

PART III: COMPARATIVE SURVEY

Chapter 5: United Kingdom

5.1 Brief historical overview

5.1.1 Introduction

“C” is different from what we’ve looked at so far. “E” is the vast domain of energies, and “m” is the material stuff of the universe. But “c” is simply the speed of light ... *Cleritas* is the Latin word meaning “swiftness”¹

“*Cleritas*” is not the word that comes to mind when analysing the development and reform process of insolvency law. The chapters above have examined the snail-like progress in this development, and in improving the position of the debtor. In England too, the development in this field, and particularly regarding property in bankrupt estates, was slow. But the insolvency law of the United Kingdom was woven into that of South Africa under colonisation, so it is important to investigate these roots of South African law. Furthermore, the United Kingdom insolvency system underwent a radical reform in the 1980s, and now that system has interesting innovations that can enrich a South African reform process.

The law of bankruptcy in the United Kingdom has its roots in the assumptions and the legislation of Tudor and early Stuart society.² In that period the essential distinction between bankrupts and other debtors was made. The result was that however great most debtors’ liabilities were, they could not go bankrupt.³ In England the early history of insolvency in the sense of a debt enforcement procedure was an individualistic procedure and it was generally limited to cases of insolvent traders.⁴ A creditor obtained judgment and execution against the person or property of his debtor entirely for his own benefit.⁵

¹Bodanis D $E=mc^2$ *A Biography of the world’s most famous equation* (2000) at 37.

²Jones WJ *The foundations of English bankruptcy: Statutes and commissions in the early modern period* at 5 (1979) (hereafter *Jones Foundations*).

³*Jones Foundations* at 5.

⁴This restricted application persisted until 1861 (Bankruptcy Act 1861 (24 and 25 Vict c 134) s 69) when it was legislated that the provisions of the Bankruptcy Act would apply to all debtors, whether traders or not. See Cork K *Insolvency law and practice Report of the Review Committee* (1982) at 14 and further (hereafter the *Cork Report*) and Fletcher *The law of insolvency* (3rd ed) (2002) at 6 and 8 (hereafter *Fletcher Insolvency law*).

⁵Bauer HG *The bankrupt’s estate: A study of individual and collective rights of creditors under Roman and early English bankruptcy laws* (1980) at 33 (hereafter *Bauer Thesis*).

Initially, however, the institution of imprisonment of persons for debt owing to creditors was foreign to English law.⁶ Execution could be taken only against the assets of the debtor during the twelfth and thirteenth century. A writ, known as the *levari facias*, a pre-thirteenth-century remedy, authorised the use of profits emanating from the debtor's land (chattels and rent) to satisfy a judgment creditor's claim. This did not provide a useful remedy of sale and distribution of assets.⁷ In accordance with what was known as a writ of *feri facias*, however, a true collection procedure was developed, since the movable assets of the debtor could be sold in execution.⁸ The Statute of Westminster⁹ provided for the writ of *elegit*¹⁰ which allowed a creditor to take possession of half the debtor's lands as well as all the profits and rents for a term of years, but these could not be sold. This developed into a judgment lien valid for a limited period.¹¹ A development that laid the foundation for English and United States exemption law was the statute's provision that the debtor's oxen and plough animals could not be levied upon.¹² Execution on the person became permissible only in 1283 and 1285 when it was introduced by the Statute of Merchants,¹³ which provided for imprisonment of defaulting debtors, however, this remedy was available only to traders. It was introduced to stimulate foreign trade by protecting foreign merchants, in that it provided them with an efficient means of personal and proprietary execution. In 1352 and 1503 its applicability was extended, allowing creditors to imprison debtors in almost all instances.¹⁴

A writ of *capias ad respondendum*, together with the writ of *capias ad satisfaciendum*, enabled the creditor to bring the debtor into court upon imprisonment and to deprive

⁶Although imprisonment for debt was introduced in the late thirteenth century, an assignment for the benefit of creditors similar to *cessio bonorum* in Roman law apparently was not possible in early English history; see Dalhuisen JH *Dalhuisen on international insolvency and bankruptcy* vol 1 (1986) 1-43 (hereafter Dalhuisen *International insolvency*); Bauer *Thesis* at 33.

