Bankruptcy Update—Developing Issues

*By George J. Wallace, Gary D. Hammond, Jeffrey E. Tate, and Alvin C. Harrell**

Bankruptcy Statistics and Legislative Update

On November 25, 2002, the Administrative Office of the U.S. Courts reported that the number of bankruptcy filings in Fiscal Year 2002 broke records again.[1] The judiciary's fiscal year is the twelve-month period from October 1 through September 30.[2] Bankruptcy cases for the twelve-month period ending September 30, 2002 totaled 1,547,669, a 7.7% increase over Fiscal Year 2001.[3] Personal bankruptcy filings, which make up the majority of bankruptcy filings, also broke records with a Fiscal Year 2002 total of 1,508,578, an increase of 7.8% over the prior year.[4] Business filings for the twelve-month period totaled 39,091, an increase of 1.6% over the previous year.[5]

The bankruptcy reform package that was approved by a congressional conference committee early in 2002, after months of faltering, died on a procedural vote on the last day of the lame-duck session closing out the 107th Congress.[6]

In 2002, support for the bankruptcy reform legislation steadily declined for several reasons. First, the bill came under attack from conservative Republicans, who objected to the provision introduced by Senator Charles Schumer that would make fines from abortion clinic protests non-dischargeable.[7] Next, the AFL-CIO voiced its opposition, also based on the abortion clinic language.[8] According to the AFL-CIO, the offending language could be expanded to make other protest-related obligations non-dischargeable as well.[9] The U.S. Conference of Catholic

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1. Press Release, Administrative Office of the U.S. Courts, Bankruptcy Filings Hit Fiscal Year Historic High in 2002 (Nov. 25, 2002).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. 148 Cong. Rec. H8742 (daily ed. Nov. 14, 2002) (waiving points of order against conference report on H.R. 333, Bankruptcy Abuse and Consumer Protection Act of 2002).
7. *Id.* (statements of Senators Pitts, Akin and Smith).
8. *Id.*
9. *Id.*

Bishops also sent letters to congressmen opposing the legislation.[10] At this writing, it is unclear whether the 108th Congress will consider any bankruptcy legislation.

Whether bankruptcy filings will continue to increase is another unanswered question. Many predictions hinge on whether the economy falters or improves. Some cite historically low interest rates and widespread credit availability as favorable factors that may reduce filing rates in 2003. But future interest rate trends are uncertain, and others have expressed concern that the new wave of "predatory lending" laws and regulations may constrain credit availability for those who need it most, diminishing the use of refinancing as an alternative to bankruptcy.[11] If bankruptcy filings remain at very high levels or continue to increase, and perceived abuses receive increasing attention, statutory reform may receive renewed attention.

Reform from Within: Will the Bankruptcy System Reform Itself?

Introduction

Those not familiar with bankruptcy often see it as simply a system of legal rules controlled by judges. Suspicious of the bankruptcy judges themselves, observers may conclude that reform can come only through legislation. Although legislation may be necessary to reform some aspects of bankruptcy, in fact, important changes can occur without direction from Congress. If the effort at reform legislation stalls under pressure from a bad economy and legislative gridlock,[12] there remain opportunities for effective reform to be accomplished within the current statutory structure. These opportunities, however, will not develop into effective change without significant effort and attention.

U.S. Trustee Program

Created as a pilot project in 1978[13] and expanded nearly nationwide in 1986,[14] nineteen U.S. Trustees ("USTs") each administer a program in a partic-

10. *Id.* (statement of Senator Pitts) (submitting for the record Letter from Gail Quinn, Executive Director, U.S. Conference of Catholic Bishops, to Member of Congress (Nov. 13, 2002)).

11. *See, e.g.*, Alvin C. Harrell, *Introduction: Predatory Lending, Part Three*, 56 Consumer Fin. L.Q. Rep. 2 (2002); Robert M. Jaworski, *Legislating Against Bad Loans: The State/Local Battleground*, 58 Bus. Law. 1229 (2003).

12. *See, e.g.*, Lynne B. Barr, Fred H. Miller, & Alvin C. Harrell, *Introduction to the 2003 Annual Survey of Consumer Financial Services Law: Of Statutory Aging and Process Failure*, 58 Bus. Law. 1131 (2003).

13. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 224(a), 92 Stat. 2549, 2262–64 (codified at 28 U.S.C. ch. 39).

14. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, §§ 111–115, 100 Stat. 3088, 3090–95 (codified at 11 U.S.C. ch. 39). Alabama and North Carolina use a Bankruptcy Administrator appointed by the bankruptcy court to perform administrative functions similar to those performed by the U.S. Trustee Program. The U.S. Trustees should be distinguished from the panel trustees available for appointment as trustee for individual Chapter 7 cases, under 11 U.S.C. §§ 321–331 (panel trustee), and the standing trustees appointed under 11 U.S.C. § 1302 to administer Chapter 13 cases. Panel trustees and standing trustees are sometimes referred to as "case trustees."

ular region of the United States.[15] Each UST is appointed by the President, but is not subject to confirmation by the Senate.[16] The program is overseen by the U.S. Attorney General through the Executive Office of United States Trustees (EOUST).[17] The EOUST is headed by a Director, also a presidential appointment which does not require confirmation.[18] The current Director is Lawrence Friedman, a well known panel trustee from Detroit with a reputation for strong enforcement.[19]

