Bankruptcy, Contracts and Utilitarianism

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Recent efforts to develop a jurisprudence of bankruptcy have applied contract theories to the Bankruptcy Code. This Article examines two models of contract theory as they illuminate the laws of insolvency under Chapter 7 of the Code. It concludes that the utilitarian rather than contractarian paradigm of contract law is the appropriate model for analyzing bankruptcy law, despite the fact that the latter provides the basis for contract law as it is primarily studied today.

The Article begins by analyzing the relationship of contract law to bankruptcy law. It evaluates two models of contract theory: utilitarianism and contractarianism. It then turns to the policies underlying the Bankruptcy Code and argues that those policies are utilitarian in principle. Specific provisions of the Code demonstrate how the structure of the Code promotes utilitarian principles. Finally, the Article discusses the tensions created by formulating bankruptcy law according to the contractarian model and how these tensions are eased by relying on a utilitarian model as the basis for bankruptcy law.

When two parties enter into a contract, the possibility exists that one party to the contract will regret the bargain before performance is completed. Most likely this regretting party will be the individual who has yet to perform. This individual typically will choose one of three alternatives. She will perform despite the regret and risk loss of her expected benefit. She will perform despite the regret and risk loss of her expected benefit.
breach the contract and risk the sanctions for such a breach, or she will attempt to modify the terms of the contract to allow a benefit consistent with her expectations. Each alternative offers advantages and disadvantages. Depending on the circumstances and reasons for regret, one or more alternatives may not be feasible. Performance might be too expensive, or literally, or legally impossible. Breach, though less costly economically, may result in loss of goodwill or injury to the individual’s reputation. Finally, the cooperation of the other party necessary for renegotiation of the contract may be unattainable. To enter into, perform, and even breach a contract are rights recognized as part of the freedom of contract. The individual in

exceed the cost of compliance the contracting party predictably will perform assuming there exists a legal mechanism for enforcing the contract. See Barton, The Economic Basis of Damages for Breach of Contract, 1 J. LEGAL STUD. 277, 278 (1972). See also Leff, supra note 3, at 7-18 for a discussion of the collection cost to the nonbreaching and breaching parties of enforcing the contract.

5. A calculation of the sanctions for breach must include a consideration of the likelihood that the sanctions will occur. See Leff, supra note 3, at 18-19. Presumably if the party had knowledge of all the future alternatives and could competently evaluate the costs of each alternative she would choose the cheaper between breach or performance. See Goetz & Scott, supra note 2, at 1273.

6. Parties may use a variety of risk allocation devices in their initial bargain which can account for uncertainties or parties may agree to modify to meet circumstances as they occur. If the parties fail to account for an event, a desire to cooperate and to share the loss will allow for subsequent adjustments. See Gillette, Commercial Rationality and the Duty to Adjust Long-Term Contracts, 69 MINN. L. REV. 521, 559-71 (1985).

7. The Uniform Commercial Code excuses performance of a contract where performance has been made commercially impracticable "by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." U.C.C. § 2-615 (1987). Comment 4 to U.C.C. § 2-615 notes that "[i]ncreased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency." See also RESTATEMENT (SECOND) OF CONTRACTS § 261 (1979). For application of the doctrine of commercial impracticability see Transatlantic Fin. Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966) (Wright, J.).


9. See Gillette, supra note 6, at 570.

10. See F. KESSLER AND G. GILMORE, CONTRACTS CASES & MATERIALS 36-37 (L.C. 1970). This freedom represents our moral perspective on contracts; that is, one should not be compelled to enter into agreement nor should one be compelled to actually perform, one may instead pay damages. The notion that public policy will interfere to force the making of a contract is quite limited. See Poughkeepsie Buying Serv. v. Poughkeepsie Newspapers, Inc., 205 Misc. 982, 131 N.Y.S.2d 515 (Sup. Ct. 1954). The idea that specific performance will be required by the law also has limited
most transactions may act on private volition free from public coercion. Thus, if a party regrets a bargain, that party alone may weigh the various options and determine her course.

It is, however, understood that if she chooses to breach the contract she is obligated to pay damages to the other party. These damages should put that party in the position she would have been in if the contract had been performed.\(^\text{11}\) In this way, contract law balances the regretting party's right to get out of the contract with the other party's right to the benefit of her bargain.

The availability of bankruptcy provides the regretting individual with an additional alternative to performance: breach and cooperative modification. Theoretically, a party does not consider bankruptcy because of changes in the specific market context of a particular bargain. Rather, a party considers bankruptcy because of changes in her financial situation which affect all bargains into which she has entered.\(^\text{12}\) Though the reasons for considering bankruptcy may differ from those for considering breach absent bankruptcy, the results may be similar. The interests of the contracting parties and the rights that they have established in contract are brought into conflict. Bankruptcy serves as a mechanism which forces creditors to renegotiate and modify the terms of the original bargain. The debtor's institution of bankruptcy proceedings requires both parties to reassess their contract expectations and modify their behavior according to the Bankruptcy Code's prescriptions. Norms of behavior based on the Bankruptcy Code are imposed on the private expectations of the contracting parties. Behavior which was protected by the legal system before bankruptcy becomes legally intolerable--

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\(^{11}\) Placing the party in the position where she would be if performance occurred is generally understood to be the objective of contract remedies whether they be monetary damages or specific performance. See F. KESSLER & G. GILMORE, supra note 10, at 991-94.

\(^{12}\) Indeed it may be the case in situations involving breach of a single contract that the breaching party does so because of general market conditions rather than dissatisfaction with one bargain.

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in some cases retrospectively—once bankruptcy is declared.13 For example, the creditor no longer can expect to sue for contract damages for the debtor's failure to perform as bargained. Likewise, the creditor can no longer avail herself of the self-help collection methods routinely available at law under ordinary circumstances. In these ways bankruptcy procedures conflict with the rights and interests of the creditor as a contracting party.

Because most of these rights and interests are based on the contractarian model, we can reasonably conclude that bankruptcy law may be inconsistent with a strict contractarian view of contract law. Under the contractarian model, the law attempts to reconcile conflicting rights by compensating both parties' expectations, either personal or reasonable. If bankruptcy law is to be effective it must reconcile the conflict in rights which occurs when a party declares bankruptcy. The contractarian model, however, may not provide the proper framework for this reconciliation.

In bankruptcy, the conflict which occurs differs from that in an ordinary breach of contract case. The conflict arising in bankruptcy is between private expectations or rights and Code-created expectations and rights. The rights or expectations granted by the Bankruptcy Code are better characterized as public rather than private.14 Thus, the law must reconcile conflict between private and public expectations and between acceptable private behavior and public standards of behavior.15 Bankruptcy, like any state-imposed negotiation, should attempt to achieve some purposes of the parties as well as some aims of the state. Its primary purpose, however, is public.16 Moreover, because its aim is primarily public rather than private, the utilitarian contract model is a more appropriate model for developing and interpreting bankruptcy law.

Yet while its purpose is utilitarian, an examination of the Code's structure reveals a movement to a private law model. Thus, while there is a general consistency in the policies of bankruptcy law and the structure of the Code, there are some inconsistencies in the structure and interpretation. Where the private law model is adopted by the Code it is more consistent with the contractarian paradigm. In sum, the Code which was enacted to accomplish one set of goals may be drafted and interpreted to accomplish another.

14. See infra notes 37-82 and accompanying text.
15. See Jackson, Translating Assets and Liabilities to the Bankruptcy Forum, 14 J. OF LEGAL STUD. 73, 75-77 (1985); Eisenberg, supra note 1, at 955-76.

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Analyzing Chapter 7 claims for discharge exposes the tension between the private expectations of the parties and the public expectations which allow relief from debts. The question arises whether modern bankruptcy law sufficiently harmonizes the selfish interests of contracting parties with the altruistic objectives of the state. This Article looks at the substance of the Bankruptcy Code’s policies and the Code’s structure to determine how it attempts to reconcile these two ideals. As exemplified in the Code’s exemption scheme, the Bankruptcy Code begins in principle from a public law model with goals of equity and fairness to the individual claiming relief. To achieve these goals the Code adopts strict normative rules to govern debtor/creditor behavior. As applied, bankruptcy law progresses to a private law model which adopts standards of behavior based on goals of the individual. These standards of behavior demand greater flexibility of the Code to accommodate individual expectations. Often, the expressed, rhetorical goals of bankruptcy law, which generally espouse collectivistic principles, are replaced in practice by ideals that can only be characterized as individualistic.

This Article concludes that this interpretation of the Code is inconsistent with its stated policies. The structure does not lend itself to achieving those policies. Moreover, while some individualistic ideals must be considered under the Code, the Code’s exemption scheme has ignored its altruistic purposes. Finally, much of the criticism of the Code is due not only to this inconsistency but also to the fact that the Code drafters, the courts, and the critics are unclear in two areas: first, whether Bankruptcy law should address situations of individual economic regret; and second, whether it should develop to address broad economic failure.

Part II of this Article discusses the fresh start and equal access policies of the Code; their histories; how they are integrated into the provisions of the Code; and how they deviate from the policies promoted by contract law and other doctrines related to bankruptcy. Turning to the Code’s exemption scheme, Part III discusses the Bankruptcy Code’s definition of estate property, generally, and whether pension funds are estate property, specifically. Part III examines the relationship of the Code’s definition of estate property to the Code’s fresh start and equal access policies. It also looks at the structure used to define the exceptions and exemptions to the definitions. This portion of the Article demonstrates the structural progression of these provisions from a "strict rule form" to a "standards form." Part IV discusses the ideological progression of the Code from a public interest model, as espoused in its underlying policies, to a private expectation model, as exemplified in its exemption scheme. Part IV also relates the structural progression to the ideological progression.17

17. For purposes of discussion consider the hypothetical case of Dr. Jonna Erick, a thirty-eight year old medical professional. Dr. Erick has an income of approximately
$75,000 per year. She is an independent health care provider who shares physical facilities with several other physicians. She participates in an ERISA qualified group pension plan and has a separate KEOGH plan. She has one dependent. Her debts are the result of starting her business and shortly thereafter assuming the marital debts in a divorce settlement which occurred in January 1987.

In March of 1987, Dr. Erick began considering the possibility of filing bankruptcy. In May of that year she consulted an attorney who advised her on Chapter 7 and Chapter 13 ramifications. In April of 1987 she filed under Chapter 7 of the Bankruptcy Act. In July of 1987 Dr. Erick transferred $100,000 to her KEOGH account from savings accounts and money market accounts. In September of 1987 she borrowed $30,000 from the account and refinanced a mortgage on her home making a $10,000 down payment on the home. In October she repaid the money borrowed from the account at a market interest rate. In December of 1987, Dr. Erick transferred $50,000 to her KEOGH plan and $150,000 to her ERISA retirement plan. The $200,000 represented proceeds from jewelry, automobiles, and commercial real estate property which Dr. Erick owned.

Dr. Erick claims that the funds in the retirement plans and her home are not property within the Bankruptcy Code and are beyond the trustee’s reach during the bankruptcy proceedings. Dr. Erick further claims that if the funds and income from the pension fund are not excluded from the estate property, they are exempt under section 522(d)(10) of the Bankruptcy Code. First, we will consider the validity of Dr. Erick’s claims and then the implications of such claims for the creditors of Dr. Erick.

