

## **A PROPOSAL FOR MORE EFFECTIVE BANKRUPTCY REFORM**

**By A. Thomas Small and Eugene R. Wedoff**

### **Introduction**

This Proposal addresses the goals of bankruptcy reform advanced in the last several sessions of Congress and most recently incorporated in S. 256 in the 109th Congress. The Proposal furthers the principal objective of the reform legislation—to curb bankruptcy abuse—both by making bankruptcy relief more difficult for the most likely abusers and by adjusting procedures that could impair the goals of the legislation by imposing unnecessary costs on parties and the court system.

The Proposal is set out in 15 separate recommendations, followed by a summary table. For several of the recommendations, statutory language is provided to effect all or part of the changes recommended. The recommendations for individual bankruptcy cases (1) make the reform provisions applicable to *all* debtors, rather than limiting them to debtors with primarily consumer debts, (2) expand the criteria for determining abuse to include both ability to pay and the amount of property exempted, and (3) maintain incentives for debtors to choose repayment of their debts through a Chapter 13 plan. The recommendations for business bankruptcy are consistent with the objective of expediting the confirmation process, reducing costs for both debtors and creditors, and providing increased oversight.

The Proposal is limited to those areas with the greatest impact on the bankruptcy system, and does not address all of the provisions of S. 256. The failure to comment on a particular section of the legislation reflects neither support of nor disagreement with that section.

### **Proponents**

**A. Thomas Small** has been a United States Bankruptcy Judge for the Eastern district of North Carolina for 20 years and served a 7-year term as Chief Judge from 1992 to 1999. His involvement with bankruptcy reform began in the early 1980s. As an attorney in the Legal Division of First Union National Bank and as a representative of the American Bankers Association and the National Coalition for Bankruptcy Reform, Judge Small participated in hearings on bankruptcy abuse conducted by Senator Robert Dole, Chair of the Senate Judiciary Committee's Subcommittee on Courts, and by Representative Peter Rodino, Chair of the House Judiciary Committee. These reform efforts led to significant amendments to the Bankruptcy Code, including the addition of § 707(b) and amendments to § 523 to discourage the "loading up" of pre-bankruptcy debt. In 1985, Judge Small, along with Judge Thomas M. Moore (B.J., E.D.N.C.) testified before a joint Senate committee chaired by Senators Charles Grassley and John East regarding agricultural bankruptcies. Together with Judge Keith Lundin (B.J., M.D. Tenn.), Sam Gerdano (majority counsel for the Senate Judiciary's Subcommittee), and Vince Lavoie (legislative aid to Rep. Mike Synar), Judges Small and Moore drafted Chapter 12, which became part of the Bankruptcy Code in 1986. In 1987, Judge Small developed a fast track procedure for handling small business Chapter 11 cases. These procedures have been adopted in many districts and are the basis of many of the present small business provisions in the Bankruptcy Code and in S. 256.

Judge Small is the former chair of the Advisory Committee on Bankruptcy Rules of the United States Judicial Conference, was a member of the Long Range Planning Committee of the United States Judicial Conference from 1991 to 1996, and was a member of the Board of the Federal Judicial Center from 1997 to 2001. He was president of the National Conference of Bank-

ruptcy Judges (2000-2001), served on the Board of the American Bankruptcy Institute from 1989 to 1995, and currently is on the Board of the American College of Bankruptcy.

**Eugene R. Wedoff** is the Chief Bankruptcy Judge for the Northern District of Illinois, in Chicago. He has been serving as a bankruptcy judge in that district for 17 years. After graduating from the College and Law School of the University of Chicago, Judge Wedoff became a partner and member of the Executive Committee at the Chicago law firm of Jenner & Block, specializing in the defense of businesses and individuals in complex civil litigation. Judge Wedoff is presently presiding over the bankruptcy of United Airlines and its related entities.

In 1997, Judge Wedoff became co-chair of the Consumer Bankruptcy Committee of the American Bankruptcy Institute. In that capacity, he has prepared analyses of the bankruptcy reform legislation presented in the last several terms of Congress, and testified concerning the legislation before the House Subcommittee on Commercial & Administrative Law. For his work in this area, Judge Wedoff received a special award from the ABI in 1998. Judge Wedoff has also engaged in discussions regarding bankruptcy reform as a participant in the Annual Bankruptcy Conferences sponsored by Visa USA, and has been a member of the Visa Bankruptcy Roundtable. An advocate of the Chapter 13 bankruptcy system, Judge Wedoff drafted the model Chapter 13 plan now used in the Northern District of Illinois and introduced that District's model retention agreement, which sets out the duties owed by debtors' attorneys to their clients.

Judge Wedoff is the author of the chapter on professional employment in Queenan, Hendel and Hillinger, *Chapter 11 Theory and Practice* (LRP Publications, 1994), and has served as an associate editor of *The American Bankruptcy Law Journal* and as a member of the Board of Governors of the National Conference of Bankruptcy Judges. He is a director and member of the executive committee of the American Bankruptcy Institute, a Fellow of the American College of Bankruptcy, and a member of the National Bankruptcy Conference.

## **The Proposal**

### **1. Section 707(b), abuse, means testing**

#### Recommendation

- 1) Change "substantial abuse" to "abuse" in § 707(b) [same as S. 256, § 102(a)(2)].
- 2) Remove the presumption in favor of the debtor's choice of relief in § 707(b) [same as S. 256, 102(a)(2)].
- 3) Expand the scope of § 707(b) to include *all* individual debtors, not just those with "primarily consumer debts" [new, modifies S. 256, 102(a)(2)].
- 4) Expand the criteria for § 707(b) "abuse" to include (1) the ability to repay general unsecured debt at a rate of at least \$150 monthly, and (2) the totality of the debtor's circumstances, with specific reference to the extent of exemptions claimed by the debtor and to the intent of the debtor to reject a personal services contract [new, modifies S. 256, 102(a)(2)].
- 5) Clarify income measurement for purposes of § 707(b) to require that the determination of abuse be based on the debtor's projected earnings, considering both the debtor's income

at the time of filing and the debtor's income for the preceding calendar year [continues approach of S. 256, 102(a)(2) by considering past earning history, but eliminates difficulties caused by 6-month averaging].

- 6) Permit creditors to file motions to dismiss under § 707(b) if the debtor's current or prior year income exceeds the applicable state median [expands approach in S. 256, § 102(a)(2)].
- 7) Determine debtor's expenses on an actual and necessary basis, without application of IRS standards [new, modifies S. 256, 102(a)(2)].
- 8) Provide for a study of the effect of employing IRS standards or other measures of appropriate living expenses in determining abuse under § 707(b) [same as S. 256, 103(b), but with the study preceding the use of IRS standards].

#### Comment

Perhaps the most important change proposed in S. 256 is its "needs-based" approach to Chapter 7 relief. This approach is designed to limit Chapter 7 relief to debtors who genuinely need it, because their income is not sufficient to pay both their living expenses and their debts. S. 256 effectuates needs-based Chapter 7 relief through amendments to § 707(b) of the Code. Section 707(b) currently allows dismissal of Chapter 7 cases for "substantial abuse," with the understanding that it would be a substantial abuse for a debtor to seek an immediate discharge in Chapter 7 if the debtor could repay debts from current income, under Chapter 13 if necessary. However, § 707(b) has had limited impact—for several reasons: (1) only judges and the U.S. trustee or bankruptcy administrator have standing to bring a § 707(b) motion; (2) the provision is limited to debtors with primarily consumer debts; (3) it contains no definition or description of "substantial abuse"; and (4) it includes a presumption that the debtor has properly chosen to proceed in Chapter 7.

S. 256 amends § 707(b) to accord standing to all parties in interest if the debtor's average monthly income over a six-month period exceeds a defined state median; it allows dismissal for simple "abuse" rather than "substantial abuse"; it describes abuse as involving the totality of the debtor's financial situation; it eliminates the presumption in favor of the debtor's choice of Chapter 7; and it creates a new presumption: that abuse exists in any case where the debtor's average monthly income over six months—less deductions for living expenses and payment of secured and priority debt—exceeds defined "trigger points." For purposes of this presumption, the debtor's expenses are based, in part, on standards developed by the IRS for negotiating payment of tax liabilities from delinquent taxpayers.

S. 256's approach is problematic in two respects. First, it continues the current limitation of § 707(b) to debtors with primarily consumer debts, with the effect of excluding from its scope wealthy debtors with substantial business liabilities. Second, its presumption of abuse is complex, and creates substantial difficulties in calculating both income and allowable expenses. Six-month income averaging produces skewed results for debtors with seasonal employment, and fails to take into consideration recent changes in employment. Moreover, the IRS collection standards for expense allowance, which are complex in their own right, were not created for use in bankruptcy, and so S. 256 contains numerous provisions modifying or supplementing them (for example, one provision requires that the IRS standards be adjusted to eliminate any expense attributable to secured debt repayment, since such payments are allowed as a separate deduction). As a result, the presumption is difficult to apply and subject to manipulation. It also imposes sub-

stantial costs on all debtors, regardless of their ability to pay debts, as well as on trustees and the court in administering the presumption.

To achieve the goal of needs-based Chapter 7 more effectively, the Proposal suggests retaining the overall modifications to § 707(b) set out in S. 256 as follows: (1) changing “substantial abuse” to simple “abuse”; (2) removing the presumption in favor of the debtor’s choice of Chapter 7 relief; (3) defining “abuse” to include consideration of the debtor’s ability to pay general unsecured debt at a defined level; (4) considering the debtor’s past earnings in determining ability to pay; and (5) extending standing to creditors and case trustees where the debtor’s income exceeds the applicable state median. However, the Proposal would delay application of a presumption of abuse until the completion of a study of the potential use of IRS collection standards for this purpose, as directed by § 103(b) of S. 256.

