

THE BANKRUPTCY REFORM ACT OF 1978

by Frank J. Vecchione*

Congress recently passed the Bankruptcy Reform Act of 1978,¹ the first major revision in bankruptcy law in the forty years which have passed since the Chandler Act² was enacted. The Chandler Act was the most significant development in this area of law since modern bankruptcy law began in the United States in 1898.³ The Chandler Act introduced many rehabilitative provisions to the Bankruptcy Act of 1898, including Chapters X, XI, XII, and XIII.⁴ The Chandler Act will continue to apply to cases filed prior to October 1, 1979.⁵

Introduction

The Bankruptcy Reform Act of 1978 contains four titles. The substance of the new bankruptcy law is found in Title I,⁶ which codifies and enacts a new Title 11 of the United States Code. The provisions found in Title I have become known as the "Bankruptcy Code." Title II, which consists of amendments to Title 28 of the United States Code and to the Federal Rules of Evidence, creates a new system of bankruptcy courts, establishes a United States Trustee Pilot Program, and expands the jurisdiction of the bankruptcy court.⁷ Title III is a compendium of amendments to other federal statutes which makes them consistent with the changes brought about by the new bankruptcy laws.⁸ Title IV contains the repealer of the old Bankruptcy

*A.B., Syracuse University, 1957; LL.B., Seton Hall University Law School, 1964. Mr. Vecchione is a partner with the Newark, N.J., law firm of Crummy, Del Deo, Dolan & Purcell where he specializes in bankruptcy law, and is an adjunct faculty member at Seton Hall University Law School where he teaches debtor-creditor law.

¹ 11 U.S.C. §§ 101-151326 (Supp. III 1979). On November 6, 1978, President Carter signed Pub. L. No. 95-598, entitled The Bankruptcy Reform Act of 1978, which became effective on October 1, 1979.

² 11 U.S.C. §§ 1-1103 (1976) (repealed 1978).

³ Bankruptcy Act of July 1, 1898, 11 U.S.C. §§ 1-1255 (1976) (repealed 1978).

⁴ These chapters appear respectively at 11 U.S.C. §§ 501-676, 701-99, 801-923, and 1001-86 (1976) (repealed 1978).

⁵ Pub. L. No. 95-598, Title IV, § 403, 92 Stat. 2549, 2683 (1978). This savings provision can also be found in the material immediately preceding 11 U.S.C. § 101 (Supp. III 1979).

⁶ 11 U.S.C. §§ 101-151326 (Supp. III 1979).

⁷ These amendments are found respectively at 28 U.S.C. §§ 151, 581-89, and 1471 (Supp. III 1979).

⁸ Pub. L. No. 95-598 [hereinafter cited as *Bankruptcy Reform Act*], Title IV, § 401(a), 92 Stat. 2549, 2682 (1978).

Act⁹ and also contains provisions for the transition period from the old Bankruptcy Act to the new Bankruptcy Code.¹⁰

The scope of this article is simply to summarize the most significant changes in the law brought about by the Bankruptcy Reform Act of 1978.

Changes in 28 U.S.C.

As mentioned above, Title II makes several changes in Title 28 of the United States Code. A new chapter has been added, entitled "Bankruptcy Courts," which deals with the structure of the courts.¹¹ This new chapter provides that after the effective date of the Act, the bankruptcy court shall be a court of record,¹² an adjunct of each district court,¹³ to be referred to as the United States Bankruptcy Court.¹⁴

The President, with the advice and consent of the Senate, giving "due consideration" to the nominees recommended by the judicial council of the relevant circuit, will appoint the bankruptcy judges.¹⁵ Each bankruptcy judge shall serve for a term of fourteen years,¹⁶ unless such judge is removed by the circuit's judicial council, or by a majority vote of all the judges in that circuit.¹⁷ There are other provisions dealing with salaries,¹⁸ a chief judge,¹⁹ time²⁰ and place²¹ for holding court, and vacancies.²²

The new Chapter 50 of the Code²³ includes section 771 which creates the office of Clerk of the Bankruptcy Court, whose appointment is made by the bankruptcy court judges.²⁴ The Clerk, subject to the approval of the court, may appoint deputy clerks, clerical assistants, and such other employees as are approved by the Administrative Office of the United States

⁹ *Id.* Title IV, § 401(a), 92 Stat. 2549, 2682 (1978). This provision appears in the material immediately preceding 11 U.S.C. § 101 (Supp. III 1979).

¹⁰ *Id.* §§ 403-11, 92 Stat. 2549, 2683-88 (1978).

¹¹ 28 U.S.C. §§ 151-60 (Supp. III 1979).

¹² *Id.* § 151(a).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* § 152.

¹⁶ *Id.* § 153(a).

¹⁷ *Id.* § 153(b).

¹⁸ *Id.* § 154.

¹⁹ *Id.* § 155.

²⁰ *Id.* § 157.

²¹ *Id.* § 158.

²² *Id.* § 159.

²³ *Id.* §§ 771-75.

²⁴ *Id.* § 771(a).

Courts.²⁵ Each bankruptcy judge may also appoint a law clerk and a secretary.²⁶ The bankruptcy court is also given the power to appoint a court reporter.²⁷ All court proceedings are required to be recorded.²⁸

One of the most important additions to Title 28 is found in new Chapter 90.²⁹ Here it is provided, among other things, that the district courts shall have original and exclusive jurisdiction in all cases under Title 11 of the United States Code.³⁰ With reference to matters in which Congress previously conferred exclusive jurisdiction on courts other than the district courts, the district courts, pursuant to Chapter 90, are now endowed with original but not exclusive jurisdiction in all civil proceedings arising under Title 11, or arising in or related to cases under Title 11.³¹ The bankruptcy court is then given the power in bankruptcy matters to exercise all of the jurisdiction conferred in these sections on the district court.³² However, the bankruptcy court may abstain from hearing a particular proceeding arising under Title 11 or arising in or related to a case under Title 11. Decisions concerning abstention are not appealable.³³ Exclusive jurisdiction over all property of the debtor, wherever located as of the commencement of a bankruptcy case, is conferred upon the bankruptcy court.³⁴

These provisions on jurisdiction are extremely important and greatly expand the jurisdiction previously granted to the bankruptcy courts. They also eliminate the necessity of distinguishing between summary proceedings and plenary proceedings.³⁵ The bankruptcy courts are now endowed with jurisdiction as long as the proceedings arise under a bankruptcy case or arise in relation to a bankruptcy case. The language of this section³⁶ is purposely broad.