⁷Bauer *Thesis* at 33.

⁸Bauer *Thesis* at 33.

⁹Statute of Westminster II of 1285.

¹⁰Abolished in England only in 1956; see Dalhuisen *International insolvency* at 1-39.

¹¹Dalhuisen *International insolvency* at 1-39.

¹²Dalhuisen *International insolvency* at 1-39.

¹³11 Edward I (1283), which became known as the Statute of Acton-Burnell, and 13 Edward I (1285).

¹⁴Holdworth *History of English law VIII* (1936) 231 as cited in Bauer *Thesis*; the *Cork report* at 14 *an further*; Dalhuisen *International insolvency* at 1-41. See also Bauer *Thesis* at 35.

him of his goods in payment of his debts.¹⁵ These writs could be invoked without the creditor becoming liable for the debtor's support. In this respect, the court in *Manby v Scott*,¹⁶ in the mid seventeenth century, stated that:

[i]f a man be taken into execution and lies in prison for debt, neither the plaintiff at whose suit he is arrested, nor the sheriff who took him, is bound to find him meat, drink, or clothes; but he must live on his own, or on the charity of others; and if no man will relieve him, let him die in the name of God.

The writs of *feri facias* and *elegit* were excluded by this remedy and much later were made preventable by an assignment for the benefit of creditors.¹⁷

5.1.2 Execution against property

During early English history land occupied a central position under the feudal system. Execution against the debtor's property was consequently limited to personal property and the profits or rents of real property.¹⁸ The writs of *feri facias*, *levari facias* and *elegit* were specific remedies under the common law for execution against a debtor's property.¹⁹ For merchant creditors, the Statutes of Merchants and the Statute of Staples provided procedures that could be used.²⁰

These individual remedies remained in force for a long time. The sale of the debtor's land became possible only in the nineteenth century.²¹

¹⁵These measures were introduced because the leniency of English law had resulted in abuse, particularly by wrongdoers without property. Thus, because of abuse by debtors, the law shifted towards the protection of creditors. See Bauer *Thesis* at 37-39. In this respect Jacob JH *The reform of civil procedural law and other essays in civil procedure* (1982) (hereafter Jacob) at 296 says that the introduction of imprisonment for debt reflected the longstanding dissatisfaction towards debtors who failed to satisfy their debts. He says that it was "a reflection that had persisted over many centuries that debtors were almost outside the protection of the law, that they were people who battered on society and were basically fraudulent and their practice of defaulting in paying their debts undermined confidence and credit in society and that therefore no sympathy or indulgence should be extended or expended on them".

¹⁶1 Mod 124 132 86 Eng Rep 781, 786 (ex 1659) as cited in Countryman V "Bankruptcy and the individual debtor – a modest proposal to return to the seventeenth century" (1983) *Catholic University Law Revue* 809 at 811.

¹⁷Dalhuisen *International insolvency* at 1-41.

¹⁸Bauer *Thesis* at 39.

¹⁹See para 5.1.2 above, and see also in Pollock F and Maitland FW *The history of English law before the time of Edward I* (vol 2) (1959) (hereafter Pollock *History*) at 596 "But our common law will not seize his land and sell it or deliver it to the creditor; seignorial claims and family claims have prevented men from treating land as an available asset for the payment of debts".

²⁰See paras 5.1.3.2 and 5.1.3.3 below.

²¹Dalhuisen *International insolvency* at 1-40.