At the same time, the Proposal suggests the following additional provisions to make § 707(b), as amended, more effective:

- Remove the “primarily consumer debt” limitation, so that § 707(b) is applicable to all individual Chapter 7 debtors.
- Allow the expanded standing for parties in interest to be based on the debtor’s prior year’s gross income, as well as on current income.
- create a single, clear “trigger point” of \$150 per month (\$1800 annually), at which available income to pay general unsecured debts will constitute abuse of Chapter 7. The trigger points for the presumption of S. 256 range from \$100 per month to \$166.67 per month, depending on the total amount of general unsecured debt. This range creates complexity, and provides incentive for debtors to increase their debt prior to bankruptcy so as to avoid a finding of abuse.
- Specify that, in calculating the amount of income the debtor has available to pay general unsecured debt, the debtor’s projected earnings be used, determined by the debtor’s earnings history as well as the debtor’s current earnings. Specify further that the expenses claimed by the debtor must be the debtor’s actual expenses, in amounts reasonably necessary to provide for the maintenance or support of the debtor and the debtor’s dependents.
- Clarify that the “totality of the circumstances” may lead to a finding of abuse even where the debtor has not been shown to have ability to repay debt above the trigger point, and that, in this regard, the court may consider the extent of the exemptions claimed by the debtor as well as bad faith and the intent by the debtor to reject a personal services contract.

Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

## **2. Random audits; attorney liability for accuracy of schedules**

### Recommendation

- 1) Provide for random audits of all individual debtors, conducted by auditors approved by the U.S. trustee or bankruptcy administrator; provide for the cost of such audits to be borne by the U.S. trustee system unless a willful, material misstatement is established; in

case of such a misstatement, provide for the audit cost to be assessed against the debtor [consistent with, but expanding on S. 256, § 603].

- 2) Eliminate increased liability for debtor's counsel beyond that currently required by Rule 9011, FRBP [omits additional liability provided in S. 256, §§ 102(a), 319].

#### Comment

*Random audits.* In order for the bankruptcy system to operate fairly, it is essential that the information provided by debtors in their schedules be accurate. To achieve greater accuracy S. 256 provides for random audits of not less than one in every 250 cases of individual debtors (0.4%). If the cost is \$1500 for each audit, and individual bankruptcy cases continue to be filed at the current rate (1.5 million annually), the total annual cost to audit 0.4% of the cases would be \$9 million. S. 256 does not address payment of the costs of these audits.

Random audits have the potential to be effective in encouraging accuracy by debtors. At the same time, the question of payment for the audits must be addressed. Most Chapter 7 debtors have no assets available to pay the costs of an audit. Chapter 13 debtors often are required to devote nearly all of their debt repayment to priority and secured indebtedness, which must be paid in full, leaving little for payment of general unsecured claims. A requirement that such debtors bear the cost of an audit would be very difficult to enforce, and likely cause the failure of many Chapter 13 plans. Thus, as a general rule, the costs of the audits should be borne by the U.S. trustee system, with funding provided to that system for this purpose. On the other hand, where a random audit reveals a willful, material misstatement by the debtor, it is appropriate for the audit costs to be assessed against the debtor; the imposition of such costs will serve as an additional incentive for accuracy.

*Attorney liability.* The burden of full and accurate disclosure in bankruptcy schedules is properly placed on the debtor. With the addition of random audits, there should be no need for the enhanced liability that S. 256 would impose on debtors' attorneys to investigate the accuracy of schedules. Requiring such investigation would increase the cost of legal representation and interfere with the attorney-client relationship.

### **3. Conditions precedent for relief (credit counseling, financial documentation, education)**

#### Recommendation

- 1) Require credit counseling as a condition of eligibility for individual Chapter 7 debtors [same as S. 256, § 106(a), but limited to Chapter 7].
- 2) Require debtors to produce proof of earnings to the trustee, prior to the § 341 creditors meeting, rather than filing the documentation with the court; provide that if the debtor fails to produce information required under § 521 of the Code, the court must dismiss the case on motion of a party in interest, unless (a) the debtor demonstrates that the failure was due to circumstances beyond the debtor's control or (b) the trustee establishes grounds for seeking a denial of discharge or administering the estate for the benefit of creditors [modifies S. 256, §§ 315(b) and 316].

- 3) Commence a program of mandatory debtor education only after consideration of a study of the effectiveness of various educational methods [retains S. 256, § 105; defers S. 256, § 106(b)].

#### Comment

*Credit counseling.* Section 106(a) of S. 256 requires that each individual debtor obtain a briefing from a credit counseling agency as a condition of eligibility for bankruptcy filing. The briefing would inform the debtor of the opportunities for credit counseling and assist the debtor in performing a budget analysis. Such a briefing could be helpful to Chapter 7 debtors. A Chapter 7 debtor may not have carefully considered the possibility of paying creditors over time through available income, and a limited delay in filing the case to allow for a credit counseling briefing is unlikely to cause significant difficulties, since Chapter 7 is not generally used to prevent foreclosures or repossessions.

In contrast, credit counseling briefings are not likely to be helpful in Chapter 13. A Chapter 13 debtor must propose a budgeted repayment plan as part of the bankruptcy process, and so any budgeting work done with a credit counselor would be duplicative, adding unnecessary expense. Moreover, Chapter 13 debtors frequently approach their attorneys shortly before a foreclosure sale or repossession, with a need to file the bankruptcy immediately if the threatened action is to be avoided. Any delay required to obtain counseling could cause the loss of property essential to the debtor's success in reorganizing under Chapter 13. (While S. 256 does provide an exception for filing in emergencies, it requires the debtor to establish that credit counseling services were unavailable for five days, and so the exception would not apply in situations where the attorney is contacted within five days of a threatened foreclosure or repossession.) Limiting the credit counseling requirement to Chapter 7 debtors would provide maximum value, limit unnecessary expense, and provide a valuable incentive for debtors to file under Chapter 13.

Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

*Financial documentation/dismissal for failure to produce.* Section 521 of the Code sets out the duties of debtors, including the duty to file schedules. Section 315(b) of S. 256 imposes several additional duties on individual debtors, including a duty to file with the court "copies of all payment advices or other evidence of payment received within 60 days before the filing." Such payment advices are likely to include identifying information of a personal nature (including social security numbers) that would be difficult for the court to protect from disclosure. For tax returns filed prior to the bankruptcy, § 315(b) provides that the debtor is not required to file the information with the court, but to provide it to the trustee at least seven days before the creditors' meeting. By treating payment advices in the same way, the problems of protecting privacy can be avoided.

Sections 315(b) and 316 of S. 256 set out a complex set of rules for dismissal of individual bankruptcy cases in situations where the debtor fails to submit required financial information. In some situations, dismissal is required automatically, without notice to the debtor. In others, dismissal is required unless there is a showing of good faith on the debtor's part, or a showing that circumstances beyond the debtor's control prevented timely production of the documents. Automatic dismissal is problematic, in that neither the debtor nor the trustee may be aware of any deficiency in providing required information; and, dismissal in the absence of a showing of good faith by the debtor may prevent a trustee from seeking a denial of the debtor's discharge or the recovery of avoidable transfers. It is preferable to require a motion for dismissal based on the

debtor's failure to provide required information, and to allow denial of the motion if the debtor shows the existence of circumstances beyond the debtor's control, or the trustee shows good cause to continue administering the case for the benefit of creditors.

*Debtor education.* Section 105 of S. 256 establishes a pilot educational program, in six judicial districts, designed to help individuals better manage their finances. The program would be studied by the Executive Office for United States Trustees, and would be followed by a report to Congress by the director of that office. The program, study, and report would be of great value. A number of educational programs already have been developed, primarily in the context of Chapter 13, and knowledge of their effectiveness would be very helpful to Congress in determining what type of educational program would be most effective in bankruptcy. For example, it might be determined that educational programs are much more effective in Chapter 13, where debtors are in contact with the bankruptcy process for an extended period of time, than they are in Chapter 7, where the debtor is generally involved in bankruptcy for only a few weeks.

In contrast to § 105, § 106(b) of S. 256 mandates debtor education in both Chapter 7 and Chapter 13 cases, on penalty of a loss of the bankruptcy discharge. It is premature to require completion of the educational programs before the results of the study. If it is determined, for example, that educational programs are not effective in Chapter 7, requiring completion of such programs will unnecessarily expend both the time and financial resources of debtors with limited income. Moreover, allowing completion of the study before mandating education will allow any mandated course of study to be based on the best available curriculum.

#### **4. Reaffirmation agreements**

##### Recommendation

- 1) Conduct a study to determine extent of any abuse and need for legislation [same as S. 256, § 205].
- 2) Defer modifying reaffirmation procedures until completion of the study [defers extensive and confusing reaffirmation requirements in S. 256, § 203].

##### Comment

Under present law counsel must certify that reaffirmation agreements (other than agreements involving a consumer debt secured by real property) do not impose an undue hardship on the debtor or a dependent of the debtor and that the agreement is in the debtor's best interest. 11 U.S.C. § 524(c)(6). If the debtor is not represented by an attorney in connection with the reaffirmation agreement, the court must hold a hearing at which it informs the debtor of the effect of the agreement and finds that the agreement (other than an agreement involving a debt secured by real property) does not impose an undue hardship on the debtor or a dependent and is in the debtor's best interest. 11 U.S.C. § 524(d). These requirements—attorney certification and court approval for agreements involving pro se debtors—may be adequate to protect the interests of debtors. The protections provided by S. 256 are cumbersome and should not be enacted until the study has been completed and a need for the additional protections has been established.