Venue provisions state that a case should be filed in the district where the debtor resides or has its principal place of business or assets,³⁷ or in the

²⁵ *Id.* § 771(b). In cases where there is no clerk of the bankruptcy court, the bankruptcy judge may appoint deputy clerks, clerical assistants, and other employees. *Id.*

²⁶ *Id.* § 772.

²⁷ *Id.* § 773(a).

²⁸ *Id.*

²⁹ *Id.* §§ 1471-82.

³⁰ *Id.* § 1471(a).

³¹ *Id.* § 1471(b).

³² *Id.* § 1471(c).

³³ *Id.* § 1471(d).

³⁴ *Id.* § 1471(e).

³⁵ *See, e.g.,* *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940) and *Security Savings and Loan Ass'n. v. Westinghouse Credit Corp.*, 447 F.2d 387 (9th Cir. 1971).

³⁶ 28 U.S.C. § 1471 (Supp. III 1979).

³⁷ *Id.* § 1472(1).

same district where a case is pending concerning such person's affiliate, general partner, or partnership.³⁸ Once a bankruptcy case has been filed in a particular district, all related proceedings and suits may be brought in that same bankruptcy court proceeding.³⁹ One exception to this is that if a suit is commenced to recover a money judgment or property worth less than \$1,000.00 (or a consumer debt less than \$5,000.00), such action must be brought in the bankruptcy court in the district where a defendant resides.⁴⁰ Also, the trustee in bankruptcy or debtor in possession who brings an action based on a claim arising after the bankruptcy petition was filed from the operations of the business of the debtor, may commence such action only in the bankruptcy court for the district in which an action on such claim might have been brought under applicable non-bankruptcy venue provisions.⁴¹ Chapter 50 also contains a provision for change of venue on traditional *forum non conveniens* grounds.⁴²

Provided that the bankruptcy courts have jurisdiction over the claim or cause of action, any civil action may be removed from any other court to the bankruptcy court, except for a proceeding pending before the United States Tax Court or a civil action by a government unit to enforce that government unit's police or regulatory powers.⁴³ Notwithstanding such removal to the bankruptcy court, the court will have power to remand the case on any equitable grounds.⁴⁴ A decision to remand or not to remand may not be appealed.⁴⁵

The bankruptcy court, although given the powers of the courts of equity, law, and admiralty, is denied the power to enjoin another court or to punish criminal contempt not committed in the presence of the bankruptcy judge or which may warrant imprisonment.⁴⁶

An amendment to 28 U.S.C. § 451 would seem to allow *in forma pauperis* petitions in bankruptcy for the first time.⁴⁷

³⁸ *Id.* § 1472(2).

³⁹ *Id.* § 1473(a).

⁴⁰ *Id.* § 1473(b).

⁴¹ *Id.* § 1473(d).

⁴² *Id.* § 1475.

⁴³ *Id.* § 1478(a).

⁴⁴ *Id.* § 1478(b).

⁴⁵ *Id.*

⁴⁶ *Id.* § 1481.

⁴⁷ This amendment was made by the Bankruptcy Reform Act which defined the term "Court of the United States" as used in 28 U.S.C. § 451 (Supp. III 1979) to include bankruptcy courts. Under 28 U.S.C. § 1915(a) (1976), any court of the United States was authorized to allow proceedings *in forma pauperis* as stated in that section. This amendment would have the effect of overruling *United States v. Kras*, 409 U.S. 434 (1973), which held that payment of filing fees was a condition to discharge and that any change in that holding would have to be made by statute.

Appeals from bankruptcy court decisions shall continue to be made to the district court.⁴⁸ However, if the circuit council of a particular circuit so elects, an alternate method of first appeal may be established by the designation of panels of three bankruptcy judges to hear appeals from the bankruptcy court.⁴⁹ As before, whether the first appeal is taken to the district court or to the panel of three bankruptcy judges, a second appeal of right to the circuit court will continue.⁵⁰ A new provision has been added wherein a final judgment, order, or decree of a bankruptcy court may be appealed directly to the circuit court if the parties to such an appeal so agree.⁵¹

A new section has been added providing for *habeas corpus* power to the bankruptcy court.⁵² The bankruptcy court may issue a writ of *habeas corpus* to bring a person before the court for testimony, to perform any duty imposed by the bankruptcy code, to order the release of a debtor who is in custody under a judgment of a federal or state court under an arrest in any civil action, or for the collection of a debt which is dischargeable or which will be provided by a plan of payment in the bankruptcy proceeding.⁵³

The Office of United States Trustee has been created under a new Chapter 39.⁵⁴ The program is experimental and will run for a period of less than five years, terminating on April 1, 1984, unless Congress passes legislation to continue it.⁵⁵

Ten pilot districts have been created, each under the supervision of a single United States Trustee.⁵⁶ Under the experiment, some districts, such as the District of Delaware and the District of New Jersey, have been combined into one pilot district.⁵⁷

The United States Trustee is appointed by the Attorney General of the United States and is subject to removal for cause by the Attorney General.⁵⁸ The duties of the United States Trustee include establishing and supervising a panel of private trustees eligible and available to serve as trustees in cases under Chapter 7 of the Bankruptcy Code⁵⁹ and generally supervising the

⁴⁸ 28 U.S.C. § 1334 (Supp. III 1979).

⁴⁹ *Id.* § 160.

⁵⁰ *Id.* § 1294(6) (eff. April 1, 1984).

⁵¹ *Id.* § 1293(b).

