Restructuring Individual Debts[*]

by

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The National Conference of Bankruptcy Judges has asked me to present a proposal at the annual conference dealing with restructuring individual debts. A comprehensive, thoughtful proposal on this topic requires a short book, or at the very least a series of articles. Nevertheless, this essay permits us to tackle the topic from a broad philosophical perspective. Once we agree on the general approach, the details can follow.

This essay assumes that the reader is familiar with individual debt restructuring problems in the United States and the data pertaining to those problems. To place the proposal in context, however, a brief outline of the chapters that would be included in a book on this topic is in order.

Chapter 1 defines the scope of individual debt restructuring and develops the history of individual debt

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restructuring from cave dwellers through the Code of Hammurabi, the Roman Law of the Twelve Tables, Dutch Mercantile Law, English debtors' prisons, and the American Bankruptcy Act of 1898. This chapter develops the different kinds of debts that have been restructured over the years, ranging from contract and tort debts to civil and criminal governmental obligations. Chapter 1 concludes that the purposes of individual debt restructuring have changed over time.

Chapter 2 explores modern approaches to individual debt restructuring around the world. Western European approaches are contrasted with Asian and Muslim views on the subject. This chapter concludes that there are a few basic conflicting modern goals that are balanced differently, depending on religious, cultural, and political values in each society. In particular, societies that restrict access to consumer credit often restrict access to bankruptcy, because there is no broad societal need for debtors to get a fresh start. Likewise, societies with broad social safety nets adopt restrictive bankruptcy laws, because bankruptcy is not precipitated by health bills or loss of employment. On the other hand, countries with massive amounts of consumer credit and limited social safety nets have liberal consumer bankruptcy systems. In order to diminish the

prospects of wide-spread social unrest, these liberal consumer bankruptcy systems grant relief to large numbers of debtors. Generally, these persons are poor but honest debtors who seek relief based on loss of income or rising expenses, which are largely beyond their ability to control.

Chapter 3 discusses individual debt restructuring in the United States, focusing on out-of-court resolution as well as cases under chapters 7, 11, 12, and 13 of the United States Bankruptcy Code. This chapter not only develops the substantive and procedural law involved, but summarizes the available data respecting restructuring costs, uniformity of remedy, and magnitude of indebtedness, assets, income, age, family status, and other attributes that profile individual debtors.

Chapter 4 analyzes the goals and incentives that inform current restructuring laws in the United States. After discussing the traditional goal of equality of distribution of debtors' resources among creditors with similar legal rights, this chapter develops the concepts of discharge of indebtedness and fresh start.

Chapter 5 explores deficiencies in the current restructuring regimes. Tremendous regional variations

continue to exist in both out-of-court and in court remedies. Some individuals are denied relief to which they are entitled because they are poor or uninformed. Others are denied relief because creditors or judges take unfair advantage of them. And others gain relief to which they are not entitled through abuse of the system. The insolvency system itself is exposed as inefficient and unjust. This chapter concludes by stating that reform is necessary and inevitable.

Chapter 6 notes the structural impediments to reform that would be imposed in any situation generally and with respect to individual debt restructuring in particular. The dual state/federal system creates political obstacles to change. Path dependence limits the possibilities for change based on enormous sunk cost in existing systems. And incumbency guarantees that radical reform will be opposed vigorously by creditors, lawyers, accountants, judges, court staff, and others who benefit from the current system. Irrespective of truth, some of these incumbents will make the "chicken little" argument that dramatic change to the current system is "dangerous" and will cause the sky to fall: "Banks will not lend money"; "Consumer credit will evaporate"; "The best consumer credit system in the world will collapse". Even academics who teach and theorize about

individual debt restructuring will rise up to resist radical reform. This chapter concludes by anticipating the stock criticisms that accompany any reform proposal, including the need for further study, the charges that existing data is flawed, that the proponent is acting out of self-interest or conflict of interest, and that the proposed reform will cost too much.

Chapter 7 sets forth the reform proposal. It begins by identifying the goals to be served and the conflicting values that underlie those goals. It next sets forth a proposal that attempts to reconcile competing interests in an inexpensive, just, and speedy manner. Chapter 7 concludes by explaining the proposal. The essence of chapter 7 is what this essay entails.

Chapter 7. The Reform Proposal.

In order to evaluate the proposal to restructure individual debts, we must first identify the goals and principles to be served by such a proposal. Several possible goals and principles come to mind:

- Individual debts should be restructured consensually, if possible.