The duties of the nineteen USTs are set out in 28 U.S.C. § 586. They select the panel of Chapter 7 trustees (panel trustees) and supervise them and the cases they administer.[20] The USTs also have the power to intervene in cases in certain instances.[21] For example, they are the only party empowered to bring cases under section 707(b) of the Bankruptcy Code seeking dismissal for "substantial abuse" of the Bankruptcy Code.[22] The USTs, however, have historically concentrated their efforts on commercial Chapter 11 cases.[23]

Before EOUST Director Larry Friedman took office, Martha Davis, then the Acting Director of the EOUST, directed the USTs to significantly increase their efforts to find and address fraudulent and abusive uses of the bankruptcy system by consumers.[24] When Director Friedman took office, he reinforced this approach.[25] This initiative has already resulted in increased UST efforts to uncover undisclosed and misdisclosed assets and false claims of exemptions, as well as more activity under section 707(b) based on both abusive conduct and an ability to pay.[26]

How successful the relatively untested UST system will be in carrying out this initiative over the long term remains to be seen. The potential is there for significant change, but it will require careful direction and strong leadership. Through leadership and effective budget advocacy, the bankruptcy system could more effectively limit relief to those who need it, and at the same time provide more effective rehabilitation to those who obtain relief. Some indication of the promise of the UST program can be found in the report of the UST program.[27] This is the

15. 28 U.S.C. § 581 (2000).
16. *Id.*
17. *Id.* § 586(c).
18. 28 C.F.R. § 0.37 (2002).
19. Press Release, U.S. Department of Justice, Executive Office for United States Trustees, Lawrence A. Friedman Selected as Director of Executive Office for U.S. Trustees (Feb. 28, 2002), *available at* http://www.usdoj.gov/ust/press/pr02282002.htm.
20. 28 U.S.C. § 586(a).
21. *Id.* § 586(a)(3)(D).
22. *See generally* Richard E. Coulson, *Substantial Abuse of Bankruptcy Code Section 707(b): An Evolving Philosophy of Debtor Need*, 52 CONSUMER FIN. L.Q. REP. 261 (1998).
23. U.S. TR. PROGRAM, ANNUAL REPORT OF SIGNIFICANT ACCOMPLISHMENTS 1 (2001), *available at* http://www.usdoj.gov/ust/press/annualreport/ar2001.pdf.
24. *Id.* at 7–21; *see also*, EXECUTIVE OFFICE FOR U.S. TRS., REPORT ON THE DEBTOR IDENTIFICATION PROGRAM (2001), *available at* http://www.usdoj.gov/ust/debtorid/report/DI-Report.pdf.
25. U.S. TR. PROGRAM, *supra* note 23, at 1.
26. *Id* at 7–9, 16–19.
27. *Id.*

first annual report the UST program has issued, and it describes some of the initiatives that are underway.[28]

Bankruptcy Rules

Revision of the Bankruptcy Rules ("Rules") involves a sustained effort over a number of years. Ignoring the political process by which the Rules and local bankruptcy court rules are created is a mistake that can have long-term consequences for those who decline to participate.

The Rules, of course, shape what forms the debtor must fill out in order to file, what notice the creditors will get of various proceedings, what information the debtor must provide, the procedures for Chapter 7, 11, 12, and 13 cases, and the procedures for adversary proceedings. The Rules cannot "abridge, enlarge, or modify any substantive right."[29] But that limitation is surprisingly unimportant. In practical terms, the Rules can and do strongly influence how bankruptcy cases are handled and the efficiency with which the bankruptcy system operates. For example, the bankruptcy process is built upon accurate information about the debtor's financial status and affairs. The debtor has that information, but the dishonest debtor may have an incentive to misrepresent or withhold it.[30] Creditors and the panel trustee usually do not have that information. Rules that require the debtor to provide accurate financial information and that set up the possibility of dismissal if the information is not provided or if it can be demonstrated that the information provided is false, are likely to encourage better information. Rules that are vague about what is required and about the effect of failure to provide it will help the dishonest debtor. Similarly, rules that permit ineffective notice to creditors will encourage "gaming" activity, for example, cases being rushed through before significant creditors receive effective notice.

The rulemaking process is built on the Rules Enabling Act, which has a specific provision authorizing Bankruptcy Rules.[31] This provision vests the power to make Rules for the bankruptcy system in the U.S. Supreme Court.[32] In turn, the Supreme Court has delegated the responsibility to develop and propose Rules to the Judicial Conference, which has developed its own procedural rules under which various committees deal with different issues.[33] There is a Bankruptcy Committee, which is charged with developing proposals for amending the Bankruptcy Rules, and within that Committee there is a Consumer Subcommittee. There is also an

28. *Id.*; *see also* U.S. Trustee Program, Asset Administration Questionnaire, *available at* http://www.usdoj.gov/ust/library/chapter07/ch7lib.htm (last visited Mar. 15, 2003). These materials are being sent to USTs around the country, and provide a measure of how, for the first time, the EOUST is focusing on consumer case administration by the USTs.

29. 28 U.S.C. § 2075 (2000).

30. A debtor who successfully conceals assets from the Trustee can emerge from bankruptcy much wealthier than an honest debtor. *See* U.S. Tr. Program, *supra* note 23, at 16–19.

31. 28 U.S.C. § 2075.

