.\textsuperscript{124} The Commission was unusual among presidential commissions in that it not only prepared a report of its findings but also wrote a new bankruptcy act embodying its recommendations.\textsuperscript{125} The Commission bill, entitled "The Bankruptcy Act of 1973" was introduced in both houses of Congress in late 1973.\textsuperscript{126} The House and Senate judiciary committees are expected to begin hearings on the bill sometime during the year 1974.

There appears to be little objection to the Commission's proposal for the establishment of a separate and independent bankruptcy court vested with jurisdiction to determine most controversies arising from cases commenced under the Act.\textsuperscript{127} A comprehensive grant of jurisdiction to the bankruptcy courts over controversies arising out of any bankruptcy or rehabilitation case would greatly diminish the basis of litigation of jurisdictional issues which consume so much time, both of the bankruptcy system and of those involved in the administration of debtors' affairs. It would foster the development of a more uniform, cohesive body of substantive and procedural law which would be applicable to the administration of estates under the Act. The

\textsuperscript{121} RULE 13-407.
\textsuperscript{122} Pub. L. No. 91-354 (July 24, 1970).
\textsuperscript{123} Id.
\textsuperscript{125} REPORT, Part II.
\textsuperscript{126} See note 5 supra.
\textsuperscript{127} REPORT, Part I, at 85.
withdrawal from state and federal courts of the jurisdiction of the so-called plenary proceedings, when coupled with the establishment of uniform federal standards and rules as proposed by the Commission for adoption and application in lieu of diverse state laws governing debtors' and creditors' rights, would eliminate a major source of uncertainty and division which has long characterized bankruptcy law.\textsuperscript{128}

The proposed new bankruptcy court with comprehensive jurisdiction has been patterned somewhat after the tax court. The judges of the court would be appointed by the President, with the advice and consent of the Senate, for terms of fifteen years. The territorial boundaries and territorial jurisdiction of the bankruptcy court would be fixed by the Judicial Conference of the United States and would not necessarily be conterminous with that of the present United States district or circuit courts, or with state lines.\textsuperscript{129}

The Commission has sought to enhance the real and apparent judicial independence of bankruptcy judges through the separation of administrative and judicial functions. However, the Commission's recommendation to separate the bankruptcy courts from matters involving administration by vesting administrative functions in a newly created agency in the Executive Branch, to be called the United States Bankruptcy Administration,\textsuperscript{130} has generated considerable opposition.\textsuperscript{131} In a sense, this recommendation is somewhat passé in that Congress has twice previously rejected similar recommendations,\textsuperscript{132} and it seems likely that total responsibility for the bankruptcy process will remain in the Judicial Branch.

The Commission proposes that the President be authorized to appoint an Administrator as the principal executive officer for conducting the business and affairs of the Bankruptcy Administration. The Administrator would maintain a central office in Washington, D.C. and would establish such regional and local offices as he deemed necessary in order to make the bankruptcy

\textsuperscript{128} Id. at 90-91.
\textsuperscript{129} Id. at 85.
\textsuperscript{130} Id. at 103.
process available to the public. He would be authorized to appoint other officers of the administration who would serve at his discretion and to hire employees for lesser positions under the classified civil service system. The Administrator further would be permitted to delegate to such officers and employees as many of his assigned duties as he desires.\textsuperscript{133}

The principal objectives underlying the proposal to create the independent administrative agency are increased uniformity in bankruptcy administration and the elimination of conflict between the judicial and administrative responsibilities of the bankruptcy judges. However, a functional analysis of the responsibilities assigned by the Commission to the proposed United States Bankruptcy Administration suggests that this agency would have far more conflicting responsibilities than the bankruptcy court has under the present system. The Administrator would be authorized, and at various times required, to serve as clerk of the court, counsel to debtors, advisor and consultant to creditors, appointer of fiduciaries, trustee, receiver, appraiser, liquidator, litigant, distributing agent, court advisor, rule-maker, regulator of fees, and judge, as well as the head of an independent federal agency within the Executive Branch of government.\textsuperscript{134}

Instead of separating judicial and administrative functions, the Commission seems to have further integrated them in the hope that a bright administrator might be able to compartmentalize the functions of his office in such a manner as to minimize the conflicts.