- Individual debts should be restructured out of court, if possible.

- If intermediaries are required to assist with individual debt restructuring, a private system is preferable to a governmental system.

- Individual debt restructuring that involves more than one debt should treat creditors with similar legal rights similarly.

- Individual debt restructuring should afford the debtor a fresh start, *i.e.*, the debtor should retain sufficient resources to survive and pursue employment without laboring under a debt burden that removes all incentives for the debtor to become productive.

- Individual debt restructuring should not be granted to a debtor with sufficient resources to pay all debts when due.

- Individual debt restructuring should be free from corruption.

- Individual debt restructuring should be inexpensive.

- Individual debt restructuring should be expeditious.

- If individual debts cannot be restructured consensually, they should be restructured by operation of law, if the debtor qualifies.

- Confirmation of a debt restructuring plan should discharge the debtor from all dischargeable debts.

- An individual debtor should qualify for legally-imposed debt restructuring if:

    a. Voluntary debt restructuring has not worked;

b. The debtor has no reasonable likelihood of paying debts as they become due;

c. The debtor has not committed disqualifying bad acts;

d. The debtor has not recently received the benefit of a compulsory debt restructuring; and

e. The debtor has necessary contacts with the United States to invoke our laws.

- In order to obtain the benefits of individual debt restructuring imposed by operation of law, the individual debtor should be required to devote any surplus assets and disposable future income to the repayment of creditors' claims.

- Uniform national guidelines should be enacted to define surplus assets and disposable income.

- Certain debts owed by an individual should not be subject to compulsory restructuring. These nondischargeable debts should include:

    a. All criminal obligations to whomever owed; and

    b. Intentional torts that injure the person or property of another.

- Individual debtors who seek compulsory restructuring should be counseled how to avoid incurring excessive future debts.

- A compulsory restructuring system should be financed first from debtors' resources and second from the federal fisc.

- Government officials should supervise or audit persons who administer compulsory individual debt restructurings.

- The compulsory debt structuring regime should be uniform in application throughout the United States.

- Debtors should be subject to involuntary relief.

The current regime for restructuring individual debts adheres to some but not all of these goals and principles. Variable application of compulsory individual debt restructuring under chapters 7 and 13 of the Bankruptcy Code reflects strong underlying disagreement over some of these principles. For example, data shows that individual debtors use chapter 13 about half of the time in some districts, but only ten percent in other districts. While this discrepancy could be based on different regional attitudes in whether debtors want to devote their future income to repay their debts, a more plausible explanation is that judges and lawyers use their own values to steer individuals toward chapter 7 or 13. The time has come to integrate individual debt restructuring in a unified chapter that will increase the prospects for uniformity.

The following proposal is premised on the goals and premised identified above, as well as the following contentions:

- There is a fundamental inequality of bargaining power between an individual debtor and creditor, favoring the creditor almost invariably.

- Individual debtors cannot afford to litigate to protect their legal rights in many circumstances.

- It is inefficient to use the federal court system to administer most individual debt restructurings.

- Some debtors will seek to obtain the benefits of individual debt restructuring without paying the price required by law to use the system.

- Although consensual individual debt restructuring is preferable to compulsory restructuring, the cost and delay to require an individual debtor to attempt consensual debt restructuring are unacceptable.

- The chapter 13 standing trustee system works well.

- In order to effectuate a debtor's fresh start and induce the debtor to become a productive member of society, reaffirmation agreements should be unenforceable as a matter of law and public policy.

A Proposal for the Restructuring of Individual Debts

1. CIDR in the Judicial Code. Prospectively, chapters 7 and 13 will be consolidated into a single chapter of the Judicial Code to deal with compulsory individual debt restructuring ("CIDR"). Chapters 11 and 12 of the Bankruptcy Code will remain as available options.

2. Eligibility. Any individual is eligible to be a debtor under the single chapter, if, at the time the CIDR petition is filed, the individual is not a stockbroker or commodity broker, has contacts with the United States as set forth in section 109(a) of the Bankruptcy Code, and has not received a discharge under title 11 of the United States Code or in a CIDR within 7 years before the date of the filing of the CIDR petition. (Perhaps sole proprietors should also be ineligible.)