32. *Id.*

33. *Id.*; Procedures for the Conduct of Business by the Judicial Conference Committees on Rules of Practice and Procedure (Oct. 1997), *available at* http://www.uscourts.gov/rules/procedurejc.htm.

elaborate procedure for proposing Rules, distributing them to interested parties for comment, holding hearings, and eventually proposing new Rules to the Judicial Conference as a whole.[34]

Over the years, pursuant to this process, the Rules have been fashioned by those who are active in the bankruptcy process and who have taken the time to be recognized by the judges and bankruptcy lawyers as experienced and informed. Some creditors' advocates have complained that over the years when they do comment, their comments appear to be ignored by what they see as an isolated process. The process, however, is open and is subject to participation by those who make a sustained effort to do so. Thus the Rules process remains a potential avenue for reform if there is a willingness to make the effort.

Educating Judges

Bankruptcy judges learn about the underlying realities of bankruptcy in the courtroom. Because the vast majority of cases never reach the courtroom (a routine Chapter 7 case will automatically mature into a form discharge without any judicial input), the judges learn from only the cases that actually involve litigation. Those cases usually involve creditors versus debtors and the facts are shaped by the adversarial process. The judges, therefore, may develop a perception of bankruptcy realities from the litigated cases involving conflicts between debtors and creditors, with a focus on cases in which the use of credit was ultimately unsuccessful.

Although bankruptcy necessarily deals with unsuccessful debt, little in the judging process teaches the judge about the realities of making legitimate credit available and the benefits that flow to those who use it successfully. Many judges do not come from a business background. Although they may be skilled in making legal judgments about statutory matters, such as whether a business debtor is likely to successfully reorganize under the Bankruptcy Code, most do not have direct experience in the details of the credit business. Judges may not understand that there is a significant impact on credit costs and availability, for example, when they impose costs on creditors. The mechanism of the economy, which passes on those costs over time to those who are trying to qualify for new credit extensions and those who conscientiously pay their bills, is not well understood in all cases. Bankruptcy judges may develop a tendency over time to see credit providers as a problem rather than part of the solution because they learn from the hard cases involving the most extreme conduct and do not fully understand the details of the credit business or the economic consequences of their decisions. The bankruptcy system, structured around a relatively low-status judiciary handling only litigated bankruptcy cases, may tend to create a bias. Education, however, can overcome that bias. Judges in the main want to be impartial, but they also act based on their knowledge and experience. In recent years, significant funds have

34. Procedures for the Conduct of Business by the Judicial Conference Committees on Rules of Practice and Procedure, *supra* note 33, at pt. 1.

been made available to provide judges with legal training at a new center. It would also seem to be important to provide judges with training about the underlying economy they regulate.

CURRENT SIGNIFICANT TRENDS

INTRODUCTION

Based on developments during 2001 and 2002, 2003 looks like a year in which several major issues may develop significantly. Some of these, such as privacy and predatory lending initiatives, are discussed elsewhere in this Survey, though usually without a focus on the bankruptcy implications. This Article will focus on the bankruptcy-related implications of some of these issues. The following discussion makes no effort to cover bankruptcy developments that, although broadly significant to local practice, are not likely to have long-term impact. Instead, this Article focuses on issues likely to be of national significance in the coming year and also discusses local developments thought to be of widespread interest.

PRIVACY

Although Congress was not active on consumer privacy issues in 2002, the Judicial Conference was. On September 24, 2002, after adopting a number of changes to the original proposal by those concerned about its practical implications, the Judicial Conference accepted the Rules Committee's recommendation that the Rules and Official Forms be amended, effective December 2003, to change the way significant information is collected from debtors, particularly with respect to social security numbers.[35]

Debtors are required to disclose significant information about their assets, liabilities and personal budgets, and in the last few years they have been required to disclose their social security number.[36] These bankruptcy disclosure requirements have not been lightly imposed. On the contrary, they have come either through legislation or the laborious Bankruptcy Rule amendment process.[37] Not surprisingly, when each disclosure requirement is examined, the required information turns out to be dictated by the needs of the bankruptcy system. Restricting that information to accomplish privacy goals is likely to change, perhaps adversely, the way the bankruptcy process works.

For example, panel trustees and creditors alike routinely use the debtor's social security number to verify the debtor's identity. For a creditor, verifying a debtor's social security number is a crucial first step before stopping collection and taking any other action to comply with the automatic stay, because debtors sometimes

35. Report of the Judicial Conference Committee on Rules of Practice and Procedure to the Chief Justice of the United States and Members of the Judicial Conference of the United States (Sept. 2002), *available at* http://www.uscourts.gov/rules/jc09-02/report.pdf.

36. *See* Official Bankruptcy Forms, Form B1, Voluntary Petition (2002), *available at* http://www.uscourts.gov/bankform/.

37. *See supra* notes 29–34 and accompanying text.

tell creditors they have filed bankruptcy when in fact they have not done so. In other cases, creditors get a notice of a debtor's filing from the bankruptcy court but must determine which of its customers with that first and last name (or sometimes with an entirely different name) has actually filed. The social security number is therefore central to creditor compliance with the automatic stay.