⁵² *Id.* § 2256.

⁵³ *Id.*

⁵⁴ *Id.* §§ 581-89.

⁵⁵ Bankruptcy Reform Act, Title IV, § 408(c), 92 Stat. 2549, 2687 (1978).

⁵⁶ 28 U.S.C. § 581(a) (Supp. III 1979).

⁵⁷ *Id.* § 581(a)(3).

⁵⁸ *Id.* § 581(a) & (c).

⁵⁹ *Id.* § 586(a)(1).

administration of all cases and trustees under Chapters 7,⁶⁰ 11,⁶¹ or 13⁶² of the Bankruptcy Code.⁶³

In non-pilot districts, where there is no United States Trustee appointed, the panel of private trustees to act in Chapter 7 cases shall be established and supervised by the Administrative Office of the United States Courts.⁶⁴

Changes in Other Statutes

Title III of the Bankruptcy Reform Act, in altering statutes other than Title 28, makes certain changes in the dischargeability of student loans under the student loan program,⁶⁵ the Public Health Service Act,⁶⁶ the Social Security Act,⁶⁷ the Merchant Marine Act,⁶⁸ and in Title 18, provisions relating to bankruptcy crimes.⁶⁹

Transition Provisions

The transition provisions of Title IV of the Bankruptcy Reform Act contain a specific repealer of the old Bankruptcy Act and all of its major amendments.⁷⁰ Most provisions of this new body of law took effect on October 1, 1979, although some will not become effective until April 1, 1984.⁷¹

The terms of all bankruptcy judges serving as of the date on which the Bankruptcy Reform Act was passed, are automatically extended to March 31, 1984.⁷² During the interim period, from October 1, 1979, through March 31, 1984, any judge whose original term would expire may be reap-

⁶⁰ 11 U.S.C. §§ 701-66 (Supp. III 1979).

⁶¹ *Id.* §§ 1101-74.

⁶² *Id.* §§ 1301-30.

⁶³ *Id.* § 586(a)(3).

⁶⁴ *Id.* § 604(f).

⁶⁵ Bankruptcy Reform Act, Title III, § 317, 92 Stat. 2549, 2678 (1978) (repealed 20 U.S.C. § 1087-3 (1976)).

⁶⁶ Bankruptcy Reform Act, Title III, § 327, 92 Stat. 2549, 2679 (1978) (repealed 42 U.S.C. § 294(f) (1976)).

⁶⁷ Bankruptcy Reform Act, Title III, § 328, 92 Stat. 2549, 2679 (1978) (repealed 42 U.S.C. § 656(b) (1976)).

⁶⁸ Bankruptcy Reform Act, Title III, § 334, 92 Stat. 2549, 2680 (1978) (amended 42 U.S.C. §§ 1241-47 (1976)).

⁶⁹ Bankruptcy Reform Act, Title III, § 314, 92 Stat. 2549, 2676 (1978) (amended 18 U.S.C. §§ 151-55 (1976)).

⁷⁰ Bankruptcy Reform Act, Title IV, § 401(a), 92 Stat. 2549, 2682 (1978).

⁷¹ *Id.* § 402, 92 Stat. at 2682.

⁷² *Id.* § 404(b), 92 Stat. at 2683.

pointed until March 31, 1984, upon successful completion of a merit screening proceeding. A merit screening committee composed of the president (or his designee) of the state bar association, the dean (or his designee) of a law school located within the state, and the president (or his designee) of the local bar association for the area where the particular bankruptcy judge has his chambers is organized and summoned to meetings by the appropriate circuit executive.⁷³ The committee passes on the qualifications of that judge to determine whether his term should be extended,⁷⁴ and then reports to the chief judge of that circuit. The chief judge will extend the term of the bankruptcy judge to March 31, 1984, unless he finds that the bankruptcy judge is not qualified to continue in office.⁷⁵

Other transition provisions provide for several studies during the transition period. For instance, the Director of the Administrative Office of the United States Courts will make continuing studies to determine the number of bankruptcy judges to be appointed commencing March 31, 1984, and the location of their courts.⁷⁶ The Director will also appoint a committee of not fewer than seven bankruptcy judges to advise the Director with respect to other matters which may arise during the transition period.⁷⁷ The Attorney General of the United States will conduct studies to determine the feasibility of continuing the United States Trustee System.⁷⁸

The Bankruptcy Code

As indicated at the beginning of this article, the substance of the new bankruptcy law is set forth in Title I of Public Law 95-598. All of the sections found in Title I are located in Title 11 of the United States Code, which deals with the substantive bankruptcy laws and which has become known as the "Bankruptcy Code."⁷⁹ Although many of the provisions of the old Bankruptcy Act are carried through to the Bankruptcy Code with little or no change, many areas have been significantly altered. The discussion which follows explores the most important of the new code provisions.

The Bankruptcy Code is composed of eight odd numbered chapters, as follow:

⁷³ *Id.* § 404(b) & (c), 92 Stat. at 2684.

⁷⁴ *Id.* § 404(c), 92 Stat. at 2684.

⁷⁵ *Id.* § 404(b), 92 Stat. at 2683.

⁷⁶ *Id.* § 406(a)(1), 92 Stat. at 2683.

⁷⁷ *Id.* § 407(a), 92 Stat. at 2686.

⁷⁸ *Id.* § 408(a), 92 Stat. at 2686-87.

⁷⁹ 11 U.S.C. §§ 101-151326 (Supp. III 1979).