In 1986 Dr. Erick, the party who will become the debtor in a bankruptcy proceeding, was faced with an initial dilemma. Should she perform as per the terms of her credit agreements? That is, should she make payment to her creditors or should she default? Some of the transactions upon which she must decide were undoubtedly secured by collateral in the debtor’s possession. Others were no doubt unsecured. Supplies, services and perhaps some medical equipment were provided to the debtor on an unsecured basis on a number of contracts. These parties, both unsecured and secured, are thus awaiting the performance of the debtor. It is the unsecured creditor who is the concern of this Article. The unsecured party relies principally on income from the debtor’s operation as the source of its return performance. Dr. Erick will probably conclude that a Chapter 7 liquidation is an attractive alternative for her. She will not have to establish that she is unable to repay her debts over time nor that the circumstances which caused her to regret the bargains entered into were unforeseen or beyond the contemplation of the parties. Also because of the increased resort to bankruptcy, generally, the social stigma which may have at one time attached to this choice no longer exists. She will be able to pay a portion of her debt to all of her unsecured creditors and will be relieved from the threat of collection on any that remain. As she is some years from retirement and enjoys an above average income, the threat of the unavailability of credit for seven years is lessened. Finally, she will be able to protect some of her property through the exclusions and exemptions provided by the Code or by state exemption schemes. If she must resort to the Code she is likely to protect $7500 interest in her homestead, unmatured life insurance and her pension funds. The level of protection afforded her pension funds will vary depending on whether the bankruptcy court concludes that the pensions are excluded
II. THEORIES OF CONTRACT LAW

Contract law since the latter half of the eighteenth century and as we study it today is concerned primarily with the enforcement of executory promises. The law developed under the influences of the free market's growth and a laissez-faire political and social philosophy. The free market society has aptly been described as very much a market for individuals. Yet society generally and contract law specifically was not free of other influences. Indeed the presence of other influences may have resulted from too great an emphasis on the free market. The harshness of life that resulted from the free market economy caused "the new middle classes" to develop checks on freedom of choice and freedom of contract. Thus, the values and laws of the individualistic society as espoused by Adam Smith and Thomas Hobbes coexisted with ideas of collectivism as later promoted by John Stuart Mill.

Out of this era, two approaches of contract law, collectivistic and individualistic might have developed. In fact, what developed was an individualistic approach to contract law. The collectivistic ideas that were a part of the law were defined as outside of contract law. Contract law thus began to reflect the needs of the free market. The two models, both based on the philosophers' ideas of what was best for the individual have been called the contractarian paradigm and the utilitarian paradigm.

or exempted property. If she is a resident of a state which has opted out of the federal scheme, she may have a greater or lesser protection for her assets. If she is a resident of Oklahoma, for example, she may protect from the bankruptcy proceeding her entire interest in her home and any interest in a tax exempt pension plan including her KEOGH plan. See OKLA. STAT. TIT. 31, §§ 1-2 (1980). Nonetheless she may protect any money she has converted to these plans just prior to her declaration. Thus, bankruptcy seems a reasonable and likely alternative for Dr. Erick.

18. While this statement may seem all but self evident, it did not always represent prevailing legal thought. Early contract law emphasized certain types of contracts and relationships and executed promises. Executory promises were not enforceable at contract. See P. Atiyah, The Rise and Fall of Freedom of Contract, 308-309.

19. Id. at 233-35.

20. Id.

25. See Rosenfeld, Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory, 70 Iowa L. Rev. 769 (1985). Rosenfeld also discusses a third paradigm, libertarian which he describes as lying "next to
The contractarian paradigm is the prevailing scheme for contract law as it has developed under the free market theory. It is based on the view of the precedents of individual self interests. It recognizes, however, that the cooperation of society is necessary in order to enhance the value of individual achievement and, ultimately, individual self interest. Absent procedural unfairness, promises are enforced. Because the paradigm assumes that maximum individual welfare is achieved through freedom of contract, law is not to interfere with that freedom even to achieve what may be characterized as a "common good." In other words, promotion of individual self interests, such as the right to enforce a bargain, is the best way to achieve the common good.

The utilitarian paradigm is based on a combination of beliefs in the rights of individuals and the collective good. Under this paradigm, the law serves as an impartial judge to determine from the perspective of each party whether a contract should be enforced. In contrast to the contractarian paradigm which is concerned most with process, utilitarianism is concerned with fairness in result. According to John Stuart Mill, whose works have been characterized as utilitarian, as soon as any part of a person's conduct affects prejudicially the interests of others, society has jurisdiction over it, and the question whether the general welfare will or will not be promoted by interfering with it, becomes open to discussion. Thus, the question of enforcement of a contract which would affect the interests of society in general is an open question, even though it impacts on the rights of the extreme individualism." Id. at 786. Its purpose is to insure that individuals, through contract law and other law, be able to maintain the fruit of their own labor free from interference from the society around them. Id. at 787.

26. Id. at 790-93. According to Professor Rosenfeld the contractarian paradigm originated from the philosophy of Thomas Hobbes who recognized the need for cooperation among men lest human affairs degenerate to a state of war. Though Hobbes perceived the need for a "sovereign" in order to prevent war and to preserve man, the purpose of the "sovereign" was to protect the right to live as individuals. See HOBBS, supra note 22, at 115-19.

27. According to Hobbes while "men" had a natural right to make covenants, the only way they were freed of such was either by performance or by being forgiven. HOBBS, supra note 22, at 92-95.

28. See Rosenfeld, supra note 25, at 798.

29. Id. at 801.

30. Id. at 798.

contracting parties. Accordingly, injury to society can require the law's interference in contract enforcement. Under the utilitarian paradigm of contract law, justice is determined by "weighing the consequences of all actions to determine whether they contribute to the common good." Unlike the contract model, in the utilitarian paradigm, individual good does not determine common good. Common good restrains individual good.

Both the contractarian and the utilitarian paradigms are philosophies for achieving justice and resolving issues in contract law. The following section argues that because insolvency has its most profound effect on contract rights, bankruptcy law as an interference with contract rights should be guided by a contract law model. Furthermore, the utilitarian paradigm represents the most appropriate philosophy for achieving justice in bankruptcy law.

III. UNDERLYING POLICIES OF THE CODE

Long-stated and basic purposes of modern bankruptcy law are to "relieve the honest debtor from the weight of oppressive indebtedness" and to give "the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." The Bankruptcy Act was passed "in light of those views and [is] to be construed, when possible, in harmony with them." This rhetoric has been translated into two policies of Chapter 7 of the Bankruptcy Code: (1) the free access policy, and (2) the fresh start policy. These policies reflect the collectivistic principles from which they stem.

32. It should be noted that Mill recognized the right of an individual to engage in conduct which affected himself or herself alone as a "perfect right." However, Mill apparently recognized that very little conduct would not have consequences which affected others. Thus his critics have accused him of sacrificing individual autonomy to societal needs. See Rosenfeld, supra note 25, at 803.

33. J.S. MILL, supra note 23, at 94-115. Bankruptcy law is a form of interference in the contract rights of parties as will be discussed in the following section.

34. Rosenfeld, supra note 25, at 802-03.

35. See CHITY ON CONTRACTS, §§ 1213-31 (A. Guest 2d ed. 1977), in which the author characterizes the adjudication of bankruptcy as an assignment by operation of law of the contract rights of a debtor.

36. See Warren, supra note 1, at 778-80.


39. Frederick, 400 U.S. at 19.
A. The Free Access Policy

The Bankruptcy Code's adherence to the free access policy means that discharge in bankruptcy is available with few substantive or procedural limitations. Debtors eligible for relief in bankruptcy are those persons who reside, have a domicile, or own property in the United States.\(^{40}\) Individuals who find themselves in financial distress need not be insolvent to qualify to file for Chapter 7 discharge in bankruptcy.\(^{41}\) With the exception of stockbrokers and commodity brokers,\(^{42}\) any person may be eligible for Chapter 7 discharge without a finding that the debtor is unable to pay.\(^{43}\) The individual need only be a person who has not obtained a discharge under Chapter 7 in the previous six years.\(^{44}\) As applied to a bargain disrupted by bankruptcy, the only apparent requirement for access to the process is individual, subjective regret on the part of the debtor. Thus, the creditor's right to expect the debtor's performance is interfered with when the debtor elects bankruptcy. Once the debtor decides to declare bankruptcy, the law disregards in many ways the terms for which the parties bargained.

Notwithstanding this disruption of the parties' expectations in contract law, the Bankruptcy Code places few limitations on the debtor's basis for opting for bankruptcy rather than performing the credit agreements. A wide range of reasons for regret, from bad faith in the initial agreement to unforeseeable catastrophic changes, might exist.\(^{45}\) First, the debtor, in agreeing to the credit terms, may have done so with no intention of performing. The party may have based such a decision on the legal limitations on remedies for breach, the cost of collection processing, and the bankruptcy law and policy. The party, who may have already accumulated substantial debt, may foresee that bankruptcy and related non-bankruptcy law reduces the cost of his non-performance by requiring the creditor to accept less than the rate agreed upon in the original exchange. This debtor thus makes a calculated decision to enter an agreement knowing she will get out of the bargain by declaring bankruptcy. Under pure contractarian principles, this debtor would not be allowed to declare bankruptcy and thwart the creditor's right to collect. The private expectations of the creditor created by the law on debt collection and general contract principles would require adherence to the reasonable

\(^{41}\) Id. § 301.
\(^{42}\) Id. § 109(d).
\(^{43}\) Id. §§ 109(b), 109(d).
\(^{44}\) Id. § 727(a)(8).
terms. The right of the creditor to enforce the contract against this calculating debtor prevails under the contractarian approach.

The party who contracts knowing bankruptcy will follow presents one extreme in consumer transactions. The other extreme is represented by the party who cannot perform a contract entered into as a result of creditor coercion. She ill-advisedly agrees to a credit transaction which either contains unfair terms, terms she did not understand, or terms she cannot comply with given her financial circumstances. As she begins to perform she discovers that she is unable to complete the terms of the agreement. Extension of credit under these circumstances is curtailed by general principles of contract law. The common law doctrine of unconscionability, and various consumer protection acts, however, allow extensions to continue to occur.

The improvident debtor may have had every intention of performing the agreed-upon credit transaction. Bankruptcy, however, may become the least costly alternative because the debtor, out of ignorance, naivete or fraud on the part of the creditor, has been unable to fully assess her own ability to perform. Protecting a "hypothetical bargain" with the unscrupulous creditor would not seem appropriate. Even under the contractarian paradigm, the improvident debtor would be allowed to avoid the contract because of the unfairness of the procedure leading to the contract formation. It is questionable, however, whether the improper procedure employed by one creditor might in fact support avoiding other contracts with the same creditor.

The majority of the individuals who declare bankruptcy do not fit into either of the above classes. Most parties who regret their bargains and are faced with a decision of performing or claiming bankruptcy fall between the two extremes. The majority of debtors face the choice of bankruptcy because of a combination of two factors: impulsive behavior upon entering into the agreement; and failed or changed circumstances between contract formation and contract performance.