In addition, once a creditor determines that a particular debtor has filed bankruptcy, the creditor must have the debtor's social security number to access that debtor's bankruptcy file in order to decide what steps, if any, the creditor will take in the bankruptcy.[38] Moreover, bankruptcy may affect people, companies, organizations, and governmental agencies that are not technically "creditors" but who may need access to the information in a bankruptcy filing to determine the course of action they should take.[39] Entities in this category may include some lessors, parties holding interests under executory contracts, and taxing authorities.[40]

For some years now, there has been an attempt by both the bankruptcy court system and private service companies to provide those affected by bankruptcy with more rapid access to the information filed in the bankruptcy court records. Today, most bankruptcy courts permit anyone to access by Internet (often for a fee) the docket for any currently filed bankruptcy case.[41] More and more bankruptcy courts permit direct access to information in the bankruptcy schedules, and often the pleadings, motions, briefs, and other papers that are available. In addition, Chapter 13 trustees have taken significant steps to facilitate obtaining reliable information over the Internet. These innovations have significantly increased the efficiency with which those affected by bankruptcy can obtain the information they need to comply with the automatic stay and the various deadlines imposed by the bankruptcy court. Although many have welcomed the improved efficiency, others have seen these developments as threatening to individual privacy. Though it has always been public information, what used to be available only by visiting the courthouse now is easily accessed online.

Against this background, the Judicial Conference began to develop a policy during 2000, which matured into formal action by the Judicial Conference on September 24, 2002. In a joint request for comment published on July 31, 2000 in the *Federal Register*, the U.S. Department of Justice through the EOUST, the U.S. Treasury Department, and the Office of Management and Budget, announced the commencement of a Financial Privacy and Bankruptcy Study.[42] The comment period closed in September of 2000, with a large number of responses received.[43]

38. *See* U.S. COURTS PACER SERVICE CENTER, PUBLIC ACCESS TO COURT ELECTRONIC RECORDS USER MANUAL, § 4.D.2.1, at 19 (2000), *available at* http://pacer.psc.uscourts.gov/documents/pacermanual.pdf.

39. *See, e.g.*, 11 U.S.C. § 365 (2000) (allowing the trustee to avoid executory contracts and unexpired leases); *id.* § 728 (changing the taxable year of the debtor for state and local tax purposes).

40. *Id.* §§ 365, 728.

41. *See* Public Access to Court Electronic Records, PACER Web Links, *at* http://pacer.psc.uscourts.gov/cgi-bin/links.ps#BKCTS (last visited Mar. 15, 2002).

42. Public Comment on Financial Privacy and Bankruptcy, 65 Fed. Reg. 46,735 (July 31, 2000).

43. Financial Privacy and Bankruptcy Study, 65 Fed. Reg. 54,301 (Sept. 7, 2000).

The comments reflected two main points of view. Privacy advocates strongly urged that the debtor's social security number should no longer be used as an identifier, or at a minimum that its availability should be limited to governmental officers.[44] They also urged that tight restrictions be placed on the scope of the financial information collected about the debtor and the availability of the information obtained.[45] Those who participate in and use the bankruptcy system, on the other hand, generally urged that the debtor's social security number should continue to be available to those seeking to identify parties who have filed bankruptcy, that the present level of financial information should continue to be publicly available, and that the recent initiatives to make bankruptcy information efficiently available should not be thwarted.[46]

In 2000 the Judicial Conference appointed an ad hoc committee to study privacy issues in the civil and criminal justice system, including the bankruptcy system.[47] The Conference held public hearings on various topics, including bankruptcy. In March of 2001, it held a hearing in Washington, D.C. on, among other issues, privacy in the bankruptcy system.[48] In June of 2001, the committee completed its recommendations, which were made public in August of 2001.[49] The Judicial Conference adopted those recommendations, with a few changes, on September 12, 2002.[50]

The resulting Judicial Conference policy opted to keep all records of civil proceedings public with a limited exception for social security numbers.[51] With respect to certain "sensitive information," the Judicial Conference adopted a policy under which a social security number, if required to be disclosed in a public record document, could be redacted by the debtor to the last four digits of the number.[52] Similarly, the debtor may limit disclosure of credit account numbers

44. Public Comments on Financial Privacy and Bankruptcy (Oct. 17, 2000) (comments of Joan Z. Bernstein, Director of Consumer Protection, Federal Trade Commission; S.E. Kurlansky; Beth Givens, Director, Privacy Rights Clearing House; Professor Karen Gross, New York Law School; Jay D. Lagree; Steve and Liz Ziegler; Sharman McCarvel), *available at* http://www.usdoj.gov/ust/privacy/comments1.pdf.

45. *Id.* (comments of Professor Karen Gross, New York Law School).

46. *Id.* (comments of Aimee Campin, Director of Regulatory Affairs, Iowa Credit Union League; Jeffrey Bloch, Assistant General Counsel, National Credit Union Association; Patrick M. Frawley, Director, Regulatory Relations, Bank of America; W. A. Earner, Jr., Navy Federal Credit Union; James R. Silkensen, Executive Vice President, N.J. League Community and Savings Bankers; Beth L. Climo, Managing Director, American Bankers Association).

47. Committee on Rules of Practice and Procedure, Minutes of Meeting (Jan. 2000), *available at* http://www.uscourts/gov/rules/minutes/jan2000.pdf.