(1) Chapter 1: General Provisions, Definitions and Rules of Construction;⁸⁰

(2) Chapter 3: Case Administration;⁸¹

(3) Chapter 5: Creditors, the Debtor and the Estate;⁸²

(4) Chapter 7: Liquidation;⁸³

(5) Chapter 9: Adjustment of Debts of a Municipality;⁸⁴

(6) Chapter 11: Reorganization;⁸⁵

(7) Chapter 13: Adjustment of the Debts of an Individual with Regular Income;⁸⁶ and,

(8) Chapter 15: United States Trustee.⁸⁷

The provisions in Chapters 1, 3, and 5 will apply to Chapter 7, 9, 11, and 13 cases unless otherwise stated.⁸⁸ Individual, partnership, and corporate liquidations of assets cases, previously referred to as "straight bankruptcies," will now be known as Chapter 7 cases.⁸⁹

Chapter 11 is a consolidation of Chapters VIII, X, XI, and XII of the old Bankruptcy Act.⁹⁰ Chapter 15, dealing with the United States Trustee, is directly related to Chapters 1, 3, 7, 11, and 13.⁹¹ The United States Trustee is delegated most of the administrative functions previously handled by the bankruptcy judge. Chapter 15 modifies related sections in the earlier chapters.⁹² For instance, section 303 of Chapter 3⁹³ deals with involuntary cases; section 15303 of Chapter 15⁹⁴ modifies section 303 in those pilot districts where a United States Trustee has been appointed.

Chapter 1, which contains section 101⁹⁵ (definitions) introduces some new terminology. For example, "debtor" replaces "bankrupt"⁹⁶ and "order

⁸⁰ *Id.* §§ 101-109.

⁸¹ *Id.* §§ 301-66.

⁸² *Id.* §§ 501-54.

⁸³ *Id.* §§ 701-66.

⁸⁴ *Id.* §§ 901-46.

⁸⁵ *Id.* §§ 1101-74.

⁸⁶ *Id.* §§ 1301-30.

⁸⁷ *Id.* §§ 1501-151326.

⁸⁸ *Id.* § 103(a).

⁸⁹ *Id.* § 109(b).

⁹⁰ 11 U.S.C. §§ 1101-74 (Supp. III 1979) (replacing 11 U.S.C. §§ 201-208, 501-676, 701-99, and 801-926 (1976)).

⁹¹ 11 U.S.C. §§ 1501-151326 (Supp. III 1979).

⁹² *Id.* § 15103.

⁹³ *Id.* § 303.

⁹⁴ *Id.* § 15303.

⁹⁵ *Id.* § 101.

⁹⁶ *Id.* § 101(12).

for relief" replaces "adjudication."⁹⁷ Section 102 states that any reference to "notice and hearing" means appropriate notice of an intended act with a hearing to be held only if the noticed party requests it.⁹⁸

It is now possible for a debtor and his or her spouse to file a joint case.⁹⁹ Joint filing requires only one filing fee,¹⁰⁰ and allows the case to be administered by the bankruptcy court more efficiently.

Involuntary cases can be commenced only under Chapters 7 and 11.¹⁰¹ The requirement of three or more petitioning creditors is continued,¹⁰² but their aggregate claims must now total \$5,000.00 or more.¹⁰³ If the debtor has fewer than twelve creditors, then one petitioning creditor will suffice to commence the suit, as before.¹⁰⁴ It is no longer necessary to plead that the debtor has committed an "act of bankruptcy."¹⁰⁵ In an involuntary petition, the bankruptcy court will enter an order for relief:

- (1) if the involuntary petition is not contested;¹⁰⁶
- (2) if the debtor is generally not paying its debts as they become due;¹⁰⁷ or,
- (3) if within 120 days before the filing of the petition a custodian was appointed or took possession of substantially all of the property of the debtor.¹⁰⁸

The Code provides that the first meeting of creditors will take place within a reasonable time after the bankruptcy court has entered an order for relief.¹⁰⁹ The bankruptcy judge may not preside at, or attend, any such meeting of creditors.¹¹⁰ The statute does not state who should preside at such meetings of creditors, but it is reasonable to assume that the interim trustee or the United States Trustee will preside.

Under section 6 of the old Bankruptcy Act, the exemption law of the state in which the debtor resided was utilized by the bankruptcy court in

⁹⁷ See, e.g., *id.* § 101(9).

⁹⁸ *Id.* § 102(1).

⁹⁹ *Id.* § 302(a).

¹⁰⁰ See historical and revision notes following 11 U.S.C. § 302 (Supp. III 1979).

¹⁰¹ *Id.* § 303(a).

¹⁰² *Id.* § 303(b)(1).

¹⁰³ *Id.*

¹⁰⁴ *Id.* § 303(b)(2).

¹⁰⁵ *Id.* § 303(b).

¹⁰⁶ *Id.* § 303(h).

¹⁰⁷ *Id.* § 303(h)(1).

¹⁰⁸ *Id.* § 303(h)(2).

¹⁰⁹ *Id.* § 341(a).

¹¹⁰ *Id.* § 341(c).

granting exemptions to the bankrupt.¹¹¹ Under the new exemption section of the Bankruptcy Code,¹¹² each state is given the right to pass legislation stating that the exemption statute¹¹³ shall not apply in that state. If the state does not so act, then the Code's exemption statute shall be applicable.¹¹⁴

Under the new exemption policy, the debtor will have a choice to take the exemption as allowed under state law or as allowed under section 522 of the Bankruptcy Code.¹¹⁵ If the debtor takes the Bankruptcy Code exemptions, he or she will be entitled to a homestead exemption up to \$7,500.00;¹¹⁶ equity in a motor vehicle up to \$1,200.00;¹¹⁷ all household goods, furnishings, and clothing up to \$200.00 on any particular item;¹¹⁸ jewelry up to \$500.00;¹¹⁹ the interest in any property up to \$400.00 (plus any unused portion of the homestead exemption);¹²⁰ and several other miscellaneous exemptions.¹²¹

Section 523¹²² sets forth and describes those particular debts which will not be discharged in the bankruptcy proceeding.¹²³

¹¹¹ 11 U.S.C. § 24 (1976) (repealed 1978).

¹¹² 11 U.S.C. § 522 (Supp. III 1979).

¹¹³ *Id.* § 522(b).

¹¹⁴ *Id.* § 522(b)(1).

¹¹⁵ *Id.* § 522.

¹¹⁶ *Id.* § 522(d)(1).

¹¹⁷ *Id.* § 522(d)(2).