One theory explaining consumer regret is as follows. As consumers many of us develop a plan for purchasing items whether they are necessities or luxuries. As a complement to the planning side of our personality there is an impulsive side to each individual. Depending on the individual, the availability of credit may cause the impulsive element to take over the planning element. Thus, to some extent the impulse credit-buyer does so...
without rationally assessing the possibility or likelihood of performance.\textsuperscript{50} The debtor probably intends at the time of contracting to perform. Changes in circumstances, such as job status, prior to completion of the performance cause the debtor to regret the impulse purchase. In some cases, where the impulse transaction could reasonably be performed as bargained, the changed, unanticipated circumstances are so severe as to precipitate a decision not to perform. In other cases, where performance of the impulse transaction was highly unlikely at the outset, regret may occur much earlier and may be based on a less severe change in circumstances. Nevertheless, the party begins to regret the agreement and non-performance either by default, or declaration of bankruptcy becomes an option. The two factors vary as to the influence they have on the decision to declare bankruptcy.\textsuperscript{51}

The free access policy fails to distinguish the debtor who never intends to perform, the debtor who is a victim of an unscrupulous creditor, and the debtor who is a victim of circumstances.\textsuperscript{52} In this way the Bankruptcy Code differs from much of modern contract law which follows the contractarian paradigm and allows differing results based on the faith of the party making the claim for dissolution of contract.\textsuperscript{53} The Bankruptcy Code treats the impulsive debtor, the willful debtor, and the thoughtful debtor the same.\textsuperscript{54}

\textsuperscript{50} See Jackson, \textit{The Fresh Start Policy of Bankruptcy}, 98 HARV. L. REV. 1393, 1404-1414 (1985). There is evidence that credit cards represent a particularly attractive form of credit to people who declare bankruptcy. In addition, the high interest, short term nature of credit card debt increases its impact on the financial status of the debtor. See SULLIVAN, WARREN \& WESTBROOK, \textit{AS WE FORGIVE OUR DEBTORS} 188-90 (1989).

\textsuperscript{51} Evidence suggests that a significant number of debtors who declare bankruptcy suffer employment interruption or decline in income in the two year period prior to declaration of Chapter 7 bankruptcy. See SULLIVAN, supra note 50, at 98-102.

\textsuperscript{52} The definition of debtor found in 11 U.S.C. § 101 (1988), is "any person or municipality concerning which a case under this title has been commenced." 11 U.S.C. § 109(a) (1988). The definition of "[w]ho may be a debtor" includes any person who now resides in the United States and for purposes of filing under Chapter 7, any person "if such is not (1) a railroad; (2) a domestic insurance company or [member of the domestic banking industry] per the terms of section 109(b)." Thus, the distinction made in the Code between debtors focuses on the domicile or residence of the person filing and on the nature of the business in which the debtor is engaged. For purposes of filing under Chapter 13, section 109(e) distinguishes between debtors based on the size of the secured and unsecured debt. 11 U.S.C. § 109 (1988).

\textsuperscript{53} 11 U.S.C. § 523 (1988) excepts some debts from discharge but relates to false presentations or by use of a material false written statement. This section looks only at limited objective manifestations of bad faith to determine ineligibility.

\textsuperscript{54} Unless some inference may be drawn between the distinctions found in section 109 with regard to the manner in which they become debtors, were are left to conclude that the Code is not concerned whether persons meeting the requirements of section
The free access policy refuses to judge the merit of the claim being brought even though the acceptance of that claim means a disruption of some private interest and a public interference into the agreement. For these reasons, the free access policy introduces a conflict between bankruptcy law and the expectations of the creditor based on contractarianism. Indeed, this bankruptcy policy arguably goes beyond the ideas of collectivism.

Upon initial observation, contract law appears to base rules governing breach and remedies on a standard of individual expectation rather than a collective standard of good or bad behavior. Under modern contract law, at least in theory, a party who willfully breaches a contract is no more liable for damages than an innocent breacher. Contract law assumes that in a truly consensual relationship, parties are free to agree to almost any terms. Parties are also free to choose to either perform or to breach if they are willing to pay damages for the breach. Furthermore, contract law assumes remedies for such breach will be based on the bargain between the parties and the reasonably-expected result of that bargain. Concerns about willfulness or innocence of the breaching party at the time of breach have limited utility in determining damages based on the expectations of the parties at the time the contract was made. The question which allows the adjudicator to reduce or expand damages is whether the expectations of the parties were reasonable. "Reasonable expectations," however, are often governed by the good faith standard of contract performance. This governance allows a court to interject collective constraints and speak in a language with moral implications.

Yet to some degree, even this level of morality in contract law is based on individualism, particularly where the parties involved are merchants. For example, damages for breach are based on the good faith expectation of the

55. The private distribution of the assets available to the estate which may have been contemplated by the creditor are now subject to the collective process described by Jackson, Translating Assets and Liabilities to the Bankruptcy Forum, 14 J. LEG. STUD. 73 (1985).

56. Legal remedies for breach of contract reject compulsion of certain behavior as an objective of the system. See Farnsworth, supra note 11, at 1150. See also Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685, 1693-94 (1976).

57. But see Farnsworth, supra note 11, at 1150-53, who, while recognizing this is the theoretical basis for contract damages identifies a punishment element in the assessment of remedies for breach of contract.


60. See, e.g., Holmes, supra note 58, at 463; U.C.C. §§ 1-203, 2-103 (1987); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).
nonbreaching party who is under a duty to mitigate her losses. A sort of commercial morality is thus imposed. Bad behavior or behavior which reduces compensation is not the result of some inherent wrong, but results from the failure of the nonbreaching party to behave in a commercially-reasonable way on an objective level.\textsuperscript{61} To the extent that this standard is a collective standard, it is based on the community of merchants, not the society in general. The outcome is that the party who fails to mitigate is not compensated per her personal expectations; instead she is compensated for what the merchant community believes her expectations should have been.

When the issue shifts from how much a party can collect in damages to whether the contract rights of parties should be avoided, morality is interjected into commercial law on a somewhat different basis. On this level the interjection is based on collective concerns about the utility of individual behavior. Consequently, even though the parties' expectations are capable of being fulfilled, the court may refuse to grant those expectations. The law bases its concept of bad behavior on some collective or public notion of right and wrong—apart from commercial reasonableness. Good faith in this context takes on a new role and often requires interference with the private process of commercial law.

Unconscionability, duress, misrepresentation and impracticability are doctrines which courts utilize to avoid privately-negotiated contracts. Each doctrine turns on an element of good faith on the part of the person seeking avoidance, and bad faith on the part of the person seeking performance. Under each doctrine, good faith or bad faith is defined by a concern for justice that goes beyond concern for fulfillment of individuals' rights to contract or concerns about individual welfare as defined by the individual.\textsuperscript{62} The Bankruptcy Code, under the free access policy, is not as concerned with specific individual welfare as it is with public ideas about justice and equity.\textsuperscript{63}

One distinction between the collectivist principles as applied in contract law and those of bankruptcy law is that bad faith is not a concern in bankruptcy. Another distinction is that contract law looks at the problems on

\textsuperscript{61} See Kennedy, \textit{supra} note 56, at 1694-99. \textit{See also} Roth Steel Prod. v. Sharon Steel Corp., 705 F.2d 134 (6th Cir. 1983), in which the court recognizes not only the objective measure of good faith employing the commercial reasonableness standard but also the subjective measure of good faith and asks the question of whether the party was honest in fact in its claim modification of a contract was made in good faith.

\textsuperscript{62} \textit{See} U.C.C. \textsection 2-302 (1987); \textit{Farnsworth, supra} note 8, \textsection 4.28.

a case by case basis and affects only one exchange at a time. Bankruptcy policy has greater potential for disrupting the private expectations on a broader scale.  

Arguably from a market-expectation perspective, the free access policy's failure to make distinctions between the various types of debtors is irrelevant. The results of a willful refusal to pay are the same as an inability to pay. Whether bankruptcy is considered as an alternative to performance at the point of obtaining credit or whether it is considered as an alternative to performance as the result of changed circumstances has no bearing. From a monetary standpoint, the effect on the rights of creditors is the same in either situation except that it may affect the debtor's choice of the timing of the institution of bankruptcy. Yet because the availability of bankruptcy as an alternative to performance is based on altruistic rather than market goals, the free access policy must be justified by something other than the indifference of the market to the motives of the bankrupt. If the goal is to provide the honest unfortunates with relief, arguably some concern with specific individual condition should be observed. Psychological and sociological costs associated with bankruptcy will increase or decrease the desirability of bankruptcy to some parties who otherwise may be able to perform.

To the extent the Bankruptcy Code can distinguish between the "honest" and "unfortunate" debtor and the willful breacher and at the same time approximate the monetary benefits anticipated by creditor, these goals should be reflected in the Code's access policy. The individual's particular circumstance in choosing bankruptcy as an alternative to performance should be the focus of the policy governing access to discharge because individual relief is the underlying goal of the Code.  

If the goal of the Code is to provide relief to the debtor from oppressive economic situations, access considerations should include not only the amount owed in debt and the assets available for distribution, but also the ability to earn. These considerations are the essence of what constitutes oppression for this individual. This framework is the essence of contractarianism in the context of the bankruptcy access policy.

Yet some observations based on empirical study suggest that most individuals who declare bankruptcy are unable to pay. Furthermore, specific inquiry beyond present standards into debtor motivation would be inefficient. The empirical evidence suggests that the case by case method.

65. See infra notes 68-71 and accompanying text.
66. See Sullivan, supra note 50, at 53-77. This data suggests that most debtors who declare bankruptcy cannot afford to pay creditors.
employed in a contractarian approach is not necessary or desirable to affect the goal of providing relief to the honest but unfortunate debtor. 67

The drafters of the free access policy must have determined that relieving the debtor from "oppressive indebtedness" is so important that no distinctions should be made at the level of access. Discharge in bankruptcy as a matter of right is not justified by the market or its relationship with general principles of the law regulating market exchange. Bankruptcy discharge, therefore, does not fit into the contractarian paradigm. The rhetoric of and the purposes behind the Bankruptcy Code with regard to access are utilitarian. Hence, results must be judged on the achievement of utilitarian goals.

B. Fresh Start Policy

As the free access policy represents debtors' introduction to the Code's protection, the fresh start policy represents the results of the proceedings. Like the free access policy, the policy of allowing the debtor to achieve a "fresh start" after bankruptcy proceedings reduces the cost of the debtor's nonperformance and artificially determines the bargaining positions of parties to a contract. Both free access and fresh start are granted as a matter of right, and both are arguably overinclusive. The fresh start policy of Chapter 7, which is complete and nonwaiveable, provides the debtor with relief from his existing debts in exchange for surrender and liquidation of existing assets. 68 Oddly enough, originally the Bankruptcy Code used the process of surrender and liquidation as a way of getting the regretting debtor to disclose all of her assets. 69 One of the currently-stated normative purposes of surrender and liquidation is protecting the debtor's assets from further collection efforts 70 by the preventing creditors from racing to the debtor's assets and looting the bankruptcy fund. 71 Because it alleviates some of the economic consequences of nonperformance to the debtor, the policy further enhances the option of bankruptcy over breach.

67. See Sullivan, Warren & Westbrook, Limiting access to Bankruptcy Discharge: An Analysis for the Creditor's Data, 1983 Wis. L. Rev. 1091, in which the authors analyze a study of Chapter 7 bankruptcy filings aimed at analyzing the reasons parties declare bankruptcy and their ability to repay debts which would be discharged under Chapter 7. The authors conclude that the evidence produced by the study failed to support reform which would disallow discharges different from those currently employed by the Code. Id. at 1146.


The resort to bankruptcy is thus promoted as a viable alternative to the debtor based on economics alone. First, the fresh start policy allows the debtor to be freed completely from the obligation upon conclusion of the bankruptcy proceeding. Where the amount a creditor will receive in a proceeding is less than what the creditor was to receive under the agreement, there will always be an economic disincentive to perform per the agreement or to risk a similar amount per a damage award. The following discussions merely touch upon the issue. There are several factors which will determine whether the creditor is likely to gain less through bankruptcy than through performance or judgment. Two factors that merit some discussion are first, the debtor's unsecured debt-to-asset ratio; and second, the debtor's income.