48. Memorandum from Hon. A. Thomas Small, Chair, Advisory Committee on Bankruptcy Rules, to Hon. Anthony J. Scirica, Chair, Standing Committee on Rules of Practice and Procedure (May 15, 2001) (comments of Joan Z. Bernstein, Director of Consumer Protection, Federal Trade Commission; S.E. Kurlansky; Beth Givens, Director, Privacy Rights Clearing House; Professor Karen Gross, New York Law School; Jay D. Lagree; Steve and Liz Ziegler; Sharman McCarvel), *available at* http://www.uscourts.gov/rules/comment2002/8-01.pdf.

49. Report of the Judicial Conference Committee on Rules of Practice and Procedure to the Chief Justice of the United States and Members of the Judicial Conference of the United States, *supra* note 35.

50. *Id.*

51. *Id.*

52. *Id.*

(redacted to the last four digits), children's names (redacted to initials), and date of birth (year only).[53]

Some questioned whether the Judicial Conference had the power to adopt a "policy" that conflicted with the Bankruptcy Rules.[54] After all, if the formal Rules require disclosure of information, how can the Judicial Conference overturn that "law"?

The response came in December of 2001 in the form of a Rule proposal by the Bankruptcy Rules Advisory Committee,[55] acting with unaccustomed speed. The proposal would have changed the Rules and Bankruptcy Forms so that only the last four digits of the social security number would be required on the petition and forms.[56] This proposal would have removed the one unique identifier of a debtor from the information available in a bankruptcy case, and substituted a truncated form of that identifier. In many cases, this would not have made a difference. But in some cases it could have seriously compromised the accuracy with which creditors can identify debtors who file bankruptcy timely and with the needed specificity.[57]

After some thirty-two comment letters on the topic were submitted, the proposal was revised significantly. Although the debtor would be permitted to truncate the social security number on the bankruptcy petition and any other public record document, the debtor would also be required to file a non-public notice with the court providing the entire social security number.[58] This record would be maintained by the court as a non-public record and provided on the notice to creditors mailed out to each creditor at the beginning of the case.[59] It would also be available to law enforcement officials.[60] Anyone with the debtor's full social security number could inquire of the court whether the debtor had filed bankruptcy and could obtain confirmation of that fact, presumably in connection with the case number.[61] In addition, it is expected (although the Rule does not provide for it) that the panel trustee will obtain the social security number from the debtor at or before the first meeting of creditors.

At the price of some cumbersomeness in certain cases, this compromise both protects the debtor's privacy interest in the full social security number and permits creditors and law enforcement officials the information necessary to identify precisely who has filed bankruptcy. Creditors who have in recent years moved away from reliance on the notice of bankruptcy from the court (which comes twenty-

53. *Id.*
54. Memorandum from A. Thomas Small, Chair, Advisory Committee on Bankruptcy Rules, to Anthony J. Scirica, Chair, Standing Committee on Rules of Practice and Procedure (Dec. 14, 2001), *available at* http://www.uscourts.gov/rules/comment2002/1-02Transmittal.pdf.
55. *Id.*
56. *Id.*
57. Report of the Judicial Conference Committee on Rules of Practice and Procedure to the Chief Justice of the United States and Members of the Judicial Conference of the United States, *supra* note 35.
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.*

five to forty-five days after the petition filing) in favor of using "real time" information from information retrieval companies, which report the identity of debtors who have filed by social security number, will find that the information retrieval companies will change their procedures somewhat. Those companies can retrieve records of bankruptcy filings that show the last four digits of the debtor's social security number, run it against client records for any possible hits, and then check back with the court for a positive full number identification of their client's customers using the full social security number of the customer as supplied by the creditor or obtained from the company's files. The process should be workable, although at some added cost.

The proposed amendments are now pending before the Supreme Court for adoption. Assuming they are adopted, they will then be transmitted to the Congress for review. If not objected to, they will become effective in December of 2003.

ARBITRATION OF BANKRUPTCY ISSUES

Increasingly, creditors include arbitration clauses in their consumer credit contracts, whether unsecured or secured by an automobile, real estate, or other collateral. These clauses are usually broad and apply equally to the creditor and debtor, sometimes with a special exception allowing the creditor to go to court to obtain foreclosure or repossession of collateral. The clauses are designed to be subject to the Federal Arbitration Act (FAA) which authorizes such clauses and provides that conflicting state laws are preempted.[62]

On their face, these clauses require that every issue that arises as a result of the credit transaction be subject to arbitration. They are sometimes attacked as "unfair" by consumer advocates, the trial bar, and/or various federal and state legislators. These attacks have resulted in a growing body of case law generally compelling enforcement of the arbitration clause, though sometimes developing various theories which narrowly excuse compliance.[63] A more difficult issue arises in a bankruptcy context; when the debtor files for bankruptcy relief, how does the arbitration clause apply?

The analysis may be different depending on the type of issue involved. First, there is the bankruptcy proceeding itself. In some sense, a bankruptcy proceeding involves and arises from the underlying credit transaction, yet bankruptcy relief always has been thought to be extraordinary and uniquely tied to the federal court system and the special jurisdiction conferred by Congress on the bankruptcy courts. It is unlikely that a creditor will succeed in getting a court to compel arbitration of the bankruptcy proceeding itself or of distinct issues that arise directly from it, such as confirmation of a Chapter 13 plan.

62. *See, e.g.*, Alan S. Kaplinsky & Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (but Undermine Federal Arbitration Act) by Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 BUS. LAW. 1289 (2003).

63. *See generally* Kaplinsky & Levin, *supra* note 62.