## 5. Serial filers; relief from stay

### Recommendation

- 1) Provide that, in a second bankruptcy case filed by a debtor within a one year period, the court shall enter an order terminating the automatic stay 30 days after the second petition is filed, without the need for a motion, unless prior to the expiration of 30 days the debtor demonstrates that the second case was filed in good faith or unless a trustee demonstrates the potential to administer particular assets for the benefit of the estate [consistent with S. 256, § 302 except that an order is required].
- 2) Provide that, upon a third bankruptcy filing by a debtor within a one year period, the court shall immediately enter an order terminating the automatic stay, without the need for a motion, except that the stay may be reinstated by the court if the debtor demonstrates that the third case was filed in good faith or if a trustee demonstrates the potential to administer particular assets for the benefit of the estate [consistent with S. 256, § 302 except that an order is required].
- 3) Provide in § 362(d) of the Code that, with respect to all personal property securing consumer debts in Chapter 7 cases, the court shall enter an order terminating the stay, upon motion, if there has been no redemption or reaffirmation with respect to the property within 45 days of the date first set for the first meeting of creditors, unless the trustee establishes that the property at issue is of consequential value or benefit to the estate, in which case the court shall order appropriate adequate protection of the moving party's interest [consistent with S. 256, § 304-05 except that an order on motion is required].
- 4) Provide in § 362(d) of the Code that, with respect to all personal property subject to an unexpired lease in an individual Chapter 7 case, the court shall enter an order terminating the stay, upon motion, if there has been no assumption of the lease within 45 days of the date first set for the first meeting of creditors, unless the trustee establishes that the lease at issue is of consequential value or benefit to the estate, in which case the court shall order appropriate adequate protection of the moving party's interest [consistent with S. 256, § 305 except that an order on motion is required].
- 5) Provide in § 362(d) of the Code that, in Chapter 11 cases of small business debtors, the court shall enter an order terminating the stay, upon motion, if in a prior small business case of the debtor (or of an entity that the debtor acquired) an order of dismissal or an order confirming a plan was entered less than two years prior to the order of relief in the pending case, unless the debtor shows (a) that the pending case was an involuntary one, filed without collusion with the debtor, or (b) that the need for filing the pending case arose from unforeseeable circumstances beyond the control of the debtor, and that a non-liquidating plan is probable [consistent with S. 256, § 441(2) except that an order on motion is required].

### Comment

It is not uncommon for debtors to frustrate collection efforts of secured creditors by filing bad faith bankruptcy cases. That is unfair to the creditors and relief from the stay should be promptly granted in these cases, without unnecessary cost to the creditors, unless good grounds are shown for the stay remaining in effect. S. 256 provides in several sections for automatic non-application of the stay (with the stay either not going into effect, or terminating automatically,

without motion) in situations deemed to be potentially abusive. In each of these situations, the stay would be effective if the debtor or a trustee makes a specified showing of good faith. The problem with this approach is the uncertainty of whether or not the stay is applicable—that is, whether the predicates for non-application of the stay have occurred—and there is potential for confusion if the applicability of the automatic stay is required to be adjudicated in state court. Accordingly, it would be preferable for the circumstances set out in S. 256 to be additional grounds mandating relief from the stay through an order of the bankruptcy court. This will ensure that questions regarding the grounds for relief are adjudicated in a forum with experience in the application of the laws in question, and that any dispute over the application of the law is addressed in the federal appellate process. Specifically:

*Repeat filings by individual debtors.* Section 302 of S. 256 provides that the stay should automatically terminate after 30 days if there is a second filing by an individual debtor within one year, and not be applicable at all if there are more than two filings, unless the debtor takes action to show good faith. In addition to the problem of requiring state courts to determine any dispute as to whether these provisions are effective, § 302 does not provide an opportunity for a trustee to show that property in the estate has equity that could be used to pay debts other than that of the secured creditor seeking to proceed against the property outside of the bankruptcy. The recommendation would require the bankruptcy court to enter an order terminating the stay without motion or request of the creditor if the debtor or trustee does not make the appropriate showing; state courts could then rely on an order of the bankruptcy court in allowing actions against the debtor’s property to proceed.

*Redemption or reaffirmation.* With respect to personal property that is collateral or subject to a lease, §§ 304 and 305 of S. 256 provide for automatic termination of the stay if the property is not subject to redemption or reaffirmation by an individual debtor within a specified 45-day period. The recommendation is for the court to enter an order terminating the stay if the debtor does not redeem or reaffirm a secured debt, or assume a lease, within the 45-day period. A motion would be required in these situations, since a reaffirmation agreement may not be of record. The motion would allow the trustee to present evidence of equity to the court, so as to allow the trustee to sell the property or assume the lease in question for the benefit of the estate.

*Repeat filings by small business debtors.* Section 441(2) of S. 256 provides for non-application of the automatic stay in situations of repeat filings of small business Chapter 11 cases. Here, especially, there are likely to be questions as to whether the grounds for non-application apply. For example, § 441(2) provides that an entity that acquires “substantially all of the assets or business” of a small business debtor under a confirmed plan would not get the benefit of the automatic stay in its own small business bankruptcy for a two-year period after the order of confirmation in the original case, unless it showed that the acquisition was in good faith and not for the purposes of avoiding application of the automatic stay limitation. This provision is subject to considerable potential dispute—both as to the question of whether “all or substantially all” of the business was acquired, and whether the acquisition was in good faith. It is better to allow these matters to be resolved in the bankruptcy court, with appeal through the federal courts, rather than in state court. This, again, can be accomplished by mandating that relief from the stay shall be granted on motion on the grounds set forth in § 441(2).

## **6. Notice to creditors**

### Recommendation

Continue the current law on noticing pending a study of electronic notice to creditors, conducted by the Administrative Office of the United States Courts. [modifies S. 256, § 315(a)].

### Comment

Section 315(a) of S. 256 sets out a new program for providing notice to creditors, requiring that they be served at a preferred address, which may be on file with the court generally, on file with the court in a particular case, or listed in the two most recent pieces of correspondence sent to the debtor within the 90 days preceding the bankruptcy filing, unless the creditor was prohibited from communicating with the debtor during that period, in which case the required address would be the one used on correspondence sent to the debtor prior to the 90-day period. If the preferred address is not used, the debtor or trustee would have the burden of showing that notice was actually received by the creditor's designated office in order for certain enforcement actions to be taken against the creditor.

The Administrative Office of the United States Courts is currently in the midst of a transition to electronic filing for the federal judiciary, in which bankruptcy courts are taking the lead. Participants in the electronic filing program will be able to receive electronic notice of filings, via the Internet, almost as soon as the filing takes place. This system offers possibilities for effective notice, on a nationwide basis, that can avoid the uncertainty and potential for litigation involved in the program set out in § 315(a). Accordingly, it is proposed that the current law on noticing be continued pending a study of electronic notice to creditors, conducted by the Administrative Office.

Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

## **7. Time between discharges**

### Recommendation

Retain current law regarding the effect of prior bankruptcy discharges on the ability of the debtor to obtain a discharge in Chapter 13 [modifies S. 256, § 312].

### Comment

Section 312 of S. 256 changes current law regarding the effect of prior bankruptcy cases on the ability of an individual to obtain a discharge in a pending case. Under current law (§ 727(a)(8)), a Chapter 7 debtor is subject to denial of discharge if the debtor obtained a discharge in a Chapter 7 or 11 case filed within six years of the pending case. S. 256 extends this time to eight years—a change not affected by this Proposal.

However, § 312 also creates, for the first time, a limitation on the ability of a Chapter 13 debtor to obtain a discharge, by providing that a discharge will not be granted in Chapter 13 if the debtor obtained a discharge in a Chapter 7, 11, or 12 case filed within four years of the pending

case, or in a Chapter 13 case filed within two years of the pending case. This provision has the effect of denying any possibility of a bankruptcy discharge, for four years, to an individual who has obtained a Chapter 7 discharge.

For an individual who is again in financial distress after obtaining a Chapter 7 discharge, Chapter 13 may be the most effective means for financial restructuring. Since the discharge could only be granted if the debtor devotes all disposable income to plan payments for a minimum of three years (or pays 100% of all claims), Chapter 13 may well create a framework of financial responsibility that will prevent further difficulties.

The principal problem of allowing a debtor to file Chapter 13 shortly after a Chapter 7 case is concluded has to do with the so-called “Chapter 20” abuse—in which debtors who could have addressed all of their debt in Chapter 13 instead file Chapter 7 cases, obtain a discharge of their unsecured debt, and then pursue Chapter 13 only to deal with the remaining secured debt. This type of abuse is dealt with by current law requiring that Chapter 13 cases be filed in good faith (a requirement confirmed by S. 256, § 102(g)), and by new limitations on the effect of the automatic stay included in S. 256, § 302 as discussed above in Recommendation 5. Denying a discharge to a debtor in the “Chapter 20” situation would have no impact in any event, because the Chapter 13 debtor would already have received a discharge in the prior Chapter 7 case, and would be using the Chapter 13 only to restructure nondischargeable secured debt.

## **8. Dischargeability**

### Recommendation

- 1) create a new ground for nondischargeability under § 523(a) dealing specifically with misuse of credit card obligations, and provide that the new ground for nondischargeability is not applicable to a discharge under § 1328(a) of the Code [modifies S. 256, § 314(b)].
- 2) Remove § 523(a)(1)(B) from the categories of nondischargeable tax debt as to which a discharge under § 1328(a) does not apply [modifies S. 256, § 707].