3. Commencement of CIDR. A petition for CIDR may be filed voluntarily or involuntarily (with standards similar to Bankruptcy Code section 303). Although there will be a filing fee payable to the Office of United States trustee, an impecunious debtor can proceed *in forma pauperis*.

4. Venue. The petition is authorized to be filed only with the Office of United States trustee in the district in which the individual resides.

5. Automatic Stay; Possession of Property. Upon the filing of the petition, a statutory automatic stay protects the debtor, its property, and codebtors, and the debtor retains possession of his or her property.

6. Standing Trustee. The United States trustee will appoint and supervise a private standing trustee, similar to the standing chapter 13 trustee under current law, who will administer the CIDR, including disbursements to creditors under the CIDR plan.

7. Standing Trustee's Fees. The standing trustee will be paid capped fees and costs as a percentage of disbursements, as under current law.

8. Schedules. The debtor will file sworn schedules with the United States trustee and standing trustee. The schedules will identify assets and liabilities as well as income and expenses.

9. Debt Counseling. The standing trustee will meet with the debtor, counsel the debtor with respect to the causes of his or her financial difficulties, and discuss ways for the debtor to avoid future financial difficulties.

10. Examination of the Debtor. The standing trustee will review the schedules and examine the debtor with respect to their veracity.

11. Audit of the Debtor. At random (with a weighting toward asset cases), one in every 250 debtors will be subjected to an in depth audit by the office of United States trustee. The purpose of the audit is to verify the accuracy of the schedules to deter corruption. The audits will be financed out of filing fees, just as the current system is self-supporting.

12. Standing Trustee's CIDR Plan. After reviewing the schedules and examining the debtor, the standing trustee must promptly propose a CIDR plan to the debtor.

13. Plan Provisions. The CIDR plan is based on the premise that, as the price for the debtor's fresh start and discharge on confirmation, creditors are entitled to receive the net value, if any, of the debtor's surplus assets plus 4 years' future disposable income, if any.

a. In particular, creditors would receive the net liquidation value of any surplus assets on hand as of the time of the filing of the petition, as well as any disposable income earned within 4 years after the filing of the CIDR (with a floor of zero and a cap so that creditors cannot recover more than payment in full of their allowed claims plus postpetition interest).

b. Unless the plan provides for redemption of surplus assets by the debtor from third party funds or proceeds of nonsurplus assets that the debtor sells, the CIDR plan must provide for the liquidation by the standing trustee of any surplus assets and the distribution of proceeds, net of costs and liens, to creditors holding unsecured claims.

c. The determination of surplus assets and disposable income will be based on uniform national guidelines

adopted by Congress and automatically indexed for inflation.

d. It will be permissible for debtors to convert surplus assets into nonsurplus assets, even on the eve of filing.

14. Treatment of Secured Claims. The CIDR plan specifies the amount of any secured debts based on the liquidation value of the collateral, net of any costs of sale, determined as of the date of the CIDR petition. Secured claims are treated as under chapter 13 of current law, except that a contract rate of interest (or if less, the maximum rate allowed by applicable law) is used on any deferred cash payments on the allowed secured claims.

15. Bifurcation of Undersecured Claims. As under current law, with the exception of mortgages secured by only the debtor's principal residence, undersecured claims are bifurcated into an allowed secured claim equal to the value of the collateral and an unsecured deficiency claim for the balance (unless the debt is nonrecourse).

16. <u>Specification of Nondischargeable Debts</u>. The CIDR plan must also specify any nondischargeable debts of the kind specified in paragraph 18 below.

17. <u>Debtor Files the CIDR Plan</u>. If the debtor agrees with the plan, the debtor signs it and files the plan with the United States trustee. The standing trustee sends a one page notice of the plan to all creditors indicating the identity of the debtor and the terms of the CIDR plan. If the debtor disagrees with the plan, the debtor can file its own plan with the United States trustee and send a one page notice to creditors indicating the identity of the debtor and the terms of the CIDR plan.

18. <u>Consensual Confirmation; Discharge</u>. If within 30 days after the mailing of notice, no creditor nor the standing trustee files an objection to confirmation with the bankruptcy court, the plan becomes effective, and an order confirming plan is sent to the bankruptcy court for registration on a CIDR docket. No civil case file need be opened.

a. The order confirming plan has the effect of a discharge injunction and immediately discharges all unsecured civil debts, except those debts for

intentional injury to the person or property of another that are designated as nondischargeable under the plan.

b. Criminal obligations are automatically nondischargeable whether or not designated under the plan.

c. Creditors holding nondischargeable civil or criminal debts are stayed as long as the plan is operative.