Other disputes, which involve distinct, separate proceedings relating to issues that arise under the Bankruptcy Code, are considered "core" proceedings.[64] For example, the debtor may commence litigation against a creditor to redeem personal property under 11 U.S.C. § 722, to avoid a lien under 11 U.S.C. § 522(f), or to determine the value and extent of a lien under 11 U.S.C. § 506, perhaps as part of an effort to "cram down" or "strip" the lien.[65] Finally, disputes that do not arise under the Bankruptcy Code, but nonetheless arise in the context of the bankruptcy, are usually categorized as "non-core" proceedings for jurisdictional purposes.[66] For example, the panel trustee or debtor may claim that the creditor failed to comply with consumer protection laws or that the creditor engaged in other misconduct, such as a violation of the automatic stay or post-discharge injunction.

A question arises whether any or all of these issues are subject to arbitration. The issue has been litigated frequently, and the lines are fairly clear. The principal distinction is typified by the result in the *Insurance Co. of North America v. NGC Settlement Trust & Asbestos Claims Management Corp. (In re National Gypsum Co.)*,[67] which held that an arbitration clause would not be enforced if the cause of action is not derivative of the pre-petition legal or equitable rights of the debtor, but instead arises from federal rights conferred by the Bankruptcy Code.[68] The *National Gypsum* court also suggested that judges have significant judicial discretion to enforce arbitration clauses and analyzed whether arbitration of the matter would be consistent with the purposes of the Bankruptcy Code, for example, the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.[69] Most bankruptcy courts reduce this analysis to the position that arbitration clauses are not enforceable if the matter being litigated is a "core" matter, but arbitration clauses will be enforced if the matter is a non-core matter.[70]

The implications of *National Gypsum* are important. For example, on the theory that core matters cannot be arbitrated, an arbitration clause generally may not interfere with a class action brought in the bankruptcy court alleging violation of the post-discharge injunction, because that action is viewed as a core matter by a number of courts.[71] On the other hand, the U.S. Court of Appeals for the First Circuit has indicated that the post-discharge injunction is technically not a court order, because it is statutorily based.[72] The First Circuit's decision suggests that a

64. 28 U.S.C. § 157(b)(2) (2000); Celotex Corp. v. Edwards, 514 U.S. 300, 309 n.7 (1995).

65. 11 U.S.C. §§ 506, 522(f), 722 (2000).

66. *Celotex*, 514 U.S. at 309 n.7.

67. 118 F.3d 1056 (5th Cir. 1997).

68. *Id.* at 1071.

69. *Id.*

70. *See, e.g.*, Mosley v. Shannon (*In re* Mosley), No. 99-14177, Adv. No. 00-1134 (Bankr. S.D. Ala. Aug. 6, 2001); Grant v. Cole (*In re* Grant), 281 B.R. 721, 722 (Bankr. S.D. Ala. 2000).

71. *See, e.g.*, Cavanaugh v. Conseco Fin. Serv. Corp. (*In re* Cavanaugh), 271 B.R. 414, 424 (Bankr. D. Mass. 2001).

72. Bessette v. Avco Fin. Servs. Inc., 230 F.3d 439, 446 (1st Cir. 2000), *cert denied*, 532 U.S. 1048 (2001).

suit alleging a violation of the post-discharge injunction is not a "core" matter because it could be decided by the district court without withdrawing the order of reference to the bankruptcy court, and so an arbitration clause should be enforceable.[73]

A recent U.S. Court of Appeals for the Fifth Circuit decision continues to refine the distinctions that circuit developed in *National Gypsum*. In *Gandy v. Gandy (In re Gandy)*,[74] a commercial rather than a consumer case, the Fifth Circuit recognized an exception to the general rule that arbitration clauses are enforceable for non-core matters.[75] In that case, a creditor asserted state-law fraudulent conveyance claims prior to bankruptcy and arbitration had been ordered by the state court pursuant to an arbitration clause. The debtor then filed bankruptcy and removed the state court proceeding to the bankruptcy court. The defendants again moved for arbitration. The Fifth Circuit concluded that the bankruptcy court correctly decided not to compel arbitration of the state fraudulent conveyance claim, even though it may have been technically a non-core matter.[76] *Gandy* illustrates an exception to the general rule enforcing arbitration clauses in non-core proceedings when the underlying nature of the case is derived exclusively from the Bankruptcy Code and arbitration would conflict with the purposes of the Bankruptcy Code.[77] In concluding that *Gandy* was a case excepted from the general rule, the Fifth Circuit considered several factors, including the importance of the claim to the bankruptcy case, the speed in resolving the claim, that a proof of claim had been filed by one defendant, and that certain remedies could only be obtained in the bankruptcy court.[78]

The fact that section 548 of the Bankruptcy Code overlaps so closely with state fraudulent conveyance law,[79] and that there was also a substantive consolidation claim involved, probably heavily influenced the *Gandy* court. The other factors listed by the court hardly provide a bright line test because they will usually be involved to some extent. For example, many non-core claims are "significant" in bankruptcy cases and speed in resolution is usually claimed to be paramount. So the *Gandy* rationale may be limited to fraudulent transfer cases.