### Comment

In the area of the dischargeability of debt, S. 256 makes a substantial change in current law, largely eliminating the “superdischarge” feature of Chapter 13. Under current law, a full Chapter 13 discharge, as provided for by § 1328(a), applies to a number of debts that are nondischargeable under other chapters of the Code, including the following:

- § 523(a)(1)(B) and (C) (debts arising from late-filed and fraudulent tax returns),
- § 523(a)(2) (debts incurred through fraud),
- § 523(a)(3) (debts held by creditors who received inadequate notice of the bankruptcy filing),
- § 523(a)(4) (debts for embezzlement and breach of fiduciary duty), and
- § 523(a)(6) (debts from willful and malicious personal injuries or wrongful death).

Except for willful injuries to property, all of these debts would no longer be dischargeable in Chapter 13. While most of these changes in the law would have a relatively small impact on the overall operation of the Chapter 13 process, two of the changes would make Chapter 13 much less effective, and so are proposed to be modified here. Specifically, the Proposal recommends retaining the superdischarge as to credit card misuse and tax debt arising from late-filed returns.

*Credit card misuse.* Credit card misuse is the most commonly encountered form of non-dischargeable debt in Chapter 7. Debts arising from credit card misuse are currently excepted from discharge under the fraud exception of § 523(a)(2). However, the application of this provision to credit card misuse has been problematic, since there is no actual contact between the debtor and the credit issuer at the time the credit card is used. For that reason, the traditional fraud elements of misrepresentation by the debtor and reasonable reliance by the creditor have been difficult to define. Creation of a new ground for nondischargeability, dealing specifically with credit card misuse, would resolve a number of conflicting approaches under the current law. Debts incurred with a credit card would be nondischargeable if, at the time of the transaction in question, the debtor intended to file a bankruptcy case or otherwise did not intend to repay the debt. Misrepresentation and reliance would not be relevant, and the presumption of § 523(a)(2)(C) (as amended by § 310 of S. 256) would be fully applicable.

The discharge under § 1328(a) should continue to apply to credit card misuse. This element of the Chapter 13 superdischarge is significant in any situation where a debtor has incurred questionable credit card debt. Under current law, such a debtor has a significant incentive to file under Chapter 13. Even though the debtor may have a colorable defense to a dischargeability complaint in Chapter 7, and even though Chapter 13 would require the debtor to complete a minimum three-year plan (or pay all debts in full) in order to obtain the discharge, the debtor would still likely choose Chapter 13, since that choice would avoid the expense of litigating the question of dischargeability, and offer the debtor a certain discharge if the plan is completed. If debts from misuse of credit cards are not dischargeable in Chapter 13, the incentive is reversed, with the debtor better off filing under Chapter 7. Chapter 7 would provide an immediate discharge of all other obligations and allow the debtor to use post-filing earnings to pay only the questionable credit card debt, while Chapter 13 would require the debtor to make partial payment of all unsecured debts, only to have the balance of the credit card debt still owing at the end of the plan.

*Tax debt.* The superdischarge should also continue to apply to tax debt arising from late-filed returns. Virtually all such debt is within the priority established by current § 507(a)(8), and so would have to be paid in full in any Chapter 13 plan under current § 1322(a)(2). However, making a debt nondischargeable, in addition to its status as a priority debt, has the effect of continuing interest and penalties. For late tax obligations, interest and penalties can be significant. Since the debt must be paid in full, the continuation of interest and penalties may make completion of a Chapter 13 plan impossible for many debtors with late filed claims, and again, give these debtors a substantial incentive to file under Chapter 7 rather than Chapter 13. This recommendation would not affect the provision of S. 256 denying a discharge under § 1328(a) to fraudulently incurred tax debt.

## 9. Treatment of secured debt in Chapter 13

### Recommendation

- 1) Continue current law allowing a Chapter 13 plan to bifurcate a claim secured by property other than residential real estate, with the secured portion of the claim accorded the replacement value of the collateral under § 506(a) of the Code, but provide in addition that the holder of a purchase money security interest in personal property acquired by the debtor within one year prior to the bankruptcy filing may elect to require the debtor to surrender the collateral [modifying S. 256, § 306].
- 2) Continue current law allowing § 506(a) valuation to vary according to the purpose for which the valuation is made [omits S. 256, § 327].
- 3) Clarify that holders of secured claims treated by a Chapter 13 plan must credit payments made under the plan consistent with the plan provisions [redrafting S. 256, § 202].
- 4) Require preconfirmation adequate protection payments (in the amounts proposed by the plan) to be made by the Chapter 13 trustee from payments made by the debtor to the trustee [modifying S. 256, § 309].

### Comment

*Bifurcation.* Section 306 of S. 256 changes the current treatment of secured debt in Chapter 13. Current law provides debtors with the possibility of retaining property that is collateral for loans taken out by the debtor by paying the secured creditor the value of that property instead of the full amount of the debt that the property secures. For example, if a debtor owed \$10,000 on an auto loan, but the vehicle securing the loan was only worth \$7,000, the debtor would pay \$7,000 (with interest) over the course of the Chapter 13 plan, and treat the \$3,000 difference as an unsecured debt, payable at the same rate as other unsecured debts (such as credit card obligations). This process of reducing the amount of secured claims to the value of the collateral is referred to as “bifurcation” or “stripdown.” This process is fairer to creditors, since it gives secured creditors the value of their collateral, but otherwise allows them to be paid on the same basis as other creditors. At the same time, bifurcation allows Chapter 13 debtors to prevent repossession of property that they need for employment or family support. Many debtors file Chapter 13 rather than Chapter 7 cases in order to obtain this benefit.

Section 306(b) of S. 256 would greatly reduce this incentive for use of Chapter 13. It would eliminate bifurcation for any motor vehicle loan incurred within 2-1/2 years of the bankruptcy filing and for any secured debt incurred within one year of the filing. Thus, the lender on a two-year old auto loan would have to be paid in full if a Chapter 13 debtor wished to retain the car that was collateral for the loan, even if the car was worth much less than the loan balance. This would be a windfall for the lender, who would receive much more than if the car were repossessed, and it would be a detriment to other creditors in the case, who would receive correspondingly less on their claims. Moreover, the extra payment required for secured debt would make Chapter 13 cases impossible for many debtors who now successfully complete them, whenever their income was not sufficient to pay both the increased amount on their secured claims and to pay other claims that Chapter 13 requires to be paid in full, such as family support obligations.

The Proposal would continue current law allowing a Chapter 13 plan to bifurcate claims secured by property other than residential real estate, but it would provide in addition that the holder of such a claim arising from a purchase made by the debtor within one year of the bank-

ruptcy could require the debtor to surrender the collateral. This would remove any incentive for debtors to “load up” on secured debt shortly before a bankruptcy filing.

Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

*Valuation.* Under current § 506(a), the value of a secured claim, for purposes of the bifurcation discussed above is determined “in light of the purpose of the valuation and of the proposed disposition or use of such property.” Section 327 of S. 256 would change this flexible approach to valuation so as require that, in cases of individual debtors in Chapter 7 and Chapter 13, valuation of secured claims would always be determined “on the replacement value of such property as of the date of filing the petition, without deduction for costs of sale or marketing.” Secured claims must be valued in many different contexts in individual bankruptcy cases—from determining how much a Chapter 13 debtor must pay in installments to retain collateral throughout a plan, to how much a Chapter 7 debtor must pay in a lump sum to redeem collateral, to how much a creditor must reduce its claim when collateral is surrendered. The current law, allowing for accommodation of these different circumstances, should be retained.

*Allocation of payments.* Section 202 of S. 256 adds a new subsection (i) to § 524 of the Code, which provides that a mortgage holder (or other creditor) whose claim is treated by a Chapter 13 plan must credit payments received under the plan in the manner that the plan requires; so that allocating plan payments to prepetition debt or late charges (and then attempting to collect additional sums from the debtor after the plan concludes) would be a violation of the discharge injunction. However, the language of section 202 is confusing and may unduly limit the impact of the provision:

The willful failure of a creditor to credit payments received under a plan confirmed under this title, unless the order confirming the plan is revoked, the plan is in default, or the creditor has not received payments required to be made under the plan in the manner required by the plan (including crediting the amounts required under the plan), shall constitute a violation of an injunction under subsection (a)(2) if the act of the creditor to collect and failure to credit payments in the manner required by the plan caused material injury to the debtor.

The following language would more clearly and generally require crediting of plan payments according to the plan:

Unless the order confirming a plan under this title is revoked, or the case in which the plan was filed is dismissed, or payments are not transmitted to the creditor in the manner required by the plan, the failure of a creditor to credit payments made pursuant to the plan in the manner required by the plan, and any act of the creditor to collect payments inconsistent with the treatment of the creditor’s claim under the plan, shall constitute a violation of an injunction under subsection (a)(2).

*Preconfirmation adequate protection.* Under current law, a Chapter 13 debtor is required to make full plan payments to the trustee prior to confirmation, but the trustee is directed not to distribute payments to creditors until the plan is confirmed. This situation makes it difficult for preconfirmation adequate protection payments to be made to secured creditors, and for preconfirmation lease payments to be made to lessors, whenever the Chapter 13 plan calls for these payments to be made by the trustee. Section 309(c) of S. 256 deals with the need for precon-

firmation payments, by requiring the debtor to deduct adequate protection and lease payments from the amounts otherwise payable to the trustee prior to confirmation, and send the deducted funds directly to the creditor. This approach will cause confusion: debtors will be unsure of the amounts required to be sent to the trustee, questions will arise as to whether the payments required to be sent to creditors were in fact sent by the debtor, and confirmation will likely be delayed. These problems can be avoided by retaining the requirement that the debtor submit full preconfirmation plan payments to the trustee, while directing the trustee to make adequate protection and lease payments prior to confirmation.