19. Contested Confirmation. Creditors who believe that the debtor is ineligible, that the plan improperly fails to designate their debt as nondischargeable, or that the plan violates the financial fairness standard of paragraph 13 above, may file an objection to confirmation with the bankruptcy court within 30 days of the mailing of notice of the confirmation hearing. The objection will be accompanied by a filing fee, and the bankruptcy court clerk will open a file for a civil adversary proceeding arising in the CIDR case. The bankruptcy judge will have jurisdiction over the CIDR adversary proceeding derivative from the district court.

20. Contested Confirmation Hearing. If an objection to confirmation is timely filed, the clerk of the bankruptcy court gives notice of a confirmation hearing at which the judge can enter an appropriate order.

a. If the debtor is ineligible, the judge must annul the automatic stay, dismiss the case and impose appropriate sanctions.

b. If the debtor is eligible, the judge must determine whether to confirm or modify the plan.

(1). In making this determination, the judge will apply the financial fairness standard described in paragraph 13 above.

(2). The judge must modify the plan to require the liquidation or redemption of any surplus assets or to vary the amount of disposable income.

(3). The judge must also resolve any nondischargeability dispute and amend the plan accordingly.

(4). The judge must confirm the modified plan.

21. <u>Postconfirmation Matters</u>. Under a confirmed plan, the debtor must cooperate with the standing trustee regarding the sale or redemption of any surplus assets and delivery of any disposable income.

a. If the debtor defaults, the standing trustee must determine whether changed circumstances warrant a modification of the plan. If they do, the standing trustee promptly proposes a modified plan to the debtor, and the process proceeds as in paragraphs 12-20 above, except that no income can be delivered to the standing trustee if it is earned more than 4 years after the date of filing of the original CIDR petition.

b. If the standing trustee believes that a modification is not justified, the debtor can propose a modified plan which will be noticed as set forth in paragraphs 16-20 above. If a timely objection to the modified plan is filed and the bankruptcy judge determines that the modification is not justified, then the judge must either (1) impose an appropriate modification; or (2) if no modification is appropriate, revoke or annul the confirmation order and discharge and dismiss the case.

22. Valuation. In order to discourage ongoing valuation disputes, the debtor will retain the benefit of any postpetition increase in value of equity in retained or acquired nonsurplus assets, because unsecured creditors are only entitled to the net liquidation value of any retained surplus assets as of the date of the filing of the petition. Creditors, however, are entitled to any increase in disposable income during the 4 year period, including any disposable income generated as proceeds of asset sales.

23. Reaffirmation Agreements Unenforceable. Reaffirmation agreements are unenforceable, although nothing prevents a debtor from voluntarily repaying a discharged debt.

Explanation of the Proposal

Paragraph 1 of the above CIDR proposal consolidates consumer bankruptcy into one chapter. The chapter is placed in the Judicial Code in recognition of the primary role of the United States trustee and Standing trustee in administering the system. Unless there is a dispute with respect to the debtor's eligibility, the nondischargeability of a debt, or the confirmability of the plan, the clerk of

court will enter an order confirming plan without the involvement of a bankruptcy judge. The only time a bankruptcy judge will become involved is to hear one of the above-mentioned disputes or to rule on a contested plan modification. Removal of the bankruptcy judge from these cases should reduce costs and eliminate the need for duplicate sets of files.

Paragraph 2 of the proposal prescribes eligibility rules for the consolidated chapter. The proposal opts for bright-line qualifications to minimize the prospects of litigation. Although it is theoretically desirable to require bankruptcy to be filed as a last resort, imposition of this test as an eligibility requirement probably would foster eligibility litigation that debtors could not afford to defend. Instead, the section eliminates stockbrokers and commodity brokers, because these debtor's have customers who deserve special protections. It will be rare for an individual debtor to have customers directly; usually customers will do business with a partnership or corporation, so the individual debtor-broker will not be disqualified. Paragraph 2 also requires contacts with the United States, as does section 109(a) of the current Bankruptcy Code. Finally, paragraph 2 creates a seven-year

bar. The seven-year bar has biblical origins and is more onerous than the six-year bar of current law.

It is possible that the consolidated chapter should also exclude individuals who are sole proprietors. To the extent the debtor has debts that are not primarily consumer debts, it might be appropriate the debtor to file a petition under chapter 11 or 12 of the Bankruptcy Code, rather than under the consolidated chapter.