Simply stated, the debt-to-asset ratio will typically be consistent with the proportional share that the non-secured creditor can expect. For example, if the debtor has available property worth $30,000 and debts of $45,000, each unsecured creditor who files a timely claim will receive payment of \( \frac{2}{3} \) of its debt. If the debtor has more assets than debts, the debtor will not likely claim bankruptcy. However, the fresh start policy does not distinguish between the debtor whose ratio is 3:2 and the debtor whose debt-to-asset ratio is 10:1. In other words, discharge without recourse by the creditor occurs whether 66 percent of the debt is paid or 10 percent of the debt is paid. Yet, if the situation were left to private processes, the creditors and the debtor might bargain differently under these situations.

Secondly, no distinction is made between creditors with new debts and creditors with substantially-paid debts. Under the Bankruptcy Code, the creditor with a long-term contract is treated no differently than a short-term creditor, when economically they are in quite different positions. The fresh start policy artificially ends the term of the agreement prior to both parties' expectations and prior to any term a party would renegotiate on the market. In sum, the policy fails in application to make distinctions between debtors or creditors. It is completely inconsistent with the contractarian paradigm. It is, however, quite consistent with utilitarian principles.

Unlike typical contract damages which attempt to compensate the nonbreaching party, the fresh start policy ignores performance and compensates based on the non-performer's assets. Theoretically, where the creditor

72. For an indepth analysis of the creditor's cost of collection and the efficiency of the collection process see Leff, supra note 63, at 132-42. The process employed by the Bankruptcy Code may benefit creditors by providing a more efficient joint system of collection. See Jackson, supra note 71, at 859-62.

73. 11 U.S.C. § 726 (1988), provides that claims will be paid on a pro rata basis.

74. Thus unsecured creditors are treated the same, not only within individual cases but from bankruptcy case to bankruptcy case.

75. 11 U.S.C. § 542(a) (1988), provides that the debtor must turn over property
has performed and the debtor is faced with either paying according to the agreement or paying somewhat less, the debtor will opt for the latter. Though the focus of bankruptcy is on the ability of the nonperforming party to pay the debt, the Bankruptcy Code arguably loses that focus in the fresh start policy. It ignores the availability of the debtor’s future income to support performance or to substitute for credit once discharge is granted. Declaration of bankruptcy absolutely cuts off access to the debtor’s income.

For illustrative purposes let’s assume Debtor A has a debt-to-asset ratio of 3:2 as does Debtor B. Debtor A has an income of $30,000; Debtor B has an income of $10,000. Both debtors’ income are exempt from trustee recovery, assuming that both A and B have the same number of dependents. After bankruptcy the value of getting credit for B is going to be greater than for A because A has more at risk than does B. Also, if inability to get credit is a cost of bankruptcy, then the cost to A is greater than the cost to B. Yet under the fresh start policy, Debtors B and A are treated the same. A’s added advantage from bankruptcy is not compensated by requiring A to make additional payment to his creditors above the amount which Debtor B must make. Again, this distinction is irrelevant except from a contractarian position where the focus is on the hypothetical bargain between specific individual debtors and creditors. This approach of the fresh start policy can be justified, however, from a collectivistic standpoint. One justification is that by being allowed to regain her position in society, the debtor contributes to the community as a productive member. This benefit far outweighs the benefit to creditors and the community that holding the debtor to the debt would yield.

In addition to the economic benefits to society, certain psychological benefits are attained by the fresh start policy. The psychological and sociological benefits perhaps justify the policy more completely than the economic benefits. Arguably, a modified policy which distinguished between A and B above could also achieve the same psychological and sociological benefits. Yet, because the evidence shows that most debtors are

or the value of property as defined by 11 U.S.C. § 541 (1988). Further, 11 U.S.C. § 726 (1988), provides for distribution of that property for payment of claims as submitted by creditors. The focus is not on what the debtor owes her creditors but on what the estate can afford to pay the debtor's creditors.

76. 11 U.S.C. § 524(a)(3) (1988) prohibits a creditor from commencing an action or continuing an action to hold a bankrupt personally liable or to collect against property that is acquired after the commencement of the bankrupt’s claim. A debtor’s future income is also beyond her creditor’s reach. Id.

77. One author suggests that a discharge plan which allowed for payment over a period of time might take income or ability to pay into account. See Eisenberg, supra note 1, at 977-81.

78. See Jackson, supra note 71, at 1405-24.
similar in their ability repay debts, making distinctions may be meaningless or at best inefficient.

C. Rights vs. Standards in Bankruptcy Policy

Both the fresh start policy and free access policy are stated as absolute rules of the Bankruptcy Code. With limited exception, the law requires that a party seeking discharge under Chapter 7 receive absolute and nonwaivable discharge. Parties to Chapter 7 proceedings are not allowed to waive discharge for some debts but not others or to allocate risks based on their current status and their original expectations. Both the free access and the fresh start policies are structured as rules which do not distinguish between debtors or creditors; both interject the concept of collectivism or altruism into the expectations of the parties; both serve to reduce the cost of non-performance in relation to performance or breach; and both increase the likelihood that the regretting party will elect to pursue bankruptcy. In sum, neither the substance nor the form of the policies as they appear in the Code are consistent with contractarian principles.

The absolute right of free access and to a fresh start evokes the argument of undue interference with the process of commercial renegotiations. We could conceive of a different fresh start policy which incorporated some of the concerns of parties entering into credit agreements or settlements. One might also conceive of an access policy which required proof of merit, good faith, or reasonableness. Under such a policy, the access to and outcome of bankruptcy would be determined by ability to meet certain standards either on a subjective or objective basis. Policy as currently stated reduces the

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80. 11 U.S.C. § 727 (1988) states that a court shall grant a debtor a discharge unless the debtor is not an individual. The inference to be drawn from this language is that individuals presumably have a right to discharge of the debts. Though section 727 further states some limitations on this right, it is presumed that unless those limitations are established in each case involving an individual, discharge will be granted.
81. Bankruptcy’s fresh start policy may be looked at as a risk allocation or a cost minimization device. Neither view, however, fully supports the method of implementing the policy as a nonwaiveable right. See Jackson, supra note 71, at 1398. The trustee has discretion to refuse to discharge certain debts. See 11 U.S.C. § 727(a)(3), (4) (1988).
82. See Eisenberg, supra note 1, at 955-60. See also Jackson, supra note 71, at 860-70.
83. Indeed the current policy allows for proof of bad faith to defend against a claim for discharge.
84. We might ask for example whether a reasonable debtor in the position of this
level of proof at the access and outcome points. The Code could leave the standards of reasonableness to more specific issues such as will be discussed later. The Code's adoption of a "rights" position over that of "reasonableness" position in light of the circumstances can be justified as producing greater certainty and efficiency in the initial and ending stages of the process. The inconsistency in this argument is that efficiency and certainty justifications are typically reserved for legal processes whose goals are market-oriented not those whose goals are individual protection from "oppression." More likely the current "rights" orientation is justified as the prevailing public attitude toward the debtor who is a potential bankruptcy party.

The absolute right mode of implementing the purposes of bankruptcy law is supported by the contractarian paradigm. It is also, however, supported by collective goals of the present society. The combination of the two policies means that any debtor can enter the process and is entitled to complete discharge. While the impact of these two basic policies has led to harsh criticism of the Code, such criticism ignores the utilitarian purposes of the Code. As established in the following discussion, the conflict between the underlying utilitarian principles and the desire to frame bankruptcy in contractarian terms has led to applications of bankruptcy law which are inconsistent with the policies of access and discharge as a matter of right.

IV. PROPERTY OF THE ESTATE

One critical question in bankruptcy is what is considered property of the bankrupt party's estate. The question is critical because the answer determines which assets will be used to pay debts. The analysis used in answering this question illustrates how bankruptcy law moves from a public law rights model to a private law standards model.

Once an individual files a Chapter 7 petition for discharge of her debts, she must surrender all her property to the bankruptcy trustee for liquidation. The Bankruptcy Code allows the debtor to avoid the liquidation of property in a number of ways. First, certain assets may be excluded from the definition of property. 85. See infra notes 189-93 and accompanying text.

85. See infra notes 189-93 and accompanying text.

86. While certainty within the process of bankruptcy may be effectuated by the free access policy in the overall exchange transaction process, the alternative of bankruptcy, if cost free, threatens the integrity of the exchange process.

87. See Eisenberg, supra note 1, at 976-99.

of property of the estate by relevant state or federal law.90 Secondly, assets which may come within the definition of property may be exempted from recovery under federal or state law.91 Finally, the Bankruptcy Code allows the debtor to transfer nonexempted property to exempt property on the eve of bankruptcy.92

Thus, if the party considering bankruptcy owns a home, that home would likely be considered property per the Code's definition. The house may be exempt, however, because of a state homestead exemption statute. Even if not exempt, absent fraud, the Code allows the bankrupt to sell the property and purchase exempt property.92 The following sections discuss the provisions defining property and exemptions in light of their relevance to the regret contingency and the debtor's decision to declare bankruptcy.

The exclusion or inclusion of assets available to the trustee for liquidation has a profound impact on the value of bankruptcy relative to performance of the contract.93 The Bankruptcy Code establishes a scheme to determine what property will be subject to creditors claims and thereby limits available assets for purposes of paying creditors. Because there is no established legal definition of property, assets subject to liquidation could include intangible property, such as human resources.94 The broader the category of included property the less attractive from a purely economic perspective bankruptcy will be as an alternative; conversely, the more narrow the categories, the less costly and more attractive bankruptcy is relative to performance.

Through its definition of property and express exemptions to that definition, the Bankruptcy Code limits the assets available for recovery. The Code also allows states to specifically exempt certain assets not specifically excluded or exempted by the federal provisions.95 Thus, a party seeking to

92. See In re Reed, 700 F.2d 986 (5th Cir. 1983); In re Swift, 72 Bankr. 563 (Bankr. W.D. Okla. 1987); In re Breuer, 68 Bankr. 48 (Bankr. N.D. Iowa 1985); In re Blum, 41 Bankr. 816 (Bankr. S.D. Fla. 1984); In re Levine, 40 Bankr. 76 (Bankr. S.D. Fla. 1984).
93. If a party perceives that her property subject to surrender is larger than her debts she will no doubt opt not to claim bankruptcy. This is because she does not need the state to protect her interest; she is capable of protecting her own interests. However, to the extent that she can protect her assets and start over with them intact after the proceeding, bankruptcy is more attractive.
94. See Jackson, supra note 71, at 1431-34.
95. Under 11 U.S.C. § 522(b)(2)(A) (1988), the debtor may elect to exempt from the estate any property exempt under federal law or state or local law that is applicable at the date of the filing of the petition.
protect assets has at least three chances to avoid their surrender. It is as though the debtor, prior to bankruptcy, sits with one whole pie which represents her total conceivable acquired assets. A substantial portion of the pie is removed because the Code, through its fresh start policy, necessarily excludes post-proceeding or future assets. A second portion of the pie is removed because the Code excludes human capital from the definition of accessible property found at section 541(a)(1). The pie is reduced by any exclusion which may be provided for by federal bankruptcy law. The pie is further reduced by exemptions provided by federal and state nonbankruptcy law and state bankruptcy law. Thus the property which the individual debtor must surrender may be only a slim portion of the debtor’s assets.

The basis for limiting the recoverable assets relates ideas of public concern for the individual rather than upholding private agreements. In essence, the exclusion of certain property from the estate seems to return to the debtor a protected property right in her assets over the creditor’s rights in contracts notwithstanding that the debtor, herself, willingly contracted away the protection.

Excluded or exempted property includes, for example, future earnings, specified pension funds, certain household assets and child support. While

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96. 11 U.S.C. § 541(a)(1) (1988) reads as follows:

Property of the estate.

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

Id.