## 10. Miscellaneous Chapter 13 matters

### Recommendation

- 1) The minimum term of a Chapter 13 plan, in the absence of full payment, should be extended to five years only for (a) those debtors whose income exceeds 150% of the applicable state median, and (b) those debtors who have converted their cases to Chapter 13 from Chapter 7 after the filing a motion under § 707(b) [modifies S. 256, § 318].
- 2) A Chapter 13 debtor should be required to file post-petition tax returns and amended budgets only if ordered by the court, either on its own motion or on the motion of any party in interest, based on a likelihood that the debtor's income or expenses will materially change [modifies S. 256, § 315(b)].
- 3) Chapter 13 plans should be required to provide for all debt payments to be made by the Chapter 13 trustee [new, amends § 1326(c) of the Code].

### Comment

*Minimum plan term.* Under current law, the minimum term for a Chapter 13 plan that does not pay all claims in full is three years. Section 318 of S. 256 would extend this term to five years for all debtors with income over the applicable state median. For many debtors with more than median income, there will remain a choice between filing under Chapter 7 and Chapter 13, and the five-year minimum plan term will be a significant incentive to choose Chapter 7, with its immediate discharge, rather than Chapter 13. The extended plan term should be reserved for those debtors who are most likely to be able to address their financial difficulties outside of bankruptcy (those earning more than 150% of the applicable median), and those whose Chapter 7 filings are subject to a finding of abuse under § 707(b). The latter provision would create an incentive for debtors with a potential ability to repay to file under Chapter 13 in the first instance.

*Tax returns and budgets.* Section 315(b) of S. 256 imposes on Chapter 13 debtors the obligation to file with the court, if requested by the court or any party in interest, copies of all post-petition tax returns and annual budgets for the duration of the debtor's case. The tax returns are to be subject to regulations that will allow creditor access to the filings while protecting the privacy of the debtors. This provision is likely to impose substantial administrative burdens on the courts, both in connection with maintaining files in a semi-restricted form, and in enforcing the debtors' obligations. It can be anticipated that many Chapter 13 debtors who are current in plan payments will fail to file requested tax returns or budgets, leading to enforcement motions that generate expense for all parties involved and for the court. Chapter 13 plans that would otherwise have successfully completed payments to creditors may fail because of the debtor's delay in responding to such motions. Rather than create an absolute right to the filing of post-petition

tax returns and budgets, it would be preferable to require these filings only in cases where it appears likely that the debtor's financial condition will change materially (for example, debtors with a temporary medical condition, or temporarily depressed employment). In this way, the resources of the court and the parties can be devoted to enforcing disclosure requirements in cases where they are likely to be significant.

*Plan payments through the trustee.* In many Chapter 13 cases, the most effective way to ensure that the debtor completes the plan is by deducting plan payments from the debtor's wages, pursuant to § 1325(c) of the Code. If all of the payments required by the plan are deducted, the debtor is no longer tempted to divert resources that should be used for debt payment to current consumption. However, the effectiveness of a wage deduction is lost if the debtor is responsible for making certain debt payments under the plan. Since those payments cannot be deducted from the wages, the debtor may still choose not to make the debt payment.

Frequently, Chapter 13 plans provide that debtors, rather than Chapter 13 trustees, will make current mortgage payments, or other large debt payments, in order to avoid paying fees to the trustees, whose fees are based on a percentage of the payments that they make. *See* 28 U.S.C. § 586(e)(1)(B). It would benefit the Chapter 13 system if debtors were required to make all debt payments through the trustee. This would both allow for fully effective wage deduction orders and allow the trustees to reduce their overall percentage fee. Section 1326(c) of the Code now provides that the trustee shall make payments to creditors under the plan “[e]xcept as otherwise provided in the plan or in the order confirming the plan.” The change recommended here would be effectuated by removing this exception.

## **11. Bankruptcy administrator**

### Recommendation

Give the bankruptcy administrators in North Carolina and Alabama the same rights, duties and obligations as U.S. trustees [modified S. 256 §§ 232, 405, 416, 439, 1104].

### Comment

In North Carolina and Alabama, bankruptcy administrators perform the administrative functions that are performed in other jurisdictions by U.S. trustees. Certain provisions of S. 256 affecting bankruptcy administration, noted above, refer only to U.S. trustees. These provisions should be amended to apply to bankruptcy administrators as well.

## **12. Individual Chapter 11 debtors**

### Recommendation

Omit S. 256, § 321, which would impose Chapter 13-type requirements on individual debtors in Chapter 11.

### Comment

Under S. 256, § 321, individuals in Chapter 11 are to be treated more like individuals in Chapter 13. Property of the estate would include postpetition earnings. If an unsecured creditor

objects to confirmation, the debtor must pay all disposable income as defined in § 1325(b)(2) for five years, or pay the claim in full. The debtor does not receive a discharge until all payments have been made under the plan. A creditor may request modification of a plan at any time before completion of the plan. These proposed changes, which apply to all individuals in Chapter 11 cases, are substantial changes that have not been exposed to public debate.

The provisions are based on Chapter 13 provisions that do not fit well with Chapter 11 concepts. In Chapter 13 an unsecured creditor can insist that a debtor commit all disposable income to a plan for three years. That makes sense in Chapter 13 where creditors do not vote. But in Chapter 11 creditors do vote, and a single creditor should not be able to defeat a plan by objecting. Also, a single creditor could request modification of a plan. The ramifications of delaying a discharge in a Chapter 11 case have not been sufficiently studied.

All of these proposed changes should be omitted until they have been studied and exposed to public debate. If the Chapter 13-type requirements are included at all, they should be placed in § 1129(b).

### **13. Small business provisions**

#### Recommendation

- 1) Change the definition of small business debtor to be consistent with present § 101(51C) of the Bankruptcy Code [retains the \$2 million aggregate debt limit of S. 256, § 432, but eliminates unworkable provisions of the definition].
- 2) Permit flexibility with respect to disclosure statements [same as S. 256, §§ 431, 433].
- 3) Permit conditional approval of disclosure statements [same as S. 256, § 431].
- 4) Permit combined disclosure statement and confirmation hearings [same as S. 256, § 431].
- 5) Establish uniform reporting requirements for small businesses, with uniform forms proposed by the Advisory Committee on Bankruptcy Rules [same as S. 256, §§ 434 and 435].
- 6) Provide that the debtor must file (rather than “append”) a balance sheet and statement of operations together with its petition; delete tax returns from the filing requirement [modifies S. 256, § 436].
- 7) Require status conferences “necessary to further the expeditious and economical resolution of the case”; change section title to “status conference” [modifies S. 256, § 440 only to make its title consistent with the substantive provision].
- 8) Retain the 120-day exclusivity period for plan filing by the debtor [modifies the 180-day period of S. 256, § 437].
- 9) Require the debtor to file a plan and disclosure statement within 120 days of the order for relief, with extensions for cause possible up to 300 days after the order for relief; allow further extensions of the filing deadline only upon a showing by the debtor of extraordi-

nary circumstances and a strong likelihood that a confirmable plan will be proposed within the further extension [modifies S. 256, § 437].

- 10) Omit the requirement that a plan be confirmed within 45 days of filing [modifies S. 256, § 438].
- 11) Require termination of the automatic stay in defined situations of repeat filings, as set out in Recommendation 5 [consistent with S. 256, § 441(2) except that an order on motion is required].
- 12) Conduct a study to determine why small businesses become debtors and the best way for these small businesses to reorganize [same as S. 256, § 443].

#### Comment

Under current law, special, optional treatment is provided under Chapter 11 for a “small business.” S. 256 alters the definition of small business and makes the special treatment mandatory. As a whole, the changes are helpful, but several present difficulties.

*Definition.* Consistent with current law, § 432 of S. 256 defines a “small business debtor” as a business with not more than \$2 million in aggregate debt, but then adds qualifications (1) that affiliates of the debtor, also involved in bankruptcy proceedings, are to be included with the debtor in calculating the amount of debt, and (2) that cases in which the U.S. trustee has appointed a creditor’s committee are excluded from the definition unless the court determines that the committee is “not sufficiently active and representative to provide effective oversight of the debtor.” The \$2 million limit properly includes most Chapter 11 debtors; however, the language regarding affiliates of the debtor is awkward and may exclude affiliated entities that are truly separate businesses from being small business debtors. Also, the presence of an active creditor’s committee should not preclude small business treatment (and, in any event, there would be considerable uncertainty as to whether the small business provisions applied, since the court could make a determination that a committee was insufficiently active at any time). The references to affiliates and to committees should be eliminated, retaining the substance of the current definition of small business.

*Flexible disclosure statement requirements.* S. 256, § 431 amends Bankruptcy Code § 1125(a)(1) to list factors that the court should consider when approving a disclosure statement and amends Bankruptcy Code § 1125(f) to give the court, in small business cases, the flexibility to dispense with a disclosure statement and to approve form disclosure statements. Both amendments improve the operation of Chapter 11 in small business cases.

*Conditional approval of disclosure statement; combined hearing on disclosure statement and confirmation.* S. 256, § 431 amends § 1125 of the Bankruptcy Code to give the court in small business cases the flexibility (1) to approve disclosure statements conditionally and (2) to combine the hearing on adequacy of the disclosure statement with the confirmation hearing. For many years, a number of bankruptcy courts have successfully utilized these practices, and the Code is improved by express statutory provision allowing it.