Paragraph 3 requires a petition initiating a CIDR case to be filed with the office of United States trustee, rather than the Bankruptcy Court. The petition may be voluntary or involuntary. A filing fee is payable to the Office of United States Trustee to self-fund the system, although poor debtors can file *in forma pauperis*. Under paragraphs 19 and 20, disputes will be litigated before a bankruptcy judge, and a separate fee will be collected by the clerk of court when that litigation is initiated.

Paragraph 4 lays venue in the district in which the debtor resides. Since paragraph 13 requires the determination of surplus assets and disposable income to be based on uniform federal guidelines, venue shopping should not be an issue.

Paragraph 5 retains features of current law providing that the debtor remains in possession of his or her property. The automatic stay and codebtor stay will also apply as under sections 362 and 1301 of current law.

Paragraphs 6-12 develop a standing trustee system similar to chapter 13 of current law. Under paragraph 6 the standing trustee is appointed and supervised by the United States trustee. Paragraph 7 provides for payment of capped fees and costs out of plan distributions, as under current chapter 13. Under paragraph 9, the trustee's function is to counsel the debtor to avoid future financial difficulties. This service is financed by the filing fee. The standing trustee is also charged with formulating a plan to be proposed to the debtor and serving as the disbursing agent under the plan. See paragraphs 6 and 12. The standing trustee also examines the schedules and randomly audits debtors to root out corruption. See paragraphs 8, 10-11.

Paragraphs 13-20 concern the CIDR plan process. Under paragraph 17, the debtor either files the plan recommended by the standing trustee or files a plan of his or her own. Paragraph 13 specifies that the plan must give creditors payments over a 4 year term equal to the liquidation value

of any surplus assets plus any disposable income. In many cases, there may be no surplus assets or disposable income. It is intended that disposable income can vary over the 4 year period as the debtor's income and expenses vary. The thought is that creditors should have access to any accumulated wealth as well as any excess future income. In order for the system to be efficient, the formulation of clear guidelines is essential. As noted, under paragraph 13 the determinations which assets are surplus and how much income is disposable will be made based on uniform federal guidelines. These guidelines will confront the difficult issue whether the debtor is entitled to at most a minimum standard of living or whether the debtor may maintain his or her standard of living unless it shocks the conscience. This issue exists under current chapter 13 with different judges using the good faith standard of section 1325(a)(3) to impose differing value judgments.

Under paragraph 18, all debts will be discharged on confirmation, except that the plan will not discharge criminal obligations or any designated debts for intentional torts that resulted in injury of the person or property of another. In addition, in order to reinforce the social benefits of the discharge, under paragraph 23 reaffirmation agreements are unenforceable. Unless an objection is filed,

under paragraph 18, the order confirming plan is automatically entered on the CIDR docket in the bankruptcy court. The judge is not involved in the process. On the other hand, if an objection to confirmation is timely filed, paragraphs 19 and 20 require the bankruptcy judge to resolve any disputes over the debtor's eligibility, the nondischargeability of debts, or the financial fairness standards.

Paragraph 21 requires the debtor to cooperate with the standing trustee in selling or redeeming any surplus assets or delivering any disposable income. For example, if the debtor owns a house and the equity in the house makes it a surplus asset, then the debtor must redeem the house or it will be sold by the standing trustee. The debtor might raise funds to redeem the surplus portion of the house by using proceeds of a gift, borrowed money, or net equity from the sale of nonsurplus assets. If the debtor defaults, by failing to sell or redeem surplus assets or deliver disposable income, either the standing trustee or the debtor can propose a plan modification. If the modification is justified, the court will confirm the modified plan. If modification of the plan is not justified, such as when the debtor's circumstances have not changed and the debtor has willfully defaulted under the plan, then the judge will

revoke or annul the confirmation order and the discharge and dismiss the case.

Paragraph 22 clarifies that creditors are entitled to disposable income for the four years following the date of the petition, even if the amount of the income increases. One source of income can be the sale of surplus assets. But in order to reduce valuation disputes, the debtor is given the upside in any nonsurplus assets or postpetition assets as long as they are not sold. Under paragraphs 14 and 15, with respect to any secured claims, this valuation is based on the liquidation value of the collateral, net of any costs of sale, determined as of the date of the filing of the CIDR petition.