It has been suggested that the necessary efficiency and uniformity, both administrative and procedural, as well as the desired reallocation of the power to appoint and the duty to supervise trustees and receivers can be more economically and effectively accomplished through enlargement of the administrative authority and responsibilities of the Administrative Office of United States Courts if accompanied by the segregation of the present clerical staffs of the local bankruptcy courts from the bankruptcy judges. This can be done, it is proposed, by sub-ordinating these clerical staffs to the Administrative Office of the United States Courts. Such an approach appears far superior

\textsuperscript{133} \textit{Report}, Part I, at 117.
\textsuperscript{134} \textit{Cyr}, \textit{supra} note 180, at 60-67.
to the Commission proposal because the clerks of the bankruptcy courts would have responsibility for the performance of only administrative and clerical duties, unlike the proposed Bankruptcy Administration, which would be created as a veritable corporate compendium of conflicting interests, powers, and duties.\textsuperscript{135} 

In addition to the chapters detailing the structure of the proposed new bankruptcy court and the Bankruptcy Administration, the commission bill, in separate chapters, provides for liquidation bankruptcies,\textsuperscript{136} plans for debtors with regular income,\textsuperscript{137} reorganizations,\textsuperscript{138} adjustment of debts of political subdivisions,\textsuperscript{139} and railroads reorganizations.\textsuperscript{140} There is also a general chapter detailing provisions generally applicable to all types of cases.\textsuperscript{141} 

The bill contains one significant departure from current liquidation procedures by contemplating that the Administrator will serve as trustee in most such cases.\textsuperscript{142} The selection of private trustees as permitted by the present Act would be the exception rather than the rule. 

The provisions of the Commission bill for debtors with regular income would modify present Chapter XIII in several respects. The class of eligible petitioners would be expanded to include individuals whose principal income is derived from retirement benefits, welfare payments, or any other similar source, as well as from wages, salary, or commissions.\textsuperscript{143} The present requirement that the debtor's plan be accepted by the majority, in number and amount, of creditors affected thereby would be eliminated. Under the commission proposal a plan could be confirmed without creditor consent so long as it safeguards their interests. The Commission has also made proposals whereby secured creditors may be bound by the plan so long as they are protected to the extent of the value of their collateral.\textsuperscript{144} Imposition of a moratorium on collections from co-debtors for as long as the

\textsuperscript{135} Id. at 59. 
\textsuperscript{136} Report, Part II, at 183. 
\textsuperscript{137} Id. at 201. 
\textsuperscript{138} Id. at 217. 
\textsuperscript{139} Id. at 263. 
\textsuperscript{140} Id. at 273. 
\textsuperscript{141} Id. at 67. 
\textsuperscript{142} Id. at 183. 
\textsuperscript{143} Id. at 3, 73. 
\textsuperscript{144} Id. at 207.
debtor is performing under the plan is likewise recommended.\textsuperscript{145} Present Chapters X, XI, and XII have been combined by the proposed act into a single chapter on reorganizations. A major attribute of this proposal is that it would permit a plan to affect the rights of secured creditors in all reorganization cases.\textsuperscript{146} Under the present Act secured creditors may not be dealt with in a plan of arrangement under Chapter XI.\textsuperscript{147} The principal problem resulting from the proposed merger of these chapters would be the apparent elimination of the relatively speedy rehabilitation of business entities through use of the composition which is presently available under Chapter XI of the Act. The Commission proposes that the so-called absolute priority rule now adhered to in Chapter X cases be made applicable to all reorganization proceedings.\textsuperscript{148} Under this rule, creditors of the highest class must be paid in full before creditors in the next highest class may receive any payment. Since trade creditors generally occupy a higher status than that of equity security holders (stockholders), this would mean that trade debts would have to be paid in full before the stockholders, or in the event of an unincorporated business the proprietor or the partners, would be permitted to retain any interest in the business. Predictably, application of this rule would result in the liquidation of most business enterprises involved in reorganization proceedings.