Another recent case illustrates how a creditor's failure to object to a Chapter 11 plan, and, by extension, a Chapter 13 plan, can result in losing the arbitration clause. In *Ernst & Young LLP v. Baker O'Neal Holdings, Inc.*,[80] a plan provision provided that the court would retain jurisdiction to adjudicate post-confirmation adversary proceedings. The facts indicated that the interested party had been

73. *Id.* Careful consideration should be given before pursuing this argument. The court's reasoning does not explore the full range of potential issues or the implications of its decision on bankruptcy jurisdictional matters centering on the distinction between "core" and "non-core" matters. *Id.* These issues may have to receive further attention before being fully resolved.

74. 299 F.3d 489 (5th Cir. 2002).

75. *Id.* at 500.

76. *Id.*

77. *Id.* at 496.

78. *Id.* at 498–99.

79. *Id.* at 496–97.

80. 304 F.3d 753 (7th Cir. 2002).

active in the case and had objected to certain features of the plan involving the cause of action it later sought to arbitrate, but had not raised the arbitration issue until after confirmation. Based on those facts, the U.S. Court of Appeals for the Seventh Circuit affirmed the lower court decision not to compel arbitration.[81] The Seventh Circuit treated the creditor's failure to object to confirmation as a waiver of the right to arbitrate.[82] It also held that the confirmation of the plan was binding on the party and in effect modified its contract with the debtor to eliminate the arbitration term that conflicted with the provision in the plan that said the bankruptcy court would "adjudicate" the adversary proceedings.[83] A dissenting judge indicated that he did not find a waiver on those facts, nor would he have held that the party's failure to object barred it from later seeking to compel arbitration.[84]

Means Testing Under Section 707(b)

In some parts of the country, judges and the U.S. Trustee use section 707(b) of the Bankruptcy Code to combat substantial abuse by debtors with the ability to pay.[85] After years of ignoring this provision, some judges and the UST program as a whole have taken a new interest in it, the latter spurred by the current director of the EOUST, who is urging increased efforts by the USTs in this field.[86] Initially, this interest was apparently spurred by efforts to enact the recent reform proposals, which would have made section 707(b) motions more available, combined with studies that have shown that a number of people use Chapter 7 when they have an ability to pay. Growing recognition among the bankruptcy judiciary that there is a limited group that abuses the system, combined with the realization that more draconian legislation may be avoided if the courts do something about it, may make this a fertile area for bankruptcy courts in 2003.

Recent developments have suggested that even without legislation, there are significant opportunities for judges or the UST to increase the use of section 707(b) to require debtors with ability to pay to use Chapter 13. This requires three steps. First, bankruptcy judges have to indicate that they will enforce section 707(b) in ability-to-pay cases. Some courts have historically taken the position that "mere" ability to pay is not a sufficient ground to support a successful section 707(b) motion. Reported cases over the last two or three years, however, have almost uniformly shown an increasing willingness to look closely at whether the debtor had an ability to pay. Next, the UST is empowered to bring these cases. The UST must be willing to allocate some resources to section 707(b) enforcement. The directive from the EOUST that activity in this area should increase suggests that those resources will be made available. A third step, not always

81. *Id.* at 754.
82. *Id.* at 756.
83. *Id.*
84. *Id.* at 760–61 (Fairchild, J., dissenting); *cf. infra* notes 89–94 and accompanying text (discussing discharge provisions in a plan).
85. 11 U.S.C. § 707(b) (2000); *see also supra* note 26 and accompanying text.
86. U.S. Tr. Program, *supra* note 23, at 16–19.

necessary but undoubtedly helpful, is for courts to rule that a creditor or the panel trustee in a Chapter 7 case can communicate to the UST that there are grounds for a substantial abuse dismissal of the case under section 707(b), and can assist the UST in the preparation and presentation of the case. There is already favorable law on this point on the local and circuit level.

This may open up a more effective avenue for unsecured creditors to increase the number of Chapter 13 cases in which they receive significant payment, as well as to discourage abusive use of Chapter 7. Some statistics indicate that in the fiscal year ending in September 30, 2000, only $770,000 was paid to unsecured creditors (both priority and non-priority) in Chapter 13 cases during that year. This suggests that there is room for significant improvement.

POST-DISCHARGE LITIGATION

During 2002, the fallout from the *Sears* case[87] continued, but with a change in focus. Originally, most litigation focused on what remedy debtors had for a violation of the post-discharge injunction. Was it a private cause of action that could be brought as a class action, or an action in contempt, and, if the latter, could that be brought as a class action?[88] In 2002, the focus changed more to (i) the jurisdictional issues in post-discharge violation class action cases, and (ii) the sort of creditor conduct that violates the post-discharge injunction.

From the last quarter of 2000 through 2002, four U.S. circuit courts of appeals dealt with whether there was a private cause of action if a creditor violates the automatic stay or the post-discharge injunction, while another circuit steered around the main controversy, concluding that a class action seeking injunctive relief was not appropriate.[89] As these decisions have accumulated, the courts have become increasingly detailed in their analyses of related issues. For example, some jurisdictions examined the bankruptcy court's jurisdiction over consumer

87. *In re* Latanowich, 207 B.R. 326 (Bankr. D. Mass. 1997); *see generally* George J. Wallace, *Are Unified Reaffirmations Improper?*, 53 CONSUMER FIN. L.Q. REP. 132 (1999).