Chapter 7 of the book would be followed by Chapter 8 which would analyze the advantages and disadvantages of the proposal. It might look roughly like this:

Chapter 8. Analysis of the Reform Proposal.

The CIDR proposal set forth above has several advantages over current law. The consolidation of individual debt restructuring proceedings will eliminate

conversion and substantial abuse litigation costs. Although most litigation in these cases relates to motions for relief from the automatic stay or complaints to determine the dischargeability of a debt, some litigation involves motions to convert or dismiss and substantial abuse motions.

Removal of CIDR cases from the bankruptcy court system should also result in substantial savings. Instead of having parallel files maintained in the bankruptcy court clerk's office and in the Office of United States Trustee, only the latter would retain most files. Moreover, the case burden on the bankruptcy court system would be reduced substantially. It is fair to ask why these cases belong in the bankruptcy court, except we have done it that way since 1898.

Consider the profile of the typical individual debt restructuring case. If past is prologue, of the 1 million bankruptcy cases that will be filed in 1996, about 62% will be individual chapter 7 cases and 30% will be chapter 13 cases. These 900,000 cases will average about 18 creditors that are owed approximately $31,000 in debt, more than twice the median average income of the debtors. The debtors will have above-average education and home ownership, but their median incomes will be about 2/3 of the norm for Americans.

Almost all of these debtors will have no reasonable prospect of repaying their debts. On average although 80% of the debtors will be discharged (because only about 1/3 of the chapter 13 debtors receive a chapter 13 discharge), in some districts over 90% of the debtors will be discharged, whereas in other districts fewer than half will be discharged. Another 20% of the debtors will reaffirm some debts that would otherwise be discharged. In about 94% of the cases the debtors will have no nonexempt property. Yet over $500 million will be charged in legal fees for these cases, and they will be administered as civil litigation in the federal court system by bankruptcy judges. Each new bankruptcy judgeship costs the taxpayers over $750,000 per year, taking account of direct and indirect costs. While most bankruptcy judges spend substantial time on chapter 11 cases, significant energy is spent on chapter 7 and 13 cases, at least by law clerks and court clerks.

Based on the foregoing information, it is apparent that some savings can be realized by adopting the proposal, even if it is to stem the increase in the number of bankruptcy judges and reduce the legal fees involved. Perhaps the savings will be substantial.

The proposal also should operate to eliminate or severely reduce the disparate application of current bankruptcy law on the individual debtor. With one chapter and national guidelines, the disparity caused by local exemption planning and regional tastes should abate. To be sure, some judges can still interpret the law to find very few nonsurplus assets and to find that most of the debtor's income is disposable. But elimination of the substantial abuse and good faith standards takes away much judicial discretion in this area.

Finally, the proposal should provide meaningful relief to most debtors, giving them a fresh opportunity to become productive members of society. As noted, under current law, many chapter 13 cases fail. The debtor never receives a discharge. Creditors receive payments from the standing trustee and, once the case is dismissed, accrue postpetition interest as though there never was a bankruptcy case. Even if the debtor gets a discharge, about 20% of the debtors enter into reaffirmation agreements. Therefore current law does not give many debtors the promised fresh start. The CIDR proposal grants a discharge on confirmation of the CIDR plan. Moreover, reaffirmation agreements are unenforceable. As long as the debtor performs under the plan for 4 years, the discharge is preserved. Many debtors will have neither

surplus assets nor disposable income. Others will be able to seek modifications of the CIDR plan as their situation changes. Thus the proposal should be better than current law in delivering a fresh start.

Some detractors of the proposal may point out that based on the compensation formula, the standing trustee has a conflict of interest in designing the plan. Empirical data should be easy to gather to determine whether this fear is well-founded. If it is well-founded, the Office of United States trustee could remove the standing trustee. But I suspect it is in the interest of the standing trustee to design a plan that will be performed so that the trustee can collect a percentage distribution for the full 4-year term of the plan rather than dealing with the cost of a default.

Other detractors will focus on the fairness of the proposal to debtors and creditors. Some will contend the proposal is unfair to debtors because it is a "compulsory chapter 13." There is no serious argument that such a proposal violates the 13th Amendment. Nobody forced the debtor to incur the debts, and nonbankruptcy law would allow garnishment of future wages well beyond the 4 years of the proposal. Although reasonable people can differ, it is fair

and reasonable to expect a debtor to try to repay debts out of disposable income as a condition subsequent to receiving a discharge. On the other hand, if a constitutional problem develops, the proposal can be limited to voluntary relief.