The chapter providing for adjustment of debts of political subdivisions has also been rewritten. Under the new provisions cities, counties, water and sewer districts, and other taxing entities that may have become over extended as a result of the sale of obligations for public improvements would find bankruptcy more accessible.\textsuperscript{149}

The Bankruptcy Administration proposal notwithstanding, many of the aforementioned recommendations of the Commission are relatively non-controversial. The commission bill, however, may be challenged in regard to its treatment of certain other crucial issues of substantive law. For example, its proposal that the six-year bar to successive discharges in bankruptcy be

\textsuperscript{145} Id. at 214.
\textsuperscript{146} Id. at 236, 241-243.
\textsuperscript{149} Id. at 263.
reduced to five years and that the court be empowered to grant a subsequent discharge without regard to the five-year bar in hardship cases, is a likely target for considerable criticism. The same holds true for the proposed abolition of the concept of acts of bankruptcy. The Commission’s plan would permit one creditor with an unsecured claim in excess of $2,500.00 to petition a debtor into liquidation. One creditor with a claim of $10,000.00 would be permitted to petition a debtor into reorganization. The present bankruptcy balance sheet method of insolvency would be discarded. Relief could be granted on a creditor’s petition on proof that the debtor generally fails to pay his debts as they become due, which is the equity test of insolvency. A third controversial provision would reduce the priority for tax claims from three years to one year—that is, only those taxes which accrue within one year of bankruptcy would enjoy priority.

The Commission also proposes to use federal standards to identify which property is to be deemed exempt and thus set apart from the debtors who come into the bankruptcy court. The present system, under which the debtor’s exemptions are determined by reference to the law of his domicile, tends to frustrate the constitutional mandate of uniformity in the application of the bankruptcy laws. The proposed federal exemption law covering all types of exempt property would supersede the state law in determination of the debtor’s exemptions in bankruptcy cases. Dollarwise, under the proposed exemption statute the exemptions might total as much as $8,000.00 in the ordinary consumer bankruptcy case. By comparison, under present state laws such exemptions might be considered penurious in some states and magnanimous in others.

The fradulent financial statement would be eliminated as a ground for an objection to the discharge of a bankrupt. Likewise, it would be eliminated as a ground for objecting to the dischargeability of a consumer debt. The Commission would also rewrite the law of preferences so as to reduce the present four-

150 Id. at 132-33.
151 Id. at 74.
152 Id. at 109-11.
153 Id. at 125-27.
154 Id.
155 Id. at 132-37.
month shadow period for invalidating payments on antecedent debts to three months. The term “antecedent debt” has been redefined to exclude from its meaning payments on debts for personal services or utility bills, incurred within three months of the petition, and to provide for other exclusions which would dramatically reduce the number of transactions which might fall within the definition of a preference. In addition, an attempt has been made to solve the problem presented by the blanket security agreement covering inventory and accounts receivable by application of the “net result” rule. Under this rule the position of the secured creditor three months preceding bankruptcy would be compared to his position on the date of bankruptcy. To the extent that his position may have improved, as a result of an increase in inventory or accounts receivable in relation to the amount of his outstanding debt, the net increase would be considered preferential.

These and other changes proposed by the Commission on Bankruptcy Laws involve major policy considerations and will undoubtedly undergo careful scrutiny by Congress. Moreover, it seems probable that other organizations such as the National Conference of Bankruptcy Judges and the National Bankruptcy Conference will submit to Congress alternative proposals for bankruptcy reform worthy of serious consideration. Speculation as to the exact nature and content of the resulting legislation is, therefore, hazardous and of dubious value. Still, it is highly unlikely that the exhaustive work of the Commission will go for naught, and few would argue with the conclusion that momentous changes in the structure of the bankruptcy system and in the substantive bankruptcy law are in the offing.

**Conclusion**

The adoption of the Bankruptcy Act of 1973 or some alternative thereto will be the culmination of a series of major developments which have profoundly altered the law of bankruptcy within the span of only four years. The two achievements

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156 Id. at 166-68.
157 Id. at 168.
158 Id. at 166-68.
which have figured most prominently in that process are the new dischargeability law and the new rules of bankruptcy procedure. Together, they have enhanced the power of bankruptcy courts to enforce orders discharging individual debtors, more clearly defined the relationships between the bankruptcy court and other federal and state courts, simplified and generally upgraded bankruptcy court procedures by bringing them more closely in line with the Federal Rules of Civil Procedure, and provided the impetus for and, to a large extent, the substance of, many basic reforms in the structure of the bankruptcy system. In short, they have made the bankruptcy system more nearly equal to the difficult task of protecting the interests of debtors, creditors, and the state in a fair and efficient manner.