98. Local Loan Co. v. Hunt, 292 U.S. 234 (1934), an early bankruptcy decision, expressed this idea:

The powers of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern.

Id. at 245.

the exclusion of future earnings obviously is consistent with the fresh start policy, the basis for the exclusion of future assets and human capital deserves further discussion. The inclusions of future assets would undoubtedly increase available property. Inclusion of future assets and human capital in the definition of property, however, would be problematic for a number of reasons.

One problem with attaching future assets is that they are mostly uncertain. Current conventional assets are more easily established. The difficulty of quantifying and valuing future assets and human capital presents another justification for excluding both from the definition of property. Present assets, generally, are more easily identified, and a market or resale value is more easily attached to them. If future assets were included as part of the estate, the question of how far into the future to extend coverage would need to be addressed. This question creates even more uncertainty in the process. The definition of property which closes the estate at the date of filing has the advantages of certainty and finality. We might note that in the exchange process a creditor attempts to ascertain the amount of human capital and future earnings upon which it can rely for payment of the debt. The fact that the debtor is declaring bankruptcy proves how unreliable such a process can be for certain debtors. We could convincingly argue that the bankruptcy should not engage in the same kind of speculation which has already proved fallible for this debtor.

The failure to include human assets as well as future assets is defensible on a number of mostly collectivist bases. A blanket exclusion cannot be defended from a contractarian perspective. The blanket exclusion, however, ignores the fact that the debtor’s as well as the creditor’s decision to contract on credit was based on future income and human capital. Even if the decision were improvident, the parties’ expectations at the time of contracting were that future income would be taxed, and that the future income would result from the use of available human capital. A blanket exclusion by the Code alters the parties’ expectations in an arguably arbitrary manner. For example, at the point of contracting, the factors for evaluating a party’s ability to perform include earnings over the term of the credit agreement. Also, future earnings might be applied in the judgment for breach in the amount of contract price. Such judgment could be obtained through garnishment of the debtor’s wages and future earnings. If the Bankruptcy Code followed the contractarian paradigm, at the point of regret, a comparison of the cost of

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101. See Leff, supra note 63, at 135-39.
continued performance and the cost of renegotiation or judgment in the amount of the price remaining in the contract would determine whether bankruptcy should be allowed. In a Chapter 7, however, discharged future earnings are not an element for consideration. The debtor's protection of future earnings is absolute under the definition of property and the fresh start policy. Again, this is inconsistent with contractarian analysis but is consistent with a public interest model; it allows the debtor to once again become a fully-contributing member of society with income free from the creditor's grasp.

If Chapter 7 claims were treated the same as contract law on damages, and law governing collection processes, a debtor would have all property available for seizure at the time the bankruptcy was initiated; garnishment of future income would stand; assignment of future income could be made, and a lien on property obtained after bankruptcy would be enforced. Yet, with very limited exceptions, bankruptcy allows protection of the debtor from each of these collection devices. The rationale for the current level of protection cannot be supported on the basis of contractarian principles. The utilitarian principles are further supported by protections afforded under federal and state bankruptcy law. These protections extend the amount of excludable property consistent with current local and national ideas of what is in the best interest of the individual's welfare.

A. The Exclusion of Pension Funds from Estate Property

The Code's blanket exclusion of future assets is refined by indirectly excluding from its definition of property certain types of pension funds. Section 541(c)(2) provides "that a restriction on the transfer of a beneficial interest of a debtor in a trust that is enforceable under applicable nonbankruptcy law" is excluded from the definition of property found at 541(a)(1). One area of "applicable nonbankruptcy" law is state law on spendthrift trusts. This conclusion relies partly on H.R. Rep. No. 95-595

102. Any renegotiation will also likely include a tax on future assets. In fact, on the market an individual may prefer a tax on future assets in exchange for retaining present assets which must be surrendered to the trustee.
which instructs that 541(2)(c) maintains restrictions on transfers found in a spendthrift trust account which are enforceable by state law.\textsuperscript{107}

\textsuperscript{107} A typical spendthrift trust statute reads as follows:

\begin{quote}
Alienation of interest of beneficiary—Rights and remedies of creditors—Spendthrift trusts—Trustor’s interest alienable and subject to claims of creditors .

Any instrument creating a trust may provide by specific words that the interest of any beneficiary in the income of the trust shall not be subject to voluntary or involuntary alienation by such beneficiary. Subject to the following provisions of this Section, a direction to this effect shall be valid and enforceable.

A. Notwithstanding a provision in the terms of a trust restraining the alienation of the interest of a beneficiary, such interest shall be entitled to be reached in the satisfaction of claims to the following extent:

1. All income due or to accrue in the future to the beneficiary shall be subject to enforceable claims under the laws of this State for,
   (a) support of a husband, wife, or child of the beneficiary,
   (b) necessary services rendered or necessary supplies furnished to the beneficiary, or
   (c) a judgment based on any such claim under (a) or (b).

2. In all cases not mentioned in preceding sub-section 1 herein all income due or to accrue in the future to the beneficiary in excess of five thousand dollars ($5,000.00) per annum based upon calendar year of the trust, shall be subject to garnishment by creditors of the beneficiary and shall be fully alienable by the beneficiary.

B. Where two or more creditors undertake to reach the interest of any beneficiary of a trust, pursuant to the provisions of this Section, they shall be subject to priority of payment in the order of the service of a notice of garnishment on the trustee. The pendency of any attachment or garnishment shall not prevent the filing of a further attachment or garnishment by the same or any other creditor.

C. Where the beneficiary of any spendthrift trust is also the beneficiary under any other spendthrift trust created or administered either within or without this State, the aggregate income payable under all such trusts to the beneficiary shall be considered together for the purpose of determining the rights of creditors and assignees under this Section.

D. The right of any beneficiary of a trust to receive the principal of the trust or any part of it, presently or in the future, shall not be alienable and shall not be subject to the claims of his creditors.
In re Goff\textsuperscript{108} is often cited as standing for the proposition that "applicable nonbankruptcy" law refers only to state spendthrift law. In Goff the trustee sought inclusion of a debtor's Keogh fund in the estate.\textsuperscript{109} The Fifth Circuit agreed with the trustee's interpretation of section 541(c)(2) pointing to the narrow legislative interpretation of the provision evidenced in the legislative history of the Code.\textsuperscript{110}

In In re Braden\textsuperscript{111} the Bankruptcy Court for the Eastern District of Michigan applied New York Statutes on anti-alienation as the "applicable nonbankruptcy law" to reach the conclusion that funds in a teachers' retirement and annuity plan funds were not property of the bankrupt. In granting summary judgment for the debtor, the court asserted that while some courts had included pension plans funds in a debtor's estate "each case must be evaluated on its own."\textsuperscript{112} Thus the court must look to the varying anti-alienation provisions of each plan and apply the appropriate state anti-

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E. Where the interest of the beneficiary of a trust is subject to the exercise of discretion by the trustee or by another, the provisions of this Act as to the rights of creditors and assignees shall apply with respect to any sums which the trustee or such other person determines shall be paid to or for the beneficiary.

F. A trust in which the interest of the beneficiary is subject to restraints on alienation as provided in this Act may be called a "spendthrift trust" and a direction in any instrument creating a trust that the interest of any beneficiary shall be held on or subject to a spendthrift trust shall be sufficient to restrain the alienation of such interest to the extent provided in this Act.

G. Nothing in this Act shall authorize a person to create a spendthrift trust or other inalienable interest for his own benefit. The interest of the trustor as a beneficiary of any trust shall be freely alienable and subject to the claims of his creditors.

H. The provisions of this Section may be enforced only by an action in a court of competent jurisdiction and the obligor beneficiary shall be a party defendant in such action. The trustee shall not be required to recognize any of the obligations provided for in this Section or to withhold any income from the beneficiary until said trustee has been served with summons or garnishment summons. Such action shall be governed by the rules of civil procedure under the laws of Oklahoma.

\textbf{OKLA. STAT. ANN. tit. 60 § 175.25 (West 1991).}

108. 706 F.2d 574 (5th Cir. 1983).

109. \textit{Id.} at 581.

110. \textit{Id.} Two recent decision by the Ninth Circuit Court of Appeals affirmed the limited interpretation of section 541(c)(2): \textit{In re Kincaid}, 917 F.2d. 1162 (9th Cir. 1990); \textit{In re Kaplan}, 97 Bankr. 572, 576 (9th Cir. 1989).


112. \textit{Id.}
alienation statute to determine the question of whether pension plans are property of the estate. 113

A similar conclusion was reached in In re Kwaak, 114 a Chapter 7 proceeding filed in the Bankruptcy Court of Maine. The trustee in Kwaak sought surrender of the debtor's interest in an employer-financed stock bonus and profit sharing plan. 115 Though the court concluded that the plan's funds were excluded by section 541(b)(2) based on state spendthrift law, the court referred to no specific statute or case law in Maine which described the proscriptions of Maine's spendthrift law. 116 Indeed, the court acknowledged, simply, that Maine law recognized spendthrift trusts as valid. 117 It then applied the definition found in the Restatement (Second) of Trusts section 152(2)(1959) to determine whether the fund at issue was excluded under the Bankruptcy Code provisions applying nonbankruptcy law. 118 In reading the specific clause of the Employee Retirement Security Act (ERISA) 119 qualified plan in question in light of the Restatement provision, the court concluded that the plan’s funds were not property of the estate. Because the debtor could neither "withdraw funds, deposit funds, borrow against his interests, or manage the deposits in any way," the plan was held to create "a spendthrift trust under state law." 1120

Similarly, in McClean v. Central States, Southeast & Southwest Areas Pension Fund (In re McClean), 121 a Chapter 13 proceeding, the Fourth Circuit concluded that the state law of Illinois protected a pension fund from the reach of the trustee in Bankruptcy. 122 Under the court’s reasoning, section 1306(a) of the Code adopts the section 541 definition of property for Chapter 13 plans with one distinction: for Chapter 13 purposes, the estate property includes after-acquired property which otherwise qualifies under section 541. 123 The assets excluded from the definition of property per section 541(b)(2), however, are not subject to the after-acquired property provision. 124 Because, for example, the spendthrift fund is excluded from

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113. Id.
115. Id. at 600.
116. Id. at 602.
117. Id.
118. Id.
120. Kwaak, 42 Bankr. at 602.
122. Id. at 1207.
123. Id. at 1206.
124. Id.
the definition of property of the estate, it and future income from it are precluded from becoming property in a Chapter 13 proceeding. The converse is also true; if the predistribution interest in the trust is not excluded under section 541(c)(2), then any distribution made to the debtor during the Chapter 13 plan is available to the trustee for distribution to the creditors. In applying the relevant language of the debtor's pension fund to Illinois case law on spendthrift trusts, the court of appeals concluded that the anti-assignment provision was "undistinguishable in critical respect" from the provisions held enforceable by Illinois Courts. Again, because the funds were contributed by an employer and were not subject to revocation by the employee, "public policy concerns would not therefore prevent enforcement of the restriction."

The Fourth Circuit's opinion in In re McClean is representative of a line of cases that applies state spendthrift law to determine whether the pension funds become estate property. Generally, the analysis results in excluding from property those trusts created by employers which are inalienable by the employee until the trust vests. The courts which uphold such exclusions examine each fund on a case-by-case basis to determine whether or not the fund is indeed inalienable. These courts do not address the degree of alienability necessary to include the funds. We might assume that the degree of alienability would turn on what degree the state law allowed under its spendthrift laws as the "applicable nonbankruptcy law."