Others will contend the proposal is unfair to debtors because it gives creditors access to both excess income and assets. Why should asset rich debtors with little income be treated differently from asset-poor debtors with a source of future income? Future income is simply an intangible form of asset. On the other hand, if all disposable income must be used to repay creditors, it may be that the debtor has no incentive to generate disposable income. If this proves to be the case, perhaps the proposal can be refined to require distribution of 75% of disposable income to the creditors and 25% to be retained by the debtor (which could be used to service secured or nondischargeable debt).

Some critics of the proposal will contend that the proposal is unfair to creditors, because confirmation of a CIDR plan discharges too many categories of debt. While it is true that bankruptcy evolved from a creditor remedy to a remedy for poor but honest debtors, it is time for the system to evolve further. If the debtor has done something to harm society, the criminal justice system can address the

problem, and the resulting obligation will be nondischargeable. The same is true for a civil debt that arises from intentional injury to the person or property of another. But everything else should be discharged, because 4 years is a sufficient "sentence" to impose in exchange. This 4 year rule will become the measure of the social contract. The 4 year requirement should deter negative actions, but beyond a ratable share of 4 years' disposable income, the creditors will have to buy insurance or self-insure.

Perhaps creditors will have an incentive to determine the creditworthiness of their debtor before extending credit. While this proposal might result in a contraction of consumer credit, that result might not be bad. If experience demonstrates that more than 1,000 debtors per year use the CIDR system to intentionally defraud creditors, it would be appropriate to amend the proposal to make nondischargeable those debts incurred with an actual intent to defraud creditors. But the proposal rejects this as a starting point, because creditors could use the leverage of filing a nondischargeability suit to obtain a determination of nondischargeability even in the absence of fraud. It is no answer to award attorneys fees and costs to the prevailing debtor, since this approach has proved

ineffective in a related context under section 523(d) of the Bankruptcy Code.

Critics who believe that the proposal is unfair to creditors might also argue that the unenforceability of reaffirmation agreements infringes freedom of contract. The short answer to this is "so what?" The typical consumer debtor is certainly not free; the inequality of bargaining power puts the consumer in a take it or leave it position. Many consumers are desperate for credit and do not make a rational choice to incur it (at outrageous interest rates in excess of 18% per annum). If creditors are willing to extend credit on a volume basis without determining the creditworthiness of their borrower, it is hard to see why the law should encourage this inefficient activity.

Finally, some law-and-economics academics might contend that, as is true with respect to current bankruptcy law, the reform proposal is inefficient (and therefore unacceptable). Because the proposal provides for the discharge of indebtedness, it interferes with settled state law property rights and freedom of contract. It increases the cost of credit because bankruptcy losses will be passed on in the form of higher interest rates charged to all borrowers.

This will result in an under-extension of credit that will prevent financing of marginally beneficial projects.

Some of these academics might also argue that the real purpose of the proposal is to redistribute wealth from creditors to debtors. Rather than using a cumbersome administrative apparatus to accomplish this result, it would be more efficient to achieve this policy through the tax system. The tax system could be amended to allow debtors a fresh start by permitting them to apply for a poverty tax credit (or transfer payment) that will give them enough income to make their creditors whole. Debtors could seek such a credit not more frequently than once every 7 years and would be ineligible to receive a credit to pay nondischargeable debts.

Each of these academic attacks is suspect. On a prospective basis, bankruptcy law defines limitations on property rights *ex ante*. Although there may be a distribution of wealth, there is no redistribution. Moreover, an efficiency analysis presumes that more credit is good. Based on the lack of sophistication of most consumer debtors and their relative inequality of bargaining power, there may be valid regulatory or paternalistic goals served by a bankruptcy system. One example that serves

these goals is set forth in paragraph 9 of the reform proposal: the standing trustee must administer debt counseling to the debtor. Finally, using the tax system to fund losses does not impose discipline on lenders to evaluate credit risks. Lenders who extend credit to debtors who default should bear the risk of loss, rather than imposing losses on taxpayers generally.

This essay has framed a reform proposal to restructure individual debts. Some commentators will embrace it; others will revile it. But the proposal should spark discussion on the fundamental objectives of a consumer debt restructuring system and the best way to achieve those objectives. Let the debate begin.