*Uniform reporting requirements; reporting rules and forms.* S. 256, § 434 requires small business debtors to file specific reports, to match projections with actual cash disbursements, to certify compliance with their reports and with the Federal Rules of Bankruptcy Procedure, and to explain how noncompliance will be cured. S. 256, § 435 directs the Advisory Committee on

Bankruptcy Rules to propose rules and forms and provides that the reporting requirements shall take effect 60 days after the rules are prescribed. These reports are already required in most jurisdictions by U.S. trustees or bankruptcy administrators. Some of the terms used in S. 256 are somewhat vague (e.g., “such other matters as are in the best interest of the debtor and creditors”), but these requirements can be made specific through the Rules process.

*Duties of the small business debtor.* S. 256, § 436 requires small business debtors to “append” to their bankruptcy petitions their most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return. In addition, it requires senior management to attend meetings, scheduling conferences, and meetings of creditors unless the court, upon a finding of extraordinary and compelling circumstances, waives attendance. It requires that debtors timely file all schedules (subject to a maximum extension of 30 days absent extraordinary and compelling circumstances), maintain customary insurance, timely file tax returns, and pay current taxes. Most courts already impose most of these duties and require these documents, and making these requirements uniform is good policy. However, the term “append” is not applicable to electronic filing and should be replaced with “file,” and tax returns should be excepted from the filing requirement, since they will often not be appropriately made part of the public record.

*Duties of the U.S. trustee.* S. 256, § 439 expands the duties of the U.S. trustee in small business cases to include conducting an initial interview, investigating viability, asking about the debtor’s plan, developing a scheduling order, verifying the filing of tax returns, and monitoring activities to ascertain inability to confirm a plan. If the trustee finds material grounds for relief under § 1112, the trustee shall apply promptly after making that finding to the court for relief. U.S. trustees and bankruptcy administrators are already performing many of these functions. It should be noted that the provision requiring the U.S. trustee to move for dismissal or conversion applies to all Chapter 11 cases, not just to small business cases.

*Scheduling conferences.* S. 256, § 440 amends § 105(d) of the Bankruptcy Code to make status conferences mandatory, providing that the court “shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case.” This provision applies to all Chapter 11 cases. Many courts now hold status conferences. There are no guidelines as to who should attend, but this would be left to the Bankruptcy Rules. Courts should have flexibility in designing the type of status conference that works best in the district and in the particular case. The title of this Conference Report section is “Scheduling Conferences” and should be changed to “Status Conferences.”

*Exclusivity in small business cases.* S. 256, § 437 provides that in a small business case the debtor has the exclusive right to file a plan for 180 days after the order for relief, unless the time is extended or reduced for cause. Obtaining an extension of the 180-day period is appropriately difficult, with the debtor required to “demonstrate by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time.” Furthermore, in situations where exclusivity is to be extended, a new deadline must be imposed, and the order must be signed before expiration of the first deadline. Presently all Chapter 11 debtors have a 120-day period of exclusivity that may be extended “for cause.” Small business cases should move quickly, and the exclusivity period should not be longer than in regular Chapter 11 cases. However, requiring an extension order to be signed prior to the expiration of the deadline penalizes a debtor for delays caused by a court. The period of exclusivity should remain at 120 days, and the requirement that the order must be signed prior to expiration of the deadline should be omitted.

*Deadline for plan filing.* S. 256, § 437 provides that a small business debtor must file a plan not later than 300 days after the order for relief. There is no provision for reducing the 300-day period and it may only be extended in the same manner as extending the 180-day period of exclusivity. In most small business chapter 11 cases a plan should be filed well before 300 days. If 300 days is the limit, it may become the standard. The limit should be 120 days with extensions for “cause” up to a 300-day maximum. In order for an extension beyond 300 days to be granted, the debtor would be required to “demonstrate by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time.”

*Confirmation deadline.* S. 256, § 438 provides that the plan in a small business Chapter 11 case must be confirmed within 45 days after the plan is filed with the court, unless that deadline is extended after a hearing in which the debtor shows that a plan is likely to be confirmed thereafter. This provision is intended to reduce the delay and costs involved in confirming Chapter 11 plans, but would actually have the effect of requiring the extension hearing in nearly every case, and so increase expense. The Bankruptcy Rules require 25 days notice for a disclosure statement hearing (Fed. R. Bankr. P. 3017(a)) and 25 days notice for a confirmation hearing (Fed. R. Bankr. P. 3017(b)). Combining the two hearings is discretionary, and if the two hearings were not combined it would be impossible to meet the 45-day limit. Even in districts where the hearings are routinely combined, like the Eastern District of North Carolina, the combined hearings are normally held approximately 50 days after the plan is filed.

The Proposal would extend the deadline for confirmation of small business Chapter 11 cases to 60 days. Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

*Small business serial filers.* See Recommendation 5, above.

*Small business study.* S. 256, § 443 provides that the Small Business Administration is to conduct a 2-year study to learn why small businesses become debtors and the best way for these small businesses to reorganize. This is an excellent idea.

## **14. Expanded grounds for dismissal**

### Proposal

- 1) Give the court discretion with respect to dismissal in Bankruptcy Code § 1112, by retaining the “may” dismiss in the Code and omitting the “shall” dismiss in S. 256 [modifies S. 256, § 442].
- 2) Expand the “for cause” list in Bankruptcy Code § 1112 [same as S. 256, § 442].
- 3) Omit the 30-day time limit for commencing a hearing on a motion to dismiss and omit the 15-day limit on deciding such a motion [modifies S. 256, § 442].

### Comment

S. 256, § 442 amends § 1112 of the Bankruptcy Code to provide that the court “shall” dismiss or convert a Chapter 11 case for cause unless (1) there are “unusual circumstances specifically identified by the court” that establish that such relief is not in the best interests of creditors and the estate, or (2) the debtor or another party in interest objects and shows that (a) there is

a reasonable likelihood of plan confirmation within the applicable deadline and (b) that there was reasonable justification for any act of the debtor that provided cause for relief and that the act will be cured within a reasonable time. “Cause” is appropriately defined as including gross mismanagement, failure to maintain insurance, unauthorized use of cash collateral, failure to file a report, failure to appear for examination, failure to pay taxes or file tax returns, failure to file a plan on time, failure to effectuate substantial consummation of a plan, material default under a plan and failure to pay domestic support obligations. As an alternative to conversion or dismissal, the court would be able to appoint a trustee or examiner.

Like the confirmation deadline, these provisions are intended to reduce the cost involved in administering Chapter 11 cases. However, particularly since these provisions apply to Chapter 11 cases of all sizes, they are likely to increase the cost of administration by requiring substantially longer, confirmation-like hearings whenever dismissal or conversion is contested, with the court needing to resolve factual and legal questions about the presence of unusual circumstances, the likelihood of timely confirmation, and the possibility of curing an untimely filing. Moreover, the 30-day time period for holding a hearing and the 15-day time limit for deciding the issue are too restrictive.

The Proposal would give the court discretion to convert or dismiss in consideration of the factors set out in § 442 without mandating dismissal in the absence of specified findings, and would omit the hearing and ruling deadlines.

Draft statutory language effectuating this recommendation is included in an appendix to the Proposal.

## **15. Requirement to describe tax consequences**

### Proposal

Omit the requirement in S. 256, § 717 that Chapter 11 debtors include in the disclosure statement a description of the tax consequences of the plan [modifies S. 256, § 717].

### Comment

S. 256, § 717 amends § 1125(a)(1) of the Bankruptcy Code to require that a disclosure statement include “a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case.” This requirement is not realistic. A debtor will not know the tax consequences to its creditors, and any tax opinion would be costly and speculative at best.

**Table of Proposed Revisions to S. 256**

<b>Sec. No.</b>	<b>Issue</b>	<b>Present Content</b>	<b>Proposed Treatment</b>
101	Consent to conversion in 707(b)	Allows consensual conversion to Ch. 12 or 13 as an alternative to dismissal	Retain
102	Means testing	Complex presumption of abuse based on IRS collection standards; enhanced scheduling and noticing requirements for all debtors; enhanced liability for debtors' counsel	Amend: Means test based on gross income; safe harbor under median; creditor standing to file § 707(b) motions above median; enhanced scrutiny above defined level (150% of median); omit enhanced attorney liability
103	IRS standards amendment and study	Sense of Congress that standards may be altered; EOUST study ordered	Retain study; omit sense of Congress pending study on use of IRS standards
105	Pilot educational program	18-month test of educational programs in six districts, followed by report of Director of EOUST to Congress	Retain
106	credit counseling; mandatory debtor education	credit counseling an eligibility requirement, education required for all consumer debtors.	Amend to make credit counseling required only in chapter 7; defer mandatory education pending results of pilot program
107	Schedules for Chapter 13 expenses	Part of the formula for calculating means-test deductions	Omit pending results of study on use of IRS standards
202	Failure to credit plan payments; ride-through contacts for home mortgages	Some failures to credit plan payments made a violation of discharge injunction; request for payment in lieu of foreclosure not a violation	Amend to clarify provision regarding failure to credit plan payments
203	Reaffirmation	Extensive disclosure requirement with broad safe harbors for creditors);	Omit subject to completion of study
302	Stay exceptions for serial filings	30-day termination of stay in first refiling within a year; no stay in second refiling unless required showings made	Amend to provide for order terminating stay
304	Stay for personal property collateral	Stay terminated if no redemption or reaffirmation in 45 days after first meeting; no installment redemption	Amend to provide for order terminating stay
305	Stay for personal property and leases	Similar to 304 of the Act, as above, but with conflicting terms	Amend to add leases to procedure under § 304
306	Secured debt in Chapter 13	(1) Requires lien retention until debt paid in full or discharge granted; (2) 2-1/2 year anti-stripledown for car loans; (3) 1 year anti-stripledown for all other secured debt; (4) principal residence defined.	Amend to provide that a creditor with a pmsi not more than one year old may require return of collateral
309	Chapter 13 secured claims	(1) secured claim not reduced on conversion to Ch 7; (2) procedures for debtors to assume personal property leases; (3) adequate protection payments, including preconfirmation payments directly by the debtor; (4) proof of insurance required from debtor	Amend to provide for preconfirmation adequate protection payments to be made by the Chapter 13 trustee from payments made to the trustee by the debtor
312	Extended time between discharges	727(a) extended to 8 years; no discharge in 13 if prior discharge in a 7, 11, or 12 filed within 4 years or a 13 filed within 2 years	Amend to retain current law regarding Chapter 13 discharge