125. Id.
126. Id. at 1207-08.
127. Id. at 1207.
128. Id.
129. For a discussion of how the Code abandons the broad approach of excluding future assets followed by the Bankruptcy Act in favor of a "restrictive interpretation" of exclusions found in 11 U.S.C. § 541(c) (1988), see In re Graham, 726 F.2d 1268, 1271-72 (8th Cir. 1984); In re Crenshaw, 44 Bankr. 30, 33 (N.D. Ala. 1984).
130. See In re Cates, 73 Bankr. 874 (Bankr. D. Or. 1987) in which the court applied the Oregon spendthrift law which determined that a trust created for the benefit of the person creating the trust even though it contained a restraint on alienation or assignment was void as far as creditors were concerned. Id. at 875-77. This court suggests that alienation is not the issue, rather the source of the funding is the key. Id. at 876. The court then severed the provisions to conclude that the funds that were contributed by the employer were excluded from the estate while those contributed by the employee were included in the estate property. Id.; In re Pettitt, 61 Bankr. 341 (Bankr. W.D. Wash. 1986), in which one plan of the debtor was included as property of the trust as it was funded by the debtor and subject to her withdrawals while another plan held by the debtor but funded by the employer was excluded. See also In re West, 64 Bankr. 738 (Bankr. D. Or. 1986), aff'd, 81 Bankr. 22 (Bankr. 9th Cir. 1987).
The significance of this line of cases is twofold: first, its rejection of the blanket exclusion of pension funds as "future assets" as a matter of right; and second, its application of a case-by-case analysis to determine whether a fund may be excluded from the definition of property.

Another line of cases reaches the conclusion that ERISA and other pension plan funds are not property within the section 541 definition by referring to the law governing ERISA-qualified plans as the "applicable nonbankruptcy law." In determining whether the anti-alienation provisions required by the ERISA regulation were enforceable against the trustee, the court in Liscinski v. Mosely (In re Mosely) considered the "very strong principle of state law preemption evidenced by ERISA" and the failure of the ERISA provisions to preserve state regulation of attachment laws of the state. The court pointed to a number of areas of the law to which ERISA concedes authority and noted that no such concession was made to law governing attachment. The court reasoned that "section 541(c)(2) therefore referred to all law that might normally apply outside of bankruptcy proceedings and that ERISA was thus applicable."

In a recent opinion, the Fourth Circuit affirmed the Mosely position. In Anderson v. Raine (In re Moore), the court of appeals rejected an interpretation of section 541(c)(2) which excluded ERISA as "applicable nonbankruptcy law." The court cited the plain meaning of the term itself as support that the anti-alienation provisions of an ERISA-qualified plan were sufficient to make it beyond the reach of and "not subject to turnover to the trustee."

According to the analyses of Braden, McClean, Kwaak and Mosely, the Code moves from the blanket treatment of assets under the language of section 541(a)(1) to application of state spendthrift law. Such laws typically also apply the per se rule prohibiting transfer or alienation to creditors with very

133. Id. at 188.
134. Id. at 188-89.
135. Id. at 191. Congress' intent that ERISA preempt state law may support a conclusion that ERISA is "applicable nonbankruptcy law" per 11 U.S.C. § 541 (1988). If not, and ERISA plans funds are left subject to the exemptions of 11 U.S.C. § 522 (1988), then ERISA plans would also be subject to the opt-out provisions. If a state is providing its own state exemptions providing an exemption for ERISA plans, state law is allowed to supersede the anti-alienation provisions of ERISA despite the preemptive policies behind ERISA.
136. 907 F.2d 1476 (4th Cir. 1990).
137. Id. at 1481.
138. Id. at 1477. See also In re Ralstin, 61 Bankr. 502 (Bankr. D. Kan. 1986).
little analysis of the specific provisions notwithstanding the statement by the court that each pension fund be judged on a case-by-case basis. 139

The "bottom line" treatment excluding or exempting property is of utmost importance to the debtor. In determining whether property should be excluded, considerations must be given to questions other than the direct impact on available property. Specifically, we might consider whether pension funds which questionably are excludable by the definition are excludable as a matter of some other policy of the Code. For example, benefits from pension funds can be considered as future assets or future wage substitutes. Because the Code's policy is to exclude from property future assets and future wages, this exclusion of pension funds is consistent with the fresh start policy as well as the language of the Code defining property of the estate. 140

Under section 70(a)(5) of the Bankruptcy Act future wages of the bankrupt were not "property" even though the wages were within the reach of the bankrupt party at the time of the bankruptcy. 141 As early as the decision in Segal v. Rochelle, 142 courts attempted to reconcile the Act's definition of "property" with the fresh start policy and anti-assignment provisions. 143 Though the Code's definition of property is different from that of section 70 of the Bankruptcy Act 144 the principle conflicts still exist. The question of what assets are excludable under section 541 of the Bankruptcy Code has been exacerbated by the conflicting interpretations given to section 541. 145 An interpretation of section 541 that recognizes pension funds as future assets would reconcile some of the tension between section 541 and the fresh start policy.

If pension funds are characterized as future wage substitutes, a blanket exclusion is warranted by the language of the Code as well as by the fresh start policy. Even under the fresh start policy, whether funds are excludable will turn on the definition of future wage substitutes. Should the definition include those funds that can serve only as future wage substitutes, then the distinction between alienable pension funds and unalienable funds can be

139. See Restatement (Second) of Trusts, § 152 (1959).
140. See supra notes 68-78 and accompanying text.
143. Id. at 379-80.
144. Though the Code does rely solely on the distinction between assets relating to debtor's past as opposed to future in determining what are assets, vestiges of this concept remain with the exemption of pension funds and insurance policies. See In re Cook, 43 Bankr. 996 (N.D. Ill. 1984); In re De Prazza, 29 Bankr. 916 (Bankr. N.D. Ill. 1983).
145. See supra notes 109-143 and accompanying text.
justified. If the definition includes those assets with the potential for being future wage substitutes, the definition could include funds that the debtor can transfer presently. If the latter definition is chosen, there appears to be no distinction between such pension funds and savings plans, and the latter should arguably be excluded.146

The fresh start policy and unwaiveable right to discharge of Chapter 7 would justify a distinction between treatment of a pension fund under Chapter 7 and treatment under a Chapter 13 reorganization plan. The focus of the Chapter 13 plan is the debtor’s ability to pay and to establish a plan for future payment.147 Thus, an inclusion of payments which may accrue to the debtor in the course of the plan would be reasonable. Yet if the same definition is applied to both Chapter 13 and 7 proceedings, future payments might be excluded from a Chapter 13 plan even though the payments might be made during the term of the plan.

While for a Chapter 7 discharge claim the exclusion of inalienable pension funds may be reconcilable with the Code’s language and the fresh start policy, the contractarian paradigm suggests that other considerations are warranted.148 If bankruptcy is viewed by the bankrupt party as an alternative to breach and judgment, we might consider the treatment of pension funds in judgment collection. Garnishment proceedings are governed by state law and are a regular part of judgment collection.149 Many states provide that the anti-alienation provisions in pension agreements are valid to protect the funds against being garnished by creditors.150 Congressional intent to preempt state garnishment proceedings is expressed in ERISA and its legislative history.151 This language serves as the basis for upholding the

146. See In re Gillett, 55 Bankr. 675 (Bankr. S.D. Fla. 1985). However, the distinction between employee established funds and employer established funds can only be justified if the employee established fund is alienable and therefore readily available as present income.


148. See supra notes 26-28 and accompanying text.

149. For example, in Missouri, see MO. REV. STAT. §§ 513.427, .430 (1986).


151. See General Motors Corp. v. Buha, 623 F.2d 455 (6th Cir. 1980). See also United Mine Workers of America v. Boyle, 567 F.2d 112 (D.C. Cir. 1977), cert. denied sub. nom. Antal v. Boyle, 435 U.S. 956 (1978) (where attachment of pension funds of former union officers was refused though officers were found to have breached their fiduciary duty to the union); Hospital v. Greenwald, 82 Ill.App.3d 1024, 403 N.E.2d 700 (Ill. App. Ct. 1980). Cf. St. Paul Fire’s Marine Ins. Co. v. Cox, 752 F.2d 550 (11th Cir. 1985) (employee’s bad faith served as the basis for the garnishment); Electrical Workers, Local No. 1 Credit Union v. IBEW NECA Holiday Trust Fund, 583 S.W.2d 154 (Mo. 1979); National Bank of N. Am. v. International Bhd. of
anti-alienation provisions found in ERISA plans. If bankruptcy were simply
to serve as a less-costly alternative to breach and judgment, funds unavailable
through judgment and collection processes should likewise be unavailable at
bankruptcy. If funds could be taxed under bankruptcy but not under state
collection proceedings, a debtor trying to protect pension funds would have
an incentive to await a judgment rather than file for discharge under Chapter
7 and risk recovery of the funds by her creditors through this process. The
anti-alienation language required of ERISA-qualified plans, like that protected
by state spendthrift provisions, is adequate to prevent the trustee from reaching
the funds of such a plan and supports the utilitarian policies the Code attempts
to promote.152

The blanket exclusion of pension funds is justified by the language and
policy of the Code as well as certain nonbankruptcy law governing garnish-
ment and state spendthrift trust law.153 Yet many courts addressing the
question have concluded that certain pension funds are not excludable.154
Thus, the protection of the property and the promotion of the Code’s policy
is left to the provisions exempting property from inclusion.

B. Pension Funds as Exempt Property

The Bankruptcy Code provides a scheme whereby assets of the debtor
included within the definition of "property" found at section 541 may be
exempt under section 522 from liquidation for the benefit of the creditors.155
Though the "bottom line" treatment of exempt property may be the same as
excluded property, certain distinctions remain which may affect the decisions
of the party in bankruptcy.

First, though some property is totally exempt from creditors, certain
exempt property is subject to the limitation of being "reasonably necessary"
for "the support of the debtor."156 Thus a party may choose to have assets
classified as excludable property rather than exempt property in order to insure
blanket protection.157 Secondly, the Code allows states to opt out of the

152. Comment C of the RESTATEMENT (SECOND) OF TRUSTS § 152 (1959)
provides that "no particular form of words is necessary for the creation of a spendthrift
trust." Comment I also provides that the funds of a spendthrift trust do not pass to a

153. See supra notes 104-108 and accompanying text.
154. See supra notes 125-128 and accompanying text.
157. The addition of the requirement of reasonableness in 11 U.S.C
federal exemption scheme and provide for their own exemptions;\textsuperscript{158} a number of states have elected to do so.\textsuperscript{159} Depending on the coverage allowed by the debtor’s state, a party may choose to have the questioned assets classified for coverage under state exemption provisions.\textsuperscript{160}

While there is no consensus as to whether all pension funds are exempt property under the federal bankruptcy scheme, a majority of the cases have concluded that they are not. Section 522(b) of the Code provides that,

\[\text{n}otwithwithstanding\ \text{section}\ 541\ \text{of}\ \text{this}\ \text{title},\ \text{an}\ \text{individual}\ \text{debtor}\ \text{may}\ \text{exempt}\ \text{from}\ \text{property}\ \text{of}\ \text{the}\ \text{estate}\ \ldots\]

\(1\) property that is specified under subsection \(d\) of this section, unless the State law that is applicable to the debtor under paragraph \(2\)(A) of this subsection specifically does not so authorize; or in the alternative,

\(2\)(A) any property that is exempt under Federal law, other than subsection \(d\) of this section, or State or local law that is applicable on the date of the filing of the petition \ldots\ \textsuperscript{161}


\textsuperscript{159} See Rhodes v. Stewart, 705 F.2d 159 (6th Cir. 1983). For example, the following states have opted out of the federal scheme: Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Missouri, Montana, Nebraska, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming.