5.1.2.1 The writs of *fiery facias*, *levary facias* and *elegit*

English courts developed methods of final process to enforce their judgments by the creation of specialised writs of execution, namely *fiery facias* and *levary facias*. The former writ granted a creditor the right to cause the sheriff to levy and seize his debtor's chattels, while the latter writ granted satisfaction of a debt from the profits of the debtor's land.²² Neither of these writs permitted the creditor to obtain the debtor's land itself. In 1285 it became possible by statute²³ for a creditor to take possession of half of his debtor's lands, as well as his chattels, under the writ of *elegit*. However, this right of possession was in the nature of a chattel interest and possession had to be relinquished upon payment of the debt by the debtor.²⁴

5.1.2.2 The Statutes of Merchants

As described above, these statutes of 1283 and 1285²⁵ provided for execution against the debtor's property, and imprisonment for debt when debts were owing to merchant creditors. The statute of Acton Burnell²⁶ provided for execution against the debtor's personal property, but not against real property. In 1285 the succeeding statute²⁷ improved the position of creditors by providing for a form of execution against the debtor's real property, similar to the writ of *elegit*.²⁸ In 1311 the operation of the Statutes of Merchants was limited by another statute²⁹ to debts between merchants which arose in consequence of their dealings as merchants.³⁰

5.1.2.3 The Statute of Staples

The Staples Court was a specialised court created to promote security of transactions between merchants in certain basic commercial commodities. The Statute of Staples of 1353 provided creditors with remedies against property of debtors regarding debts

²²Pollock *History* at 569.

²³The Statute of Westminster, 13 Edward I, c18 (1285).

²⁴Bauer *Thesis* at 40.

²⁵See 5.1.2 above.

²⁶Statute of Merchants 11 Edward I (1283) see para 5.1.2. above.

²⁷13 Edward I (1285) see 5.1.2 above.

²⁸Bauer *Thesis* at 42.

²⁹5 Edward II, c 33 (1311).

³⁰Bauer *Thesis* at 42.

within the jurisdiction of the Staple Court.³¹ To improve foreign trade and the collection of customs, certain “staple towns” were identified. Dealings in certain commodities could take place only in those towns.³² If unpaid debts arose within their jurisdiction, Staple Courts could imprison the debtor, and seize and sell his goods if found in the relevant town. If the creditors’ claims were not satisfied by such goods, and the debtor could not be traced to be imprisoned, the creditors could seize his land and other assets in a procedure similar to the Statute of Merchants of 1285.³³

5.1.3 *Collective rights*

At this point creditors’ remedies were still of an individualistic nature, and this system was proving to be unfair and expensive. But it was only in the sixteenth century that creditors’ collective rights attained recognition and this was by way of the early bankruptcy statutes, which were also limited to traders.³⁴ In respect of other debtors, bankruptcy became an alternative to creditors only in the nineteenth century. The Statute of 34 & 35 Henry VIII³⁵ appears to be the earliest English bankruptcy legislation,³⁶ encompassing the basic principle of collective property execution.³⁷ It allowed creditors, under certain circumstances, to initiate the collection and sale of the bankrupt’s estate, comprising all his personal and real property.³⁸ The proceeds were distributed *pro rata* to the respective creditors in accordance with their respective claims.³⁹

³¹Bauer *Thesis* at 43.

³²Bauer *Thesis* at 44.

³³Bauer *Thesis* at 44.

³⁴Bauer *Thesis* at 62 - 63.

³⁵34 & 35 Henry VIII, c 4 (1542-3) “An Act Against Suche Persones As Do Make Bankrupte”; Blackstone W *The commentaries on the laws of England* (1876) at 422 (hereafter Blackstone); Stephen S *New commentaries on the laws of England* vol II (10th ed) (1886) at 152 (hereafter Stephen); Jenks E (general editor) *Stephen’s commentaries on the laws of England* vol III (18th ed) (1925) at 152 (hereafter Jenks); *Cork Report* at 16; Jones *Transactions* at 11; Dalhuisen *International insolvency* at 1-41 note 54; Rajak H “Creditors and debtors – the background to the insolvency legislation of 1986” (1990-1991) *The King’s College Law Journal* at 17.

³⁶Dalhuisen *International insolvency* at 1-41 note 54.