¹¹⁸ *Id.* § 522(d)(3).

¹¹⁹ *Id.* § 522(d)(4).

¹²⁰ *Id.* § 522(d)(5). This provision eliminates possible discrimination against debtors who do not own homes.

¹²¹ *Id.* § 522(d)(6)-(11).

¹²² *Id.* § 523.

¹²³ *Id.* § 523(a). This section enumerates nine types of debts which are excepted from discharge:

- (1) Certain taxes and custom duties (§ 523(a)(1));
- (2) Money, property, or services; or extension, renewal, or refinancing of credit obtained by false pretenses or actual fraud (§ 523(a)(2));
- (3) Unscheduled debts (§ 523(a)(3));
- (4) Debts for fraud incurred by the individual while acting in a fiduciary capacity (§ 523(a)(4));
- (5) Debts to a spouse, former spouse, or child of debtor, for alimony or maintenance for the spouse or child (§ 523(a)(5));
- (6) Debts for willful and malicious injury to another or another's property (§ 523(a)(6));
- (7) Liabilities for fines, penalties, or forfeitures payable to a governmental unit (§ 523(a)(7));
- (8) Student loans guaranteed or funded by a governmental unit or a non-profit school unless such loans become due five years before the filing of the bankruptcy provision (§ 523(a)(8));
- and,
- (9) Debts owed before a previous bankruptcy case concerning the debtor in which the debtor was denied a discharge (§ 523(a)(9)).

A new section, section 524, provides that a discharge will automatically void any judgment previously entered which involves a dischargeable debt.¹²⁴

Section 525 prohibits governmental units from discriminating against a debtor.¹²⁵ This section is a codification of *Perez v. Campbell*¹²⁶ which held that a motor vehicle agency may not refuse to renew a debtor's driver's license because a prebankruptcy judgment resulting from an auto accident had been unpaid and discharged in bankruptcy.¹²⁷

Section 541 deals with property of the debtor's estate.¹²⁸ The commencement of a bankruptcy case creates an estate which is comprised of the debtor's interests in any property wherever it may be located.¹²⁹ This provision covers tangible and intangible property, causes of action, and even property which is out of the debtor's control.¹³⁰ It includes property that the trustee may recover pursuant to his avoiding powers.¹³¹ It also includes inherited property, property settlements with a spouse, or life insurance proceeds acquired within 180 days after the filing of the petition.¹³² This section overrules *Lockwood v. Exchange Bank*¹³³ and *Lines v. Frederick*.¹³⁴ Once the property becomes "property of the estate," the court will determine what property may be exempted for the debtor and what property will remain as property of the estate.¹³⁵

¹²⁴ 11 U.S.C. § 524 (Supp. III 1979).

¹²⁵ *Id.* § 525.

¹²⁶ 402 U.S. 637 (1971). In *Perez*, a provision of the Arizona Motor Vehicle Safety Act, which permitted the Motor Vehicle Agency to suspend an individual's driving license for failure to satisfy a judgment entered against him in an action arising out of the operation of a motor vehicle, was held invalid. The Court's basis for the holding of invalidity was the conflict between the Arizona statute and the federal Bankruptcy Act, which conflict was governed by the supremacy clause of the U.S. Constitution. The *Perez* Court held that the Bankruptcy Act was intended to provide the debtor with a "new opportunity" in life, unhampered by pre-existing tort judgments.

¹²⁷ *Id.* at 656.

¹²⁸ 11 U.S.C. § 541 (Supp. III 1979).

¹²⁹ *Id.* § 541(a).

¹³⁰ *Id.* § 541(a)(1).

¹³¹ *Id.* § 541(a)(3).

¹³² *Id.* § 541(a)(5).

¹³³ 190 U.S. 294 (1903).

¹³⁴ 400 U.S. 18 (1970). 11 U.S.C. § 541(a)(1) (Supp. III 1979), which provides that property of the estate includes all property of the debtor (even that needed for the debtor to make a new start), overrules *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903) (title to property generally exempt under state law does not pass to the trustee in bankruptcy).

This section also has the effect of overruling *Lines v. Frederick*, 400 U.S. 18 (1970), in which the Court determined that the bankrupt wage earner's accrued but unpaid vacation pay was not property which would pass to trustee in bankruptcy.

¹³⁵ 11 U.S.C. § 541 (Supp. III 1979).

As soon as an order for relief has been entered, the court must appoint a disinterested person who is a member of the panel of private trustees established under 28 U.S.C. § 604(f)¹³⁶ to serve as interim trustee until a trustee has been elected or designated.¹³⁷ The interim trustee may be a corporation.¹³⁸ Where there is a United States Trustee pilot program (such as exists in New Jersey), the United States Trustee will appoint the interim trustee.¹³⁹

The election of a trustee takes place at the meeting of creditors referred to above.¹⁴⁰ The creditors may elect a trustee if requested by those creditors holding at least twenty percent of the dollar amount of total claims.¹⁴¹ Thereafter, the candidate who receives a majority in the amount of the claims held by the creditors who vote will be elected as trustee.¹⁴² If no election is called or none takes place, then the interim trustee shall serve as trustee.¹⁴³

The debtor may convert a liquidation case to a case under Chapter 11 or Chapter 13 at any time, but only if the case has not been previously converted from those chapters to a liquidation case.¹⁴⁴ This gives the debtor one absolute right to enter Chapter 11 or Chapter 13. On request of a party in interest, and after notice and a hearing, the court may convert a liquidation case to a case under Chapter 11.¹⁴⁵

Under the new law, discharges will only be granted to individual debtors.¹⁴⁶ Corporations will no longer be eligible to receive a discharge in a Chapter 7 liquidation case.¹⁴⁷ Section 727 sets forth when a discharge may not be granted.¹⁴⁸ Much of this section is derived from Section 14(c) of the old Bankruptcy Act.¹⁴⁹ While section 523 of the Bankruptcy Code defines certain non-dischargeable debts¹⁵⁰ (much like Section 17 of the old

¹³⁶ 28 U.S.C. § 604(f) (Supp. III 1979).