314	New ground for nondischargeability; superdischarge	(a) Debts incurred to pay non-federal taxes excepted from discharge; (b) superdischarge eliminated for 523(a)(2) and (4) and for personal injuries	Amend to create new ground for credit card nondischargeability, subject to Chapter 13 superdischarge
315	Notice to creditors	(a) Complex notice system with burden on debtor to show effective notice; (b) new document production requirements for debtors, including pay stubs, tax returns, and annual budgets	Omit notice provisions pending adoption of electronic filing procedures; provide for wage information to be provided to trustee prior to creditors meeting
316	Automatic dismissal for inadequate filings	Failure to file results in dismissal without motion, deadline only extended once	Amend to require entry of order on motion; allow trustee objection for avoidance actions or 727 action
318	Term of Chapter 13 plan	5 yrs for debtors over the median income level	Amend: 5 years for debtors with income more than 150% of median or who pursue Chapter 13 after a 707(b) motion
321	Individual Chapter 11 cases	Generally imposes Chapter 13 rules	Omit
327	§ 506(a) valuation	Requires retail value in Ch 7/13 individual cases	Omit
431	Flexible Rules for disclosure statement and plan	List of factors when considering disclosure statement; flexibility in approving disclosure statement; approval of form disclosure statements; conditional approval of disclosure statements; combining hearings on disclosure statement and confirmation of plan	Retain
432	Definition	\$2 million in aggregate debt (includes debtor affiliates but excludes debtor affiliates with more than \$2 million in debt) where creditors' committee has not been appointed or committee is not sufficiently active	Omit references to affiliates and committees; keep present definition in § 101(51C)
433	Standard form disclosure statement and plan	Bankruptcy Rules Committee to propose standard forms for disclosure statements and plans	Retain
434	Uniform reporting requirements	Small business debtors must file reports and certify compliance with reports and Bankruptcy Rules	Retain
435	Uniform rules and forms	Bankruptcy Rules Committee to propose forms for reports	Retain
436	Debtor duties in small business cases	Small business debtors must "append" most recent balance sheet, statement of operations, cash flow, and income tax statement to petition; senior management must attend meetings and conferences; must file schedules on time, maintain insurance. file tax returns and pay current taxes	Retain most provisions; delete "append;" do not make income tax return part of public record; delete "extraordinary and compelling circumstances" standard

437	Plan filing and confirmation deadlines	Small business debtor has 180-day period of exclusivity; debtor must file a plan not later than 300 days after the order for relief; deadlines may not be extended unless debtor can demonstrate by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time	Amend to provide 120-day exclusivity period, extendable for cause; small business debtor must file plan within 90 days of order for relief, but time may be extended for cause; court may not extend time beyond 300 days unless the debtor makes specified showing
438	Plan confirmation deadline	Court shall confirm a plan not later than 45 days after it is filed	Omit
439	UST duties	Expands duties of UST in small business cases, including verifying filing of tax returns	Retain
440	Scheduling conference	Court shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case	Retain, except change caption to "Status Conferences"
441	Serial filer provisions	Automatic stay does not apply with respect to certain serial filing small business debtors	Retain, except require order terminating the stay on motion
442	Expanded grounds for dismissal or conversion	Court "shall" convert or dismiss "absent unusual circumstances" upon showing of cause; cause is defined	Modify to give court more discretion as to whether to convert or dismiss
443	Small business study	Small Business Administration to study causes of small business filings and to determine best way for small business debtors to reorganize	Retain
603	Audits	Audits must be conducted of a random minimum 0.4% of all consumer filings and of all schedules "reflecting greater than average variance" from district norms, under GAAS by independent certified or licensed public accountants or under regulations of the Attorney General (adopted within 2 years of enactment of the legislation); 18 month delay in effect	Amend: audits charged only to those in "enhanced scrutiny" class; all audits should be conducted pursuant to EOUST regulations, by employees or contractors of EOUST; regulations within 18 months; effective 6 months thereafter
707	Superdischarge	523(a)(1)(B) (unfilled or late filed taxes) and (C) (fraudulently filed taxes) made nondischargeable in Ch 13	Amend: remove only § 523(a)(1)(C) tax debts from the superdischarge of § 1328(a)

**Draft Statutory Language for Selected Recommendations Modifying S. 256**

***Recommendation 1***

**SEC. 102. DISMISSAL OR CONVERSION.**

(a) **IN GENERAL**- Section 707 of title 11, United States Code, is amended--

(1) by striking the section heading and inserting the following: “Sec. 707. Dismissal of a case or conversion to a case under chapter 11 or 13”;

and

(2) in subsection (b)--

(A) by inserting “(1)” after “(b)”;

(B) in paragraph (1), as so redesignated by subparagraph (A) of this paragraph--

(i) in the first sentence--

(I) by striking “but not at the request or suggestion of” and inserting “trustee (or bankruptcy administrator, if any), or”;

(II) by striking “whose debts are primarily consumer debts”;

(III) by inserting “, or, with the debtor’s consent, convert such a case to a case under chapter 11 or 13 of this title,” after “consumer debts”; and

(IV) by striking “a substantial abuse” and inserting “an abuse”; and

(ii) by striking the next to last sentence; and

(C) by adding at the end the following:

“(2)(A) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor’s projected annual disposable income exceeds \$1800. ’

“(B) For the purposes of this paragraph, ‘disposable income’ shall have the meaning set out in section 1325(b) of this title, except that ‘disposable income’ shall not include’’’’’’’, for a debtor eligible for chapter 13, the expenses that the debtor would incur in’ administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees. ’’’’’’’’

“(C) As part of the schedule of current income and expenditures required under section 521, the debtor shall include a statement of the debtor’s projected annual disposable income showing how this amount was calculated.

“(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the

provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider--

“(A) whether the debtor filed the petition in bad faith; or

“(B) the totality of the circumstances (including the extent of the exemptions claimed by the debtor and whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor’s financial situation demonstrates abuse.

“(4)(A) The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of Bankruptcy Procedure, may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under section 707(b), including reasonable attorneys’ fees, if--

“(i) a trustee files a motion for dismissal or conversion under this subsection; and

“(ii) the court--

“(I) grants such motion; and

“(II) finds that the action of the attorney for the debtor in filing under this chapter violated rule 9011 of the Federal Rules of Bankruptcy Procedure.

“(B) If the court finds that the attorney for the debtor violated rule 9011 of the Federal Rules of Bankruptcy Procedure, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order--

“(i) the assessment of an appropriate civil penalty against the attorney for the debtor; and

“(ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy administrator, if any).

“(C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has--

“(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

“(ii) determined that the petition, pleading, or written motion--

“(I) is well grounded in fact; and

“(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

“(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

“(5)(A) Except as provided in subparagraph (B) and subject to paragraph (6), the court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described

in rule 9011 of the Federal Rules of Bankruptcy Procedure, may award a debtor all reasonable costs (including reasonable attorneys' fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)) under this subsection if--

“(i) the court does not grant the motion; and

“(ii) the court finds that--

“(I) the position of the party that filed the motion violated rule 9011 of the Federal Rules of Bankruptcy Procedure; or

“(II) the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

“(B) A small business that has a claim of an aggregate amount less than \$1,000 shall not be subject to subparagraph (A)(ii)(I).

“(C) For purposes of this paragraph--

“(i) the term “small business” means an unincorporated business, partnership, corporation, association, or organization that--

“(I) has fewer than 25 full-time employees as determined on the date on which the motion is filed; and

“(II) is engaged in commercial or business activity; and

“(ii) the number of employees of a wholly owned subsidiary of a corporation includes the employees of--

“(I) a parent corporation; and

“(II) any other subsidiary corporation of the parent corporation.

“(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b), if the debtor, or in a joint case, the debtor and the debtor's spouse, had adjusted gross income in the tax year preceding the filing of the case, and will have projected adjusted gross income in the tax year in which the case is filed, equal to or less than--

“(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

“(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

“(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus \$525 per month for each individual in excess of 4.

“(7)(A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the debtor and the debtor’s spouse combined, had adjusted gross income in the tax year preceding the filing of the case, and will have projected adjusted gross income in the tax year in which the case is filed, equal to or less than--

“(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

“(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

“(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus \$525 per month for each individual in excess of 4.

“(B) In a case that is not a joint case, current monthly income of the debtor’s spouse shall not be considered for purposes of subparagraph (A) if--

“(i)(I) the debtor and the debtor’s spouse are separated under applicable nonbankruptcy law; or

“(II) the debtor and the debtor’s spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

“(ii) the debtor files a statement under penalty of perjury--

“(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

“(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received annually from the debtor’s spouse’.”.

”””

**(b) UNITED STATES TRUSTEE AND BANKRUPTCY ADMINISTRATOR DUTIES.** -- Section 704 of title 11, United States Code, is amended--

(1) by inserting “(a)” before “The trustee shall--”; and

(2) by adding at the end the following:

“(b)(1) With respect to a debtor who is an individual in a case under this chapter--

“(A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor’s case would be presumed to be an abuse under section 707(b); and

“(B) not later than 5 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.

“(2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) or file a statement setting forth the reasons the United States trustee (or the

bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707(b) and the product of the debtor's current monthly income, multiplied by 12 is not less than--

“(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or

“(B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.”.