88. *See, e.g.*, Lauren L. Hart, *Case Note: The Reaffirmation Provision—Is There a Private Right of Action Through the Contempt Power?*, 54 CONSUMER FIN. L.Q. REP. 40 (2000); Wallace, *supra* note 87; Lawrence A. Young & Amy H. Regent, *"Toto . . . We're not in Kansas Anymore"—After a Bankruptcy Discharge, What Can a Secured Creditor Do?*, 53 CONSUMER FIN. L.Q. REP. 123 (1999).

89. *See, e.g.*, Walls v. Wells Fargo Bank, N.A., 276 F.3d 502, 509–10 (9th Cir. 2002); Cox v. Zales Del., Inc., 239 F.3d 910, 913 (7th Cir. 2001); Bessette v. Avco Fin. Servs. Inc., 230 F.3d 439, 444–45 (1st Cir. 2000) (holding that contempt can be remedied by action for damages and therefore implying that a contempt action can probably be brought as a class action, although the decision does not address the issue); Pertuso v. Ford Motor Credit Co., 233 F.3d 417, 422–23 (6th Cir. 2000) (holding that section 524 does not create a private cause of action and therefore no class action); Bolin v. Sears, Roebuck & Co., 231 F.3d 970, 975–79 (5th Cir. 2000) (holding that class action brought under Rule 23(b)(2), seeking injunctive and "incidental" damages rather than damages under Rule 23(c), was not appropriately commenced under Rule 23(b)(2) because it really sought monetary damages, not injunctive relief); *see also* Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (*In re* National Gypsum Co.), 118 F.3d 1056, 1063 (5th Cir. 1997) (stating that a violation of the section 524 injunction is "often enforced by a motion for contempt, . . . but [is] also enforceable through a declaratory judgment action"; some have argued that this language opens the door to a private cause of action in the Fifth Circuit).

bankruptcy class actions.[90] Other jurisdictions focused on what post-discharge conduct violates the injunction against taking "acts to collect" under 11 U.S.C. § 524.[91]

Other courts have addressed claims of automatic stay or post-discharge injunction violations without deciding whether the creditor's conduct violated the injunction. In *Rein v. Providian Financial Corp.*,[92] the U.S. Court of Appeals for the Ninth Circuit concluded that res judicata and collateral estoppel barred debtors from pursuing claimed violations of the automatic stay and post-discharge injunction.[93] The debtors had settled non-dischargeability actions brought by Providian in their individual bankruptcy cases by entering into a consent judgment stipulating that the Providian debt was non-dischargeable. It was these judgments, not the post-discharge injunction, that barred subsequent attempts to litigate the alleged violations.[94]

In *Snow v. Countrywide Home Loans Inc. (In re Snow)*,[95] the bankruptcy court confirmed a plan that included a mortgage lender's debt. After confirmation, the debtor became lead plaintiff in a class action claiming that an "inspection fee" the lender charged and had included in its proof of claim violated Maryland law. The bankruptcy court concluded that *res judicata* barred the new action because the cause of action was not raised or preserved in the plan.[96]

In *Eastern Equipment & Services Corp. v. Factory Point National Bank*,[97] the Second Circuit held that a claim of violation of the automatic stay could not be brought as a claim under state tort law, because federal bankruptcy law preempted any state law claims.[98] Obviously, this is important to post-discharge and automatic stay class action cases insofar as they attempt to use state causes of action to challenge creditor conduct during or after the bankruptcy.

90. *See, e.g.*, Beck v. Chrysler Fin. Corp. (*In re* Beck), 283 B.R. 163 (Bankr. E.D. Pa. 2002); Williams v. Sears Roebuck & Co. (*In re* Williams), 244 B.R. 858 (S.D. Ga. 2000).

91. *See, e.g.*, DuBois v. Ford Motor Credit Co., 276 F.3d 1019, 1024 (8th Cir. 2002) (finding debtor's continuation of voluntary payments not violative of rules governing reaffirmations, even when the balance due on a prior car lease was "rolled" into a new car lease, presumably making it a personal liability; the payments were voluntary and the creditor's conduct was not coercive); Garske v. Arcadia Fin. Ltd, 286 B.R. 773, 774 (Bankr. N.D. Cal. 2002) (threatening to repossess collateral over the telephone was not violative) (appeal pending before the Ninth Circuit BAP) (class action aspect may be moot based on *Walls*, 276 F.3d at 510); Ramirez v. GMAC (*In re* Ramirez), 273 B.R. 620, 624 (Bankr. C.D. Cal. 2002) (sending monthly statements is permissible during the automatic stay); Henry v. Assocs. Home Equity Servs. Inc. (*In re* Henry), 266 B.R. 457, 473 (Bankr. C.D. Cal. 2001) (ruling that creditor-initiated contacts that go beyond written communications violate the injunction because they are too hard to monitor). In *Finnie v. First Union National Bank*, the court concluded that a bank could sell debt that had been discharged in bankruptcy to a collection agency. 275 B.R. 743 (E.D. Va. 2002). When the collection agency started to collect, the debtor sued the bank. The court held that the sale of the debt was not in and of itself a violation. *Id.* at 746.

92. 252 F.3d 1095 (9th Cir.), *amended by* 270 F.3d 895 (9th Cir. 2001).

93. *Id.* at 1099.

94. *Id.* at 1101–02.

95. 270 B.R. 38 (D. Md. 2001).

96. *Id.* at 42; *supra* notes 89–94.

97. 236 F.3d 117 (2d Cir. 2001).

98. *Id.* at 121.