¹³⁷ 11 U.S.C. § 701(a) & (b) (Supp. III 1979).

¹³⁸ 28 U.S.C. § 604(f) (Supp. III 1979).

¹³⁹ 11 U.S.C. § 15701 (Supp. III 1979).

¹⁴⁰ *Id.* § 702(b).

¹⁴¹ *Id.* § 702(c)(1).

¹⁴² *Id.* § 702(c)(2).

¹⁴³ *Id.* § 702(d).

¹⁴⁴ *Id.* § 702(a).

¹⁴⁵ *Id.* § 706(b) & (c).

¹⁴⁶ *Id.* § 727(a).

¹⁴⁷ *Id.* § 727(a)(1).

¹⁴⁸ *Id.* § 727(a).

¹⁴⁹ 11 U.S.C. § 32(c) (1976) (repealed 1978).

¹⁵⁰ 11 U.S.C. § 523 (Supp. III 1979).

Act¹⁵¹), section 727 covers general denials of discharge¹⁵² (much like Section 14 of the old Bankruptcy Act¹⁵³).

Priority in payment of claims has undergone slight but significant changes. Administration expenses, fees, and allowances continue to enjoy the highest priority.¹⁵⁴ Next are certain unsecured claims;¹⁵⁵ wages; commissions; and vacation, severance, and sick leave pay earned by any individual within ninety days before the petition was filed or the cessation of the debtor's business, whichever occurs first, to the extent of \$2,000.00 for each individual.¹⁵⁶ Next, a new priority has been added for contribution to employee benefit plans.¹⁵⁷ Following that is another new priority, to the extent of \$900.00, arising from a deposit of money in connection with the purchase, lease, or rental of property or the purchase of services for the personal, family or household use of the individual claimant, which services were not delivered or provided.¹⁵⁸ The next and last priority is for taxes.¹⁵⁹ Eliminated from priorities are the landlord's claims for unpaid rents for the three month period prior to bankruptcy and obligations to governmental units other than taxes.¹⁶⁰

The "strong arm clause" of section 70(c) of the old Bankruptcy Act¹⁶¹ is now located in section 544(a) of the Bankruptcy Code.¹⁶² Section 544(a) not only confers the status of a lien creditor upon the trustee,¹⁶³ but also gives the trustee all of the rights of a bona fide purchaser of real property from the debtor.¹⁶⁴ Section 544(b)¹⁶⁵ is the counterpart of section 70(e) of the old Bankruptcy Act¹⁶⁶ wherein the trustee is given the power to avoid any transfer which is avoidable by a creditor under applicable state or federal law.

¹⁵¹ 11 U.S.C. § 35 (1976) (repealed 1978).

¹⁵² 11 U.S.C. § 727 (Supp. III 1979).

¹⁵³ 11 U.S.C. § 32 (1976) (repealed 1978).

¹⁵⁴ 11 U.S.C. § 507(a)(1) (Supp. III 1979).

¹⁵⁵ *Id.* § 507(a)(2).

¹⁵⁶ *Id.* § 507(a)(3).

¹⁵⁷ *Id.* § 507(a)(4).

¹⁵⁸ *Id.* § 507(a)(5).

¹⁵⁹ *Id.* § 507(a)(6).

¹⁶⁰ These priorities were formerly found in 11 U.S.C. § 104(a)(5) (1976) (repealed 1978).

¹⁶¹ *Id.* § 110(c).

¹⁶² 11 U.S.C. § 544(a) (Supp. III 1979).

¹⁶³ *Id.* § 544(a)(1).

¹⁶⁴ *Id.* § 544(a)(3).

¹⁶⁵ *Id.* § 544(b).

¹⁶⁶ 11 U.S.C. § 110(e) (1976) (repealed 1978).

Section 546 places limitations on the avoiding powers of a trustee.¹⁶⁷ Of particular significance is Section 546(c)¹⁶⁸ which recognizes the validity of section 2-702 of the Uniform Commercial Code¹⁶⁹ and resolves conflicting decisions as to whether section 2-702 is valid when bankruptcy intervenes. Section 546(c) allows a seller of goods to reclaim such goods if the seller demands in writing reclamation of such goods within ten days after receipt of the goods by the debtor.¹⁷⁰

Section 547 of the Bankruptcy Code, the new preference statute,¹⁷¹ replaces section 60 of the old Bankruptcy Act.¹⁷² Again, slight but significant changes have been made. All of the elements of a preference have been carried forward with the following changes:

- (1) The preference period has been reduced from four months to ninety days;¹⁷³
- (2) the debtor is *presumed* to have been insolvent for that ninety day period;¹⁷⁴ and,
- (3) the requirement of actual knowledge of insolvency on the part of the transferee has been eliminated.¹⁷⁵

Many changes have been made in the right of setoff. Section 553 of the Bankruptcy Code¹⁷⁶ preserves (with some changes) section 68 of the old Bankruptcy Act,¹⁷⁷ and requires a close and careful reading. The setoff section is directly related to the preference section and prevents a creditor from improving its setoff rights during the ninety day period prior to bankruptcy.¹⁷⁸ The trustee will now be able to examine the transactions between the debtor and the setoff creditor for that ninety day period. For example, if the creditor has a deficiency after having setoff, and if that

¹⁶⁷ 11 U.S.C. § 546 (Supp. III 1979).

¹⁶⁸ *Id.* § 546(c).

¹⁶⁹ U.C.C. § 2-702 (1972 version).

¹⁷⁰ 11 U.S.C. § 546(c)(1) (Supp. III 1979).

¹⁷¹ *Id.* § 547.

¹⁷² 11 U.S.C. § 96 (1976) (repealed 1978). The legislative history of the Act states that 11 U.S.C. § 547 (Supp. III 1979) "is a substantial modification of present law," designed to bring the preference provisions "into conformity with commercial practice and the Uniform Commercial Code." S. REP. NO. 989, 95th Cong., 2d Sess. 87, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 5787, 5873.