(c) **NOTICE.**-- Section 342 of title 11, United States Code, is amended by adding at the end the following:

“(d) In a case under chapter 7 of this title in which the debtor is an individual and in which the presumption of abuse arises under section 707(b), the clerk shall give written notice to all creditors not later than 10 days after the date of the filing of the petition that the presumption of abuse has arisen.”.

(d) **NONLIMITATION OF INFORMATION.**--Nothing in this title shall limit the ability of a creditor to provide information to a judge (except for information communicated ex parte, unless otherwise permitted by applicable law), United States trustee (or bankruptcy administrator, if any), or trustee.

(e) **DISMISSAL FOR CERTAIN CRIMES.**--Section 707 of title 11, United States Code, is amended by adding at the end the following:

“(c)(1) In this subsection--

“(A) the term ‘crime of violence’ has the meaning given such term in section 16 of title 18; and

“(B) the term ‘drug trafficking crime’ has the meaning given such term in section 924(c)(2) of title 18.

“(2) Except as provided in paragraph (3), after notice and a hearing, the court, on a motion by the victim of a crime of violence or a drug trafficking crime, may when it is in the best interest of the victim dismiss a voluntary case filed under this chapter by a debtor who is an individual if such individual was convicted of such crime.

“(3) The court may not dismiss a case under paragraph (2) if the debtor establishes by a preponderance of the evidence that the filing of a case under this chapter is necessary to satisfy a claim for a domestic support obligation.”.

(f) **CONFIRMATION OF PLAN.**--Section 1325(a) of title 11, United States Code, is amended--

(1) in paragraph (5), by striking “and” at the end;

(2) in paragraph (6), by striking the period and inserting a semicolon; and

(3) by inserting after paragraph (6) the following:

“(7) the action of the debtor in filing the petition was in good faith;”.

“”

(g) **ADJUSTMENT OF DOLLAR AMOUNTS.**--Section 104(b) of title 11, United States Code, is amended by striking “and 523(a)(2)(C)” each place it appears and inserting “523(a)(2)(C), and 707(b)”.

(h) **DEFINITION OF ‘MEDIAN FAMILY INCOME’.**--Section 101 of title 11, United States Code, is amended by inserting after paragraph (39) the following:

“(39A) ‘median family income’ means for any year--

“(A) the median family income both calculated and reported by the Bureau of the Census in the then most recent year; and

“(B) if not so calculated and reported in the then current year, adjusted annually after such most recent year until the next year in which median family income is both calculated and reported by the Bureau of the Census, to reflect the percentage change in the Consumer Price Index for All Urban Consumers during the period of years occurring after such most recent year and before such current year;”.

(i) **CLERICAL AMENDMENT.**--The table of sections for chapter 7 of title 11, United States Code, is amended by striking the item relating to section 707 and inserting the following:

”707..Dismissal of a case or conversion to a case under chapter 11 or 13.”.

### **SEC. 103. SENSE OF CONGRESS AND STUDY.**

(a) **SENSE OF CONGRESS.**--It is the sense of Congress that the Secretary of the Treasury has the authority to alter the Internal Revenue Service standards established to set guidelines for repayment plans as needed to accommodate their use under section 707(b) of title 11, United States Code.

(b) **STUDY.**--

(1) **IN GENERAL.**--Not later than 2 years after the date of enactment of this Act, the Director of the Executive Office for United States Trustees shall submit a report to the Committee on the Judiciary of the Senate and the Committee on the Judiciary of the House of Representatives containing the findings of the Director regarding the utilization of Internal Revenue Service standards for determining--

(A) the current monthly expenses of a debtor under section 707(b) of title 11, United States Code; and

(B) the impact that the application of such standards would have on debtors and on the bankruptcy courts.

(2) **RECOMMENDATION.**--The report under paragraph (1) may include recommendations for amendments to title 11, United States Code, that are consistent with the findings of the Director under paragraph (1).

### *Recommendation 3*

#### **SEC. 106. CREDIT COUNSELING.**

(a) **WHO MAY BE A DEBTOR.**--Section 109 of title 11, United States Code, is amended by adding at the end the following:

“(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under chapter 7 of this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

“(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

“(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

“(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that--

“(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

“(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

“(iii) is satisfactory to the court.

“(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph

(1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.”.

(b) **CHAPTER 7 DISCHARGE.**--Section 727(a) of title 11, United States Code, is amended--

(1) in paragraph (9), by striking “or” at the end;

(2) in paragraph (10), by striking the period and inserting “; or”; and

(3) by adding at the end the following:

“(11) after filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in section 111, except that this paragraph shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter).”.

(c) **CHAPTER 13 DISCHARGE.**--Section 1328 of title 11, United States Code, is amended by adding at the end the following:

“(g)(1) The court shall not grant a discharge under this section to a debtor unless after filing a petition the debtor has completed an instructional course concerning personal financial management described in section 111.

“(2) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional course by reason of the requirements of paragraph (1).

“(3) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in paragraph (2) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter.”.

(d) **DEBTOR'S DUTIES.**--Section 521 of title 11, United States Code, is amended--

(1) by inserting “(a)” before “The debtor shall--”; and

(2) by adding at the end the following:

“(b) In addition to the requirements under subsection (a), an individual debtor in a chapter 7 case shall file with the court--

“(1) a certificate from the approved nonprofit budget and credit counseling agency that provided the debtor services under section 109(h) describing the services provided to the debtor; and

“(2) a copy of the debt repayment plan, if any, developed under section 109(h) through the approved nonprofit budget and credit counseling agency referred to in paragraph (1).”.

[Note: The remainder of § 106 of S. 256 is not affected by the recommendation.]

### ***Recommendation 6***

#### **SEC. 315. GIVING CREDITORS FAIR NOTICE IN CHAPTERS 7 AND 13 CASES.**

(a) **STUDY.**--

(1) **IN GENERAL.**--Not later than 2 years after the date of enactment of this Act, the Director of the Administrative Office of the United States Courts shall submit a report to the Committee on the Judiciary of the Senate and the Committee on the Judiciary of the House of Representatives containing the findings of the Director regarding the utilization of electronic notice to creditors in cases filed under title 11, United States Code.

(2) **RECOMMENDATION.**--The report under paragraph (1) may include recommendations for amendments to title 11, United States Code, that are consistent with the findings of the Director under paragraph (1).

[Note: The remainder of § 315 of S. 256 is not affected by the recommendation.]

### ***Recommendation 9***

#### **SEC. 306. GIVING SECURED CREDITORS FAIR TREATMENT IN CHAPTER 13.**

(a) **IN GENERAL.**--Section 1325(a)(5)(B)(i) of title 11, United States Code, is amended to read as follows:

“(i) the plan provides that--

“(I) the holder of such claim retain the lien securing such claim until the earlier of--

“(aa) the payment of the underlying debt determined under nonbankruptcy law; or

“(bb) discharge under section 1328; and

“(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law; and”.

(b) **RESTORING THE FOUNDATION FOR SECURED CREDIT.**--Section 1325 of title 11, United States Code, is amended by adding at the end the following:

”(d) Section 362(a) of this title shall not apply, pending confirmation of a plan under this section, to a claim if the creditor has a purchase money security interest securing the debt that is the subject of the claim and the debt was incurred during the 1-year period preceding the filing of the petition.”.

(c) **DEFINITIONS.**--Section 101 of title 11, United States Code, is amended--

(1) by inserting after paragraph (13) the following:

“(13A) ‘debtor’s principal residence’--

“(A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and

“(B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer;”;

(2) by inserting after paragraph (27), the following:

“(27A) ‘incidental property’ means, with respect to a debtor’s principal residence--

“(A) property commonly conveyed with a principal residence in the area where the real property is located;

“(B) all easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights or profits, water rights, escrow funds, or insurance proceeds; and

“(C) all replacements or additions;”.

### ***Recommendation 13***

#### **SEC. 438. PLAN CONFIRMATION DEADLINE.**

Section 1129 of title 11, United States Code, is amended by adding at the end the following:

“(e) In a small business case, the court shall confirm a plan that complies with the applicable provisions of this title and that is filed in accordance with section 1121(e) not later than 60 days after the plan is filed unless the time for confirmation is extended in accordance with section 1121(e)(3).”.

*Recommendation 14*

**SEC. 442. EXPANDED GROUNDS FOR DISMISSAL OR CONVERSION AND APPOINTMENT OF TRUSTEE.**

(a) **EXPANDED GROUNDS FOR DISMISSAL OR CONVERSION.**--Section 1112 of title 11, United States Code, is amended by striking subsection (b) and inserting the following:

“(b)(1) Except as provided in subsection (c) of this section and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the movant establishes cause to believe that conversion or dismissal would be in the best interests of creditors and estate.

“(2) For purposes of this subsection, the term ‘cause’ includes--

“(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

“(B) gross mismanagement of the estate;

“(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

“(D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;

“(E) failure to comply with an order of the court;

“(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

“(G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

“(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

“(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

“(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

“(K) failure to pay any fees or charges required under chapter 123 of title 28;

“(L) revocation of an order of confirmation under section 1144;

“(M) inability to effectuate substantial consummation of a confirmed plan;

“(N) material default by the debtor with respect to a confirmed plan;

“(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

“(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.”.

**(b) ADDITIONAL GROUNDS FOR APPOINTMENT OF TRUSTEE.**--Section 1104(a) of title 11, United States Code, is amended--

(1) in paragraph (1), by striking “or” at the end;

(2) in paragraph (2), by striking the period at the end and inserting “; or”; and

(3) by adding at the end the following:

“(3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.”.