\textsuperscript{160} H.R. REP. No. 595, 95th Cong. 1st Sess. 361 (1977), such a conversion is allowed provided that it is done without the intent to hinder delay or defraud creditors.

Subsection (d) of section 522\textsuperscript{162} also establishes specific exemptions and

\textsuperscript{162} 11 U.S.C. § 522(d) (1988) reads as follows:

(d) The following property may be exempted under subsection (b)(1) of this section:

(1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(2) The debtor's interest, not to exceed $1,200 in value, in one motor vehicle.

(3) The debtor's interest, not to exceed $200 in value in any particular item or $4,000 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $500 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(5) The debtor's aggregate interest in any property, not to exceed in value $400 plus up to $3,750 of any unused amount of the exemption provided under paragraph (1) of this subsection.

(6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

(7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.

(8) The debtor's aggregate interest, not to exceed in value $4,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.

(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

(10) The debtor's right to receive—

(A) a social security benefit, unemployment compensation, or a local public assistance benefit;

(B) a veterans' benefit;

(C) a disability, illness, or unemployment benefit;
(D) alimony, support or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;
(E) a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—
(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;
(ii) such payment is on account of age or length of service; and
(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. 401(a), 403(a), 403(b), 408, or 409).

(11) The debtor's right to receive, or property that is traceable to—

(A) an award under a crime victim's reparation law;
(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;
(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;
(D) a payment, not to exceed $7,500, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or
(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

Id.
section 522(b)(2)(A)\textsuperscript{163} exempts property by reference to 'applicable' federal and state nonbankruptcy law.

Four circuit courts of appeal have examined the provisions of sections 522(b) and 522(d) on the question of whether pension funds are exempted property and have concluded that ERISA-qualified plans are neither excluded nor exempt from the bankrupt's estate.\textsuperscript{164} Their reasoning as applied to ERISA plans is as follows. While both House and Senate Reports on the Bankruptcy Code list property which can be exempted under federal law, neither list ERISA pension funds.\textsuperscript{165} Other pension programs are specifical-

\begin{itemize}
  \item \textsuperscript{163} 11 U.S.C. § 522(b) (1988) reads:
  \begin{enumerate}
    \item (b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Bankruptcy Rules, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is—
    \begin{enumerate}
      \item (1) property that is specified under subsection (d) of this section; unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
      \item (2) (A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and
      \item (B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.
    \end{enumerate}
  \end{enumerate}
\end{itemize}

\textit{Id.}

\textsuperscript{164} See In re Daniel, 771 F.2d 352 (9th Cir. 1985); In re Lech Strahl, 750 F.2d 1488 (11th Cir. 1985); In re Graham, 726 F.2d 1268 (8th Cir. 1984); In re Goff, 706 F.2d 574 (5th Cir. 1983); In re Gillett, 55 Bankr. 675 (Bankr. S.D. Fla. 1985).

\textsuperscript{165} See In re Daniel, 771 F.2d 352, 359-61 (9th Cir. 1985).
ly listed as exempt property. Those listed as exempt property are peculiarly federal in origin such as Civil Service retirement benefits, Longshoremen's and Harbor Workers Compensation Act, death and disability benefits, and Railroad Retirement Act annuities and pensions. The list suggests that section 522(d) was to apply to federally-established pension funds but not privately-established funds. In addition, Congress failed to include ERISA plans under section 522(d). The exclusion of ERISA from mention in the language and legislative history of section 522(d) as well as its inclusion in other portions of the history appears purposeful and supports the conclusion that the anti-alienation provisions of ERISA alone are not enough to bring it into the protection of section 522(d).

While there is some support for the conclusion that inalienable pension funds are excludable as future wages, there is little support in light of the legislative history that ERISA funds or other private pension funds should be exempt under section 522(d). A conclusion that the ERISA plans are neither excluded or fully exempted in bankruptcy, however, proves problematic if in fact the anti-assignment and alienation clauses exempt the funds from garnishment. What this means in effect is that the debtor is allowed to lose through bankruptcy what she would not lose in a judgment against her. For those whose private pension funds make up a substantial portion of their assets, from a strictly economic point of view, default and judgment would be preferable to bankruptcy.

If ERISA or other pension funds are neither excluded or blanketly-exempted one safeguard remains. The funds may be exempted conditionally from the bankruptcy trustee's control under section 522(d)(10)(E). The conclusion that ERISA plans are exempt under Section 522(d)(10)(E) is well supported by the language of the Code and the legislative history. Because the exemption of section 522(d)(10)(E) is limited to amounts reasonably necessary for the support of the debtor, however, it may not protect fully the debtor's interests.

In pronouncing the protection of section 522(d)(10)(E), the Code speaks in terms of reason rather than absolute right to exemption or exclusion.

166. Id. at 360 n.18.
167. We could argue, however, that if Congress intended ERISA and other pension funds to be excluded from the section 541(a) then it would not have provided for their exemption under 522(d)(10). Such an argument would rely on the interpretation of the specific language of 541(c)(2) whereas the argument for exclusion relies on the general fresh start policy and exclusion of future assets altogether.
169. See supra notes 105-140 and accompanying text.
The language invites the case-by-case approach\textsuperscript{171} and allows inquiry into the appropriateness of the exemption for the particular individual. The language limits inquiry to the post-regret circumstances of the party. The standard does not lend itself to consideration of the providence of the debtor's original decision to obtain credit or the creditor's decision to extend it, or the original expectations of the parties. Nonetheless, such a standard maintains the commercial law policy of relief of hardship in worthwhile cases.\textsuperscript{172} The Code begins to shift away from its utilitarian position to a contractarian position.

Such considerations are inconsistent with the basic principles of bankruptcy law as espoused by the fresh start policy. It allows examination at the point of the debtor's regret to determine whether the assets might reasonably be used to satisfy the expectations of the creditors. If the question is whether to exempt a pension fund in the estate under section 522(d)(10)(E), another question follows: what of the debtor's future property should she have to give up in order to relieve herself of the current regretted bargain? Even this approach to bargaining away the future interests in order to protect present interests does not exist under the Code's scheme as it might in the market.\textsuperscript{173}

The reasonableness standard does allow some market considerations to be made. For example, in the context of renegotiation of an obligation in the market, two factors are important to the debtor in deciding between mortgaging the future payments and making payments currently: (1) the amount of income available in and from the fund; and (2) her ability to earn income to contribute to future payments.\textsuperscript{174} These factors are the same factors the court applying a contractarian paradigm might consider in determining what would reduce the hardship of the debtor's circumstances. The debtor who has large sums of money collected in a pension fund and nears retirement or the debtor who is unsure of his ability to earn income in the future is not likely even in good faith to agree to surrender pension funds. Conversely, the younger debtor who can expect to work thirty more years and has only


\textsuperscript{172} For a discussion of how the Code abandons the broad approach of excluding future assets followed by the Bankruptcy Act in favor of a "restrictive interpretation" of the exclusions found in 11 U.S.C. § 541(c)(2) (1988), see In re Graham, 726 F.2d 1268, 1271-72 (8th Cir. 1984); In re Crenshaw, 44 Bankr. 30, 33 (N.D. Ala. 1984).


\textsuperscript{174} The ability to earn income depends on at least two variables: the debtor's income earning ability as determined by job skills, experience, and education, and the debtor's expected income earning lifespan.
recently started a pension fund is more likely to bargain the fund away.\textsuperscript{175} In considering whether the funds in a pension plan are reasonably necessary for the support of the debtor, current lifestyle should not be the major consideration.\textsuperscript{176} Of greater concern should be earning potential in light of the debtor's current marketable skills, age, income and any changes in the debtor's circumstances such as job loss and divorce.\textsuperscript{177}

The inclusion of a reasonableness standard, however determined, marks the change in the Bankruptcy Code to an approach which is more consistent with a contractarian view of the Code's goals and is in fact consistent with expectations of parties. Such a standard as applied under section 522(d)(10)(E), however, is not consistent with the utilitarian principles of the Code or public law model for espousing those principles.\textsuperscript{178} In sum, the total exemption of pension funds is consistent with the fresh start policy of the Code. As with the blanket exclusion, questions of whether total exemption is necessary to fulfill the purposes of the Code still remain. Total exemption is at least consistent with the utilitarian view of public perspective of individual welfare. The exemption of funds necessary for the support of the debtor is consistent with the Code's goal of relieving individual hardship. Whether pension funds are excluded from the estate property under section 522(b) or section 522(b)(10)(E) conflicts with the internal policies of the Code and reasonable individual expectations of the exchange process of the underlying purposes of the Code.

Potentially, additional internal conflict is created by the Code's allowing states to opt-out of the federal exemption scheme.\textsuperscript{179} The Code's opt-out provisions have withstood several challenges.\textsuperscript{180} Challenges based on the overbreadth,\textsuperscript{181} as well as the narrowness\textsuperscript{182} of the states' provisions have been denied. Despite Congress's clear intent that ERISA preempt or supersede any state law which "may now or hereafter relate to any employee

\textsuperscript{175} For psychological reasons, this may be true of the younger individual regardless of whether they have a greater or lesser earning capacity. The younger individual who is further removed from retirement will probably have a more optimistic view of the future and the ability to provide for her retirement than the older individual. \textit{See In re Kochell}, 732 F.2d 564 (7th Cir. 1984).


\textsuperscript{177} \textit{Id.}


\textsuperscript{179} \textit{In re McManus}, 681 F.2d 353 (5th Cir. 1982); \textit{In re Sullivan}, 680 F.2d 1131 (7th Cir. 1982); \textit{In re Laurch}, 16 Bankr. 162 (M.D. Fla. 1981).

\textsuperscript{180} \textit{See} Brief for the Trustee, \textit{In re Garrison}, (Bankr. N.D. Okla. 1987) (No. 87-02508).

\textsuperscript{181} \textit{See} Rhodes v. Stewart, 705 F.2d 159 (6th Cir. 1983) (upholding State of Tennessee opt-out statute which provided less protection of debtor's property than the federal scheme).
benefit plan, a state may now adopt under the Code's opt-out provision statutes which would allow the trustee in bankruptcy to liquidate the ERISA fund of an individual debtor. The opt-out provision and the ability of a trustee to freely retain funds under the state law apparently apply even to the federally-funded programs denoted under section 522(b).

Whereas the opt-out provision may allow for more consistency with state collection proceedings, the potential for conflict with federal law including the Code is enhanced. Moreover, no restraints on the states' power to opt out of the federal scheme are apparent in the language of the Code. A court would strain to read into the Code's language any congressional intent to limit in any way state exemption schemes. In fact, a state could nullify the fresh start policy by allowing the bankruptcy trustee to collect a portion of all of the debtor's pension fund.

Allowing the state to provide its own exemptions may in fact contribute to a lack of uniformity in the bankruptcy law among jurisdictions and result in a lack of consistency between the overall policy of the Code and the exemption schemes adopted by states. The state exemption scheme as part of a debtor/creditor collection process, however, may allow for more consistency with state collection proceedings. For example, in a scheme such as the one adopted by the Oklahoma legislature, if a creditor cannot collect under a judgment or lien from the pension fund, he is precluded collecting in bankruptcy.