¹⁷³ 11 U.S.C. § 547(b)(4)(A) (Supp. III 1979).

¹⁷⁴ *Id.* § 547(f).

¹⁷⁵ *Id.* § 547(b)(4)(B)(ii). Knowledge of the transferee is important now only because it will allow for an extension of the preference period from 90 days to one year, under certain circumstances. *Id.* § 547(c)(5)(A)(ii).

¹⁷⁶ *Id.* § 553.

¹⁷⁷ 11 U.S.C. § 108 (1976) (repealed 1978).

¹⁷⁸ 11 U.S.C. § 553(c) (Supp. III 1979).

deficiency is less than it would have been ninety days prior to bankruptcy, then the creditor must return the difference to the trustee.¹⁷⁹

The automatic stay provisions have been broadened by the new statute. The filing of a petition, whether it is voluntary or involuntary, operates as an automatic stay against the commencement or continuation of all suits, claims, proceedings, executions, and actions against the debtor or the debtor's property with reference to a claim or transaction which arose prior to the filing of the petition.¹⁸⁰ The automatic stay also precludes a setoff without first obtaining court approval.¹⁸¹ The automatic stay does not apply to certain actions such as criminal actions;¹⁸² proceedings against the debtor for collection of alimony, maintenance, or support from property that is not property of the estate;¹⁸³ proceedings by a governmental unit to enforce its police powers;¹⁸⁴ and other specified exceptions.¹⁸⁵ A party in interest may obtain relief from the stay upon application to the bankruptcy court in which such party shows cause justifying such relief.¹⁸⁶ Such an application must be heard within thirty days. Failing such hearing, the stay will be terminated.¹⁸⁷

Section 363 contains many new provisions regarding the use, sale, or lease of property.¹⁸⁸ It provides generally that the trustee, after notice and hearing, may use, sell or lease property of the estate, other than in the ordinary course of business.¹⁸⁹ If the business of the debtor is authorized to be continued during the bankruptcy proceedings, the trustee may use, sell or lease such property in the ordinary course of business without notice or hearing.¹⁹⁰ However, the trustee may not use "cash collateral" in which other parties may have a lien or some other interest, without first obtaining that party's consent or demonstrating that such other party will be "adequately protected."¹⁹¹

¹⁷⁹ *Id.* § 553(b)(1).

¹⁸⁰ *Id.* § 362(a)(1).

¹⁸¹ *Id.* § 362(a)(7).

¹⁸² *Id.* § 362(b)(1).

¹⁸³ *Id.* § 362(b)(2).

¹⁸⁴ *Id.* § 362(b)(4).

¹⁸⁵ *Id.* § 362(b)(1)-(8).

¹⁸⁶ *Id.* § 362(d) & (f).

¹⁸⁷ *Id.* § 362(e).

¹⁸⁸ *Id.* § 363.

¹⁸⁹ *Id.* § 363(b).

¹⁹⁰ *Id.* § 363(c)(1).

¹⁹¹ *Id.* § 363(c)(2) & (e).

The trustee may also sell property free and clear of any other party's rights of dower or curtesy.¹⁹² The trustee also has the power to sell both the debtor's interest and the interest of any co-owner in the property in which the debtor has an undivided interest as a tenant in common, joint tenant, or tenant by the entirety.¹⁹³ As a result, in a case where one spouse files a bankruptcy petition, the real estate owned by both spouses as tenants by the entirety can be sold by the trustee, subject to a specified discretion left to the court that the benefit to the estate of such a sale free of the interest of the non-debtor spouse outweighs the detriment, if any, to such spouse.¹⁹⁴ If such a sale is ordered, the spouse, or any other co-owner, is given the right of first refusal to purchase the property at the price at which such sale is to be consummated.¹⁹⁵

Section 364 allows a debtor-in-possession or trustee who is operating the business to obtain credit.¹⁹⁶ Under the old Bankruptcy Act, it was a common practice to obtain such credit and to pay it as an administrative expense. The debtor-in-possession or receiver also had the ability to secure such debt with a lien, subject to existing liens. Now, under the Bankruptcy Code, the trustee has the power to secure such credit with a lien that is either equal or superior to a pre-existing lien.¹⁹⁷ However, before doing so, the trustee must have the approval of the court. The court cannot grant such a "super priority" without first being satisfied that there is "adequate protection" to the earlier lien holder.¹⁹⁸

Section 365 covers executory contracts and unexpired leases.¹⁹⁹ Similar to section 70(b) of the Bankruptcy Act,²⁰⁰ section 365 provides for the assumption or rejection of an executory contract or unexpired lease by the trustee within sixty days of the filing of the petition in a Chapter 7 liquidation case, or at any time before confirmation of a plan under Chapters 9, 11 or 13.²⁰¹ Where an executory contract or unexpired lease has suffered a default by the debtor, the trustee may cure such default and assume the contract or lease.²⁰² "*Ipsa facto*" (or bankruptcy) clauses have been made specifically unenforceable.²⁰³

¹⁹² *Id.* § 363(g).

¹⁹³ *Id.* § 363(h).

¹⁹⁴ *Id.* § 363(h)(3).

¹⁹⁵ *Id.* § 363(i).

¹⁹⁶ *Id.* § 364.

¹⁹⁷ *Id.* § 364(d)(1).

¹⁹⁸ *Id.* §§ 364(d)(1)(B) & 361.

¹⁹⁹ *Id.* § 365.

²⁰⁰ 11 U.S.C. § 110(b) (1976) (repealed 1978).

²⁰¹ 11 U.S.C. § 365(d)(2) (Supp. III 1979).

²⁰² *Id.*

²⁰³ *Id.* § 365(e).

