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

Likely Impact of the Amendments

On the surface, the changes adopted in 1984 appear to be serious and substantial. The costs of bankruptcy are raised, attempts are made to curtail abuses by consumers, and an impression is indirectly given that bankruptcy is a serious matter. Indeed, consumer creditors are pleased with the changes, and say that because they are better protected, they will be less reluctant to lend to lower-income consumers.

However, it is likely that the success of these changes in lowering either the total number of personal bankruptcy filings, or in lowering creditor losses, will be minor unless the bankruptcy judges strictly enforce the main anti-abuse provision and obtain the cooperation of state courts. There are several reasons for this. First, there are no solid statistical data on the number of consumer abusers, or on the dollar loss they represent. The amendments were designed with only anecdotal evidence of abuse provided by consumer lenders. If abuse is truly minor, then the preference and discharge provisions will have only marginal effects.

Second, the 1978 code allowed states to prohibit their consumers from using the relatively more generous federal exemption limits. By September 1982, 33 states substituted their own less generous exemption limits. The lower federal exemption limits thus already are inoperable in these states. They also may have little impact in the other 17 states and in the District of Columbia. Two studies comparing the number of bankruptcy filings in states that opted out of the federal exemptions with those in the other states found that lower exemption limits had a minor impact on personal bankruptcy filings. Finally, the changes unquestionably raise the cost of a Chapter 13 filing, thus giving consumers the incentive to use Chapter 7. The bankruptcy court can dismiss a Chapter 7 case if it feels that the case would be an abuse of the law. However, in certain circumstances, the amendments let any party demand that the case be referred to a state court, which has the power, without appeal, to overrule the bankruptcy court. Thus, consumers may be able to obtain a more favorable settlement. If this loophole becomes a problem, creditors may seek to amend the bankruptcy code further.

In August 1982, 33 states substituted

13. Record that new discharge provisions also raise the cost of bankruptcy to some consumers.

14. These payments are known as preferences, which are transfers of any property interest of a consumer to a creditor or for the creditor's benefit that is made within 90 days before the filing while the consumer was insolvent, and that enables the creditor to receive more than he would have received in a liquidation case without the out.

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ECONOMIC COMMENTARY

Federal Reserve Bank of Cleveland

Recent Changes in the Consumer Bankruptcy Laws

by K. J. Kowalewski

In April 1981, the Subcommittee on Bankruptcy of the Senate Judiciary Committee began hearings to determine why there was such an extraordinary increase in personal bankruptcies since the Bankruptcy Reform Act of 1978, and to determine appropriate corrective action. The subcommittee subsequently concluded that the 1978 code, which became effective in October 1979, permitted an excessive number of personal bankruptcies to be used. The old bankruptcy law and the existing bankruptcy court system could not cope with the greater complexity and growing number of consumer bankruptcy filings.

At least seven failings of the consumer provisions in the 1938 law were identified. First, the cost of filing a petition was high. Second, exempt assets (those which could be kept by the consumer after bankruptcy and not used to repay debts) were determined by state law and were usually minimal. Third, consumers could not keep collateral only if they paid the value of the creditor's security interest. 15. Bankruptcy Reform Act of 1978—A Reform and After Look, and Congress, prepared by John Reeren, September 1982. The new code significantly altered the costs of bankruptcy. Among all the changes it introduced, four important ones with regard to consumer bankruptcy cases may be distinguished. The first change limited the actions creditors can use to collect their debts both before and after a bankruptcy petition is filed. This change was intended to protect consumer creditors and their consignee creditors from abuse debt collection practices. It was also designed to help creditors prevent some creditors from "rushing the gate" by collecting the debts directly from the consumer debtor just before or after a bankruptcy petition is filed, but before the bankruptcy process begins.
Before the 1978 code, these "gate-rushers" usually could keep the money they collected, leaving less of the consumer's assets to the claims of other creditors, even those who had the same legal rights to the consumer's assets as the "gate-rushers." Under the new code, either creditors can make the "gate-rushers" return these funds to the consumer's estate for possible distribution to the other creditors. A second change in the 1938 code essentially dropped all preconditions for Chapter 13. It made Chapter 13 available to any consumer, regardless of whether or not he can pay his debts out of current income. This was designed to protect consumers from overbearing debt collectors, and to provide a "breathing spell." The third change lowered the cost of bankruptcy by allowing consumers to keep more of their assets and incomes. This was done in four ways: (1) by creating federal exemption limits, which were typically more generous than the state limits; (2) by allowing consumers to discharge a greater variety of debts, and (3) by allowing debtors to redeem goods by paying secured creditors the lesser of the market value of the collateral, or the creditors' security interest, as full payment of their debts. These provisions were created to give the honest consumer more help in starting a new life after bankruptcy.

Finally, the 1978 code attempted to make Chapter 13 relatively more attractive to financially distressed consumers with high incomes but increasing losses to them. It protected creditors by requiring that a Chapter 13 plan leave them at least as well off as under any alternative recovery plans. It also increased the cost of bankruptcy by increasing losses to them. It protected consumers to exempt most of their assets.

The changes introduced in 1984 explicitly alter the cost of bankruptcy to consumers. First, consumers using the federal exemption limits are now restricted to $4,000 in all household furnishings and goods, clothing, appliances, books, animals, crops, or musical instruments. Second, the consumer's security interest in personal or household use of the consumer or a dependent of the consumer, with the same maximum of $200 per item. This cost was increased to $2,500; the total dollar amount of exemptions in these goods was reduced to $2,000. The 1978 code also increased the cost of bankruptcy to consumers by raising the bankruptcy filing fee. The 1978 code placed a $100 fee on personal bankruptcy filings. The 1984 code increased the filing fee to $200.

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