Therefore, the problem of being able to get more under

183. The relationship of ERISA and other state law has been questioned in several cases. See, e.g., Bucyrus-Erie Comp. v. Department of Indus., 599 F.2d 205 (7th Cir. 1979). Recent challenges to state exemption schemes have resulted in invalidation of certain state exemptions which attempt to protect ERISA pension funds from inclusion in the estate of a debtor. See In re Lee, 119 Bankr. 333 (Bankr. M.D. Fla. 1990); In re Smith, 115 Bankr. 144 (Bankr. C.D. Ill. 1990). Much of this litigation results from the Supreme Court decision in Mackey v. Lanier Collection Agency & Serv., 486 U.S. 385 (1988), in which the court reiterated its interpretation of ERISA. In the Court's opinion, the provisions of ERISA preempt any state law which relates to pension funds even where the state law purpose is not in conflict with ERISA. Cf. In re Lingle, 119 Bankr. 677 (Bankr. S.D. Iowa 1990); In re Dyke, 119 Bankr. 536 (S.D. Tex. 1990).
185. See Eisenberg, supra note 1, at 955-57.
186. The courts who have ruled on the question of the validity of the state opt-out provisions have noted that the conflict is one that the Code permits. See In re Sullivan, 680 F.2d 1131, 1137 (7th Cir. 1982).
187. OKLA. STAT. ANN. tit. 31 § 1A(20) (West 1991) reads as follows: Property exempt from attachment, execution or other forced sale-Bankruptcy proceedings

http://scholarship.law.missouri.edu/mlr/vol56/iss3/2
bankruptcy than under a judgment does not exist, and bankruptcy maintains its policies. Thus, while the opt-out provision may destroy the internal consistency of the Code, it may in effect enhance its consistency with nonbankruptcy collection processes and with an expectation view of contract law.

A. Except as otherwise provided in this title and notwithstanding subsection B of this section, the following property shall be reserved to every person residing in the state, exempt from attachment or execution and every other species of forced sale for the payment of debts, except as herein provided:

20. Subject to the Uniform Fraudulent Transfer Act, Section 112 et sq. of Title 24 of the Oklahoma Statutes, any interest in a retirement plan or arrangement qualified for tax exemption purposes under present or future Acts of Congress; provided, such interest shall be exempt only to the extent that contributions by or on behalf of a participant were not subject to federal income taxation to such participant at the time of such contributions, plus earnings and other additions thereon; provided further, any transfer or rollover contribution between retirement plans or arrangements, which avoids current federal income taxation shall not be deemed a transfer which is fraudulent as to a creditor under the Uniform Fraudulent Transfer Act. "Retirement plan or arrangement qualified for tax exemption purposes" shall include without limitation, trusts, custodial accounts, insurance, annuity contracts and other properties and rights constituting a part thereof. By way of example and not by limitation, retirement plans or arrangements qualified for tax exemption purposes permitted under present Acts of Congress include defined contribution plans and defined benefit plans as defined under the Internal Revenue Code (IRC), individual retirement annuities, simplified employee pension plans, Keogh plans, IRC Section 403(b) annuities, and eligible state deferred compensation plans governed under IRC Section 457. This provision shall be in addition to and not a limitation of any other provision of the Oklahoma Statutes which grants an exemption from attachment or execution and every other species of forced sale for the payment of debts. This provision shall be effective for retirement plans and arrangements in existence on, or created after the effective date of this Act.

Id.

The portion of the statute which references ERISA funds had been invalidated as preempted by the provisions of ERISA. See In re Burns, 108 Bankr. 308 (Bankr. W.D. Okla. 1989).
On the other hand, if the state exemption scheme is consistent with
general utilitarian principles, the opt-out provision may allow greater
protection of individual welfare interests than those allowed by the Code.
Thus, the real concern with the opt-out provision is that a state is not
compelled to follow either the contractarian or the utilitarian view and the
bankruptcy policy gets inconsistently applied.

One final area of concern is the Bankruptcy Code's provision for the
conversion of nonexempt property to exempt property under either section
522(b) or section 522(d).\textsuperscript{188} The Bankruptcy Code imposes a general good
faith standard on the behavior of the individual debtor seeking discharge. It
also provides specifically for such a standard in allowing conversion of
nonexempt property. The good faith standard is apparently subjective with the
burden of proving other than good faith on the trustee.\textsuperscript{189} If the trustee can
establish that a conversion was made with the "intent to hinder, delay or
defraud the proceedings," the trustee can overcome the presumption that an
exemption is valid.\textsuperscript{190} The presumption of good faith, however, continues
even though the transfer is made admittedly in anticipation of bankruptcy.\textsuperscript{191}
The existence of this provision and the standard of proof are inconsistent with
contractarian principles which would protect the creditor's access to this
property.

No clear meaning of the term "to hinder, delay or defraud the proceed-
ings" has been pronounced. The language has been reviewed by several
courts and resulted in inconsistent conclusions in indistinguishable situa-
tions.\textsuperscript{192} Moreover, while a conversion to any allowed federal exemptions
may be limited by the language of section 522(d)(10) as "reasonably necessary
for the debtor's support,"\textsuperscript{193} property exempted under section 522(b) may not
be similarly restricted. Where the debtor transfers assets to section 522(b)
exempt property, the problem of lack of internal uniformity is again present.
The lack of uniformity may result in an inconsistency in bankruptcy law and

whereby a creditor may bring a proceeding to exempt from discharge a loan obtained
through the use of a materially false writing with the intent to deceive the creditors.
\textsuperscript{192} \textit{See, e.g., In re Levine}, 40 Bankr. 76 (Bankr. S.D. Fla. 1984) (conversion
of nonexempt assets to exempt homestead property on the advice of bankruptcy
counsel was allowed as permissible pre-bankruptcy planning). \textit{But see} Mickelson v.
Anderson, 31 Bankr. 635 (Bankr. D. Minn. 1982) (similar conversions were
disallowed).
state collection law proceedings. In striking a balance, greater weight should be given to consistent application of the policies supporting bankruptcy law.

V. THE RELATIONSHIP BETWEEN STRUCTURE, APPROACH AND FUNCTION IN THE CODE

When viewed from a utilitarian paradigm, the substance of the Code closely approximates the policies behind bankruptcy law. In addition, it also succeeds in linking the function of bankruptcy law to its structure. This subjects the Code to two criticisms of its structure and approach. The structural criticisms can be described in two related but distinct ways. The first is that of overclassification. The second problem is that of reliance upon right over reasonableness from an individual’s perspective.

A. Classification and the Code

One source has stated that the purposes of the Bankruptcy Act are: "(1) the effective rehabilitation of the bankrupt and (2) the equitable distribution of his assets among his creditors." Thus, in order to effectuate its purposes the Code must identify the "bankrupt" and "creditors." Classifications are quite helpful for the purposes of bankruptcy law. Because all debtors are not identical and the same is true of creditors, classifications can help identify nonidentical debtors or creditors for different treatment by the Code.

Classification in bankruptcy relieves the trustee of the need to determine on an individual basis who is a creditor and eventually what priority each creditor should be given. The Code assists the trustee by distinguishing between secured creditors and unsecured creditors; payment priorities are set on this basis. Use of the identification process established by the Code

194. Arguably, it is impossible to separate function from structure because structure necessarily follows function. Assuming the truth of that position indicts the Code because it chooses a structure which does not follow naturally from its stated function.


197. See Leff, supra note 63, at 134-35.

198. See Shuchman, supra note 100, at 405.
is much easier than simply applying the purpose of "equitable distribution to the creditors" in each bankruptcy claim."

Though classification may be useful, it is potentially harmful in the following ways. First, the connection between the classification and the desired end may be inaccurate. Little empirical work was done on bankruptcy cases before the adoption of the Code to determine what kinds of classifications for debtors and creditors best met the purpose of bankruptcy law. Thus, the danger of using imprecise classifications or classifications which are antagonistic to the purpose of bankruptcy exists.

Finally, if all members of a class are treated as though they are the same--either as a composite of all debtors or unsecured creditors or as a specific type of debtor or creditor--there is no room for a case-by-case approach in analyzing the bankruptcy claim; the purpose of the bankruptcy law may be lost. Thus, the Code imposes a collectivistic view of individual welfare upon the debtor and fails to take into account individual differences. This position is defensible from a utilitarian standpoint though not from the contractarian point of view.

B. Rights vs. Reason

As the Bankruptcy Code diverges from the principles of contractarianism and allows parties to be excused from their contractual obligations, its goals are less market-oriented and more social welfare-oriented. The main purpose of the Code has become the discharge of the debts of the bankrupt. Utilitarian concerns about individual welfare which serve as bases of the relief can be characterized as equitable nonmarket concepts such as relieving the individual from oppressive debts; rehabilitating the debtor; protecting the debtor's future; and granting the debtor a fresh start. It has been argued that the social and economic welfare goal of the Code is best expressed in a case-

199. See Leff, supra note 63, at 134-35.

200. Similar observations can be made about the Code's property classifications. The lines between what is included within the property of the estate and what is either excluded or exempted are obscure. 11 U.S.C. § 522, 541 (1988). No link between the different classes of property and the purposes of the Code are readily apparent.

201. The Code necessarily is 'a mixture of market-oriented policies and social welfare policies. For example, the Code's classification of creditors into secured and unsecured creditors appears to relate to market policy of recognizing additional protection fixed by the parties. However, the idea of barring collection and allocating the claims of unsecured parties based on pro rata share is supported by a nonmarket policy. See United States v. Kras, 409 U.S. 434, 446 (1973) ("bankruptcy legislation is in the area of economics and social welfare").

202. See McCauley, supra note 195, at 815. The rules or generalizing approach is best suited to promotion of market functioning policy from which the Code diverges.
by-case approach of the court as opposed to a blanket approach. The case by case or particularized approach is best stated in a legal standard that relies on reasonableness rather than an absolute right.\textsuperscript{203} The Code’s policy is a policy of relief for individuals from the hardship of certain debts.

Yet this argument ignores the right of the lawmaker to establish a line for the protection of the public’s interest in forgiving debtors. This approach is expressed in the access granted to the discharge process. It is a term of right rather than of reason and allows that right to all. The Code’s property definition initially is similarly expressed. Interests are included with specific exemptions or exclusions allowed or disallowed. It is only in the final analysis that exemptions are governed by a reasonable standard.\textsuperscript{204} Thus, the initial purpose expressed by the Code is consistent with the approach it takes in determining: who has access to the process; which debts will be discharged; and what property will be included in the estate. Though the form or the approach of the Code reduces the likelihood of individualized relief and is indefensible from a contractarian perspective, it is consistent with a utilitarian approach. A utilitarian approach, where the majority determines the appropriate level of protection for similarly-situated debtors, is appropriate for the kinds of rights protected by the Code, recognizing the great public interest the population has in establishing a policy for broad scale debt relief.

**VI. CONCLUSION**

The failures of the Bankruptcy Code can be described in a number of ways. The Code has been criticized because of its reliance on state law as well as its failure to use state law as a starting point. While some have criticized the liberality of the fresh start policy, others have defended that policy. This Article argues that much of the criticism results from the view of the Code from a contractarian perspective. The appropriate paradigm from which the Code should be viewed is utilitarian. Whether to maintain the free access or fresh start policies is a matter of debate which requires more empirical study than is available to date. Both policies promote the utilitarian function of the Code though they may not be consistent with other state and federal laws that are based on contractarianism. Moreover, not only is there consistency in the function of the law and its substance, but also there is consistency in the function and on certain levels in the Code’s form. As we near the end of the growth in bankruptcy filings, we must reassess the

\textsuperscript{203} See Fletcher, supra note 195, at 953. See also Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685, 1687-95 (1976) for a discussion of the use of standards versus rules in private law.

\textsuperscript{204} The reasonable standard was promulgated in these statutes: 11 U.S.C §§ 541, 522(b)(1), 522(d)(10)(E) (1988).
bankruptcy law and theory to determine whether to continue with the utilitarian approach and whether the specific provisions enacted are consistent with such principles.