Any individual, partnership, or corporation can qualify as a debtor in the new Chapter 11.²⁰⁴ The petition may be voluntary or involuntary.²⁰⁵ Unless a trustee is appointed, the debtor has an exclusive 120 day period to file a plan. If the debtor does file such a plan, he has an additional sixty days to obtain acceptances.²⁰⁶ If no plan is filed within that period of time, or if a trustee has been appointed, then any third party may also file a plan.²⁰⁷

The Chapter 11 court may either continue the pre-petition committee of creditors or it may appoint a committee by selecting the seven largest unsecured creditors (in dollar amounts) willing to serve on the committee.²⁰⁸ The committee should then supervise the debtor's operations, and should also meet with the debtor to discuss an appropriate plan.²⁰⁹

A trustee may be appointed by the application of any party in interest, following notice and hearing that demonstrates the need for a trustee.²¹⁰ If appointment of a trustee is ordered, the court will make the appointment,²¹¹ except in the pilot United States Trustee Districts where the United States Trustee will make the appointment subject to court approval.²¹² If a trustee has not been appointed, then on request of a party in interest, and after notice and hearing, the court may order the appointment of an examiner to make an investigation into the affairs of the debtor, including fraud, dishonesty, incompetence, misconduct, and the like.²¹³ The examiner may also comment on the desirability of continuing the business and file a statement of his investigation.²¹⁴

Any plan filed must designate classes of creditors, specify any class that is not impaired under the plan, and set forth the treatment of claims that are impaired under the plan.²¹⁵ The plan may be filed as a liquidation plan even when the business is not being reorganized but its assets are being liquidated under Chapter 11, rather than having the case transferred to Chapter 7 for liquidation.²¹⁶ Creditors are not required to file a proof of

²⁰⁴ *Id.* §§ 1101, 101(12), & 101(30).

²⁰⁵ *Id.* §§ 301 & 303.

²⁰⁶ *Id.* § 1121(b), (c)(3), & (d).

²⁰⁷ *Id.* § 1121(c).

²⁰⁸ *Id.* § 1102(b).

²⁰⁹ *Id.* § 1103(c).

²¹⁰ *Id.* § 1104(a).

²¹¹ *Id.*

²¹² *Id.* § 151104.

²¹³ *Id.* § 1104(b).

²¹⁴ *Id.* § 1106.

²¹⁵ *Id.* § 1123(a)(1)-(3).

²¹⁶ *Id.* § 1123(b)(4).

claim unless the debt is listed in the schedules as disputed.²¹⁷ A plan must be accepted by two-thirds of the creditors in dollar amount and more than one-half in number of the allowed claimants who vote on the plan.²¹⁸ The debtor must file a disclosure statement before a vote on a plan may be solicited.²¹⁹ The court must hold a hearing to determine whether the disclosure statement to be transmitted to the creditors contains adequate information.²²⁰ An interesting new feature provides that tax claims may be paid on a deferred basis without consent of the taxing authority over a period not exceeding six years from the date of assessment.²²¹

Chapter 13,²²² which sets forth the adjustment of debts of an individual with regular income, greatly expands Chapter XIII of the Bankruptcy Act.²²³ Any individual (or jointly with his or her spouse) who, on the date of filing, owes non-contingent, liquidated unsecured debts of less than \$100,000.00 and non-contingent liquidated secured debts of less than \$350,000.00, can qualify as a debtor under Chapter 13.²²⁴ In proposing a plan, the debtor must submit future income to the Chapter 13 trustee in the amount sufficient to execute the plan.²²⁵ Provision must be made for payment in full of all priority claims. Such claims may be paid by deferred payments.²²⁶ The plan shall also provide for the same treatment of all claims within a particular case.²²⁷ The plan may not provide payments over a period longer than three years, except that the court may approve a period of up to five years for cause shown.²²⁸

It is not necessary that the creditors accept a Chapter 13 plan. The court need only conclude that the value of the property to be distributed under the plan to each unsecured creditor is at least equal to what would have been paid to that creditor if the debtor's property were liquidated under Chapter 7.²²⁹

A secured creditor can be "crammed down" in Chapter 13. If the value of the collateral is less than the amount of the secured claim, the debtor can

²¹⁷ *Id.* § 1111(a).

²¹⁸ *Id.* § 1126(c).

²¹⁹ *Id.* § 1125(b).

²²⁰ *Id.*

²²¹ *Id.* § 1129(a)(9)(C).

²²² *Id.* §§ 1301-30.

²²³ 11 U.S.C. §§ 1001-86 (1976) (repealed 1978).

²²⁴ 11 U.S.C. § 109(e) (Supp. III 1979).

²²⁵ *Id.* § 1322(a)(1).

²²⁶ *Id.* § 1322(a)(2).

²²⁷ *Id.* § 1322(a)(3).

²²⁸ *Id.* § 1322(c).

²²⁹ *Id.* § 1325(a)(4).

prove the value of the collateral and can pay the secured creditor that amount, plus the dividend which is to be paid to other unsecured creditors.²³⁰

A most important feature of the new Chapter 13 is that a creditor may not sue to have his debt declared non-dischargeable, even if the debt were incurred by fraud.²³¹ Thus, where a debtor pondering a Chapter 7 liquidation petition fears a claim of non-dischargeability, he can consider filing a Chapter 13 petition and paying his creditors more than they would receive on liquidation. In this manner, he can avoid the bar to dischargeability. If the debtor proposes such a plan, the plan must be carried out and completed in order to obtain the discharge.²³²

Conclusion

The piecemeal revisions and amendments to the Bankruptcy Act of 1898 made its complete overhaul inevitable. While some of the changes brought about by the new Bankruptcy Reform Act of 1978 are minor, others are substantial and merit more than a cursory examination. The purpose of this article is to direct the reader's attention to the salient features and more difficult aspects of the Bankruptcy Reform Act of 1978 in order to highlight the differences between this new act and its predecessor.

²³⁰ *Id.* § 1322(b)(2).

²³¹ *Id.* § 1328.

²³² *Id.* § 1328(a). Under certain circumstances, enumerated in 11 U.S.C. § 1328(b)(1)-(3) (Supp. III 1979), a discharge may be granted despite the debtor's failure to complete payments under the plan.