³⁷Tabb CJ “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* at 325; Tabb CJ *Bankruptcy anthology* (2002) at 525 and further (hereafter Tabb *Anthology*) for essays on the historical developments.

³⁸This act provided for an involuntary measure affecting only dishonest and absconding debtors, who, upon petition of their creditors, could have their assets seized by the Lord Chancellor, who would distribute the proceeds among them.

³⁹Bauer *Thesis* at 65. See generally Blackstone at 422 and further.

Under early English bankruptcy legislation insolvency of the debtor was not a requirement for creditors to avail themselves of the bankruptcy process. The remedy was available if the debtor's conduct fell within certain proscribed acts.⁴⁰ "Fleeing" and "keeping house" were considered such acts.⁴¹ "Fleeing" to escape one's creditors, was common on the continent,⁴² but this practice arrived late in England. This was because English debtors could avoid their creditors by the practice known as "keeping house". In terms of this practice, a debtor would take refuge in his house with his creditor's goods, enjoying immunity from the law, which was deemed to cease at the debtor's doorstep. Bauer thinks this is perhaps related to the English idea that a man's home is his castle.⁴³ But this may also be one of the very early foundations of the idea of exempt property in bankruptcy, and more specifically the idea that the family home should be protected.

This statute of Henry VIII also provided creditors, collectively, with specific remedies against the person and the property of the debtor.⁴⁴ The debtor could be imprisoned, and his property could be collected and sold, with the proceeds being divided proportionately among the creditors. In addition, in respect of assets that could be taken, the statute allowed the judicial authorities to take the following:⁴⁵

theyre land[s] tenement[s] fees annuities and offices, whiche they have in fee simple fee taylor terme of lief terme of yeres or in the right of theyre wiewes, asmuche as in the interest right and title of the same Offendoures shall extende or be, and maie thenne lawfullye be departed with by the saide Offendour, and allso with theyre money good[s] catalls wares merchaundises and debtes wheresoever they maie be founde or knowne; And to cause theyre saide land[s] tenement[s] fees annuities offices good[s] catallswares merchaundises and debt[s] to be searched viewed rented and appraised, and to make sale of the saide land[s] tenemet[s] fees annuities and offices asmuche as the same Offendour maie [then] lawfullye give graunte or departe with, or otherwyse to ordre the same for true satissfaccon and paiement of the saide creditoure's.

⁴⁰Bauer *Thesis* at 68.

⁴¹34 & 35 Henry VIII, c 4 para 1 (1542-3) and see Bauer *Thesis* at 66.

⁴²Jones *Foundations* at 13-14.

⁴³ Bauer *Thesis* at 68.

⁴⁴Bauer *Thesis* at 70; Rajak at 17. See also Tabb CJ "The top twenty issues in the history of consumer bankruptcy" (2005) *Social Science Research Network Electronic Paper Collection*: [http://papers.ssrn.com/pape.tar?abstract id under the paragraph heading "What future income is shielded?"](http://papers.ssrn.com/pape.tar?abstract id under the paragraph heading 'What future income is shielded?)

⁴⁵34 & 35 Henry VIII, c 4 para 1 (1542-3) as cited in Bauer *Thesis* at 70; Rajak at 17; McCoid, II JC "Discharge: "The most important development in bankruptcy history" (1996) *Am Bankr LJ*; Tabb CJ *Anthology* at 525 and further. See generally Tabb CJ "The top twenty issues in the history of consumer bankruptcy" (2005) <http://papers.ssrn.com/pape.tar?abstract id>.

Thus, for the first time in English legal history the principle of collective rights of creditors to satisfaction from their debtors' property, a principle that was recognised in Roman law more than a thousand years before was legislated into English law.⁴⁶ The statute provided for the collection of all property from the debtor, both personal and real. Real property of any nature could be collected and sold if, at the moment of collection it could be lawfully departed with by the debtor.⁴⁷

5.1.3.1 Property available to creditors

All money, goods, chattels, wares, merchandise and debts, wherever found or known, could be collected and sold for the benefit of the creditors. This included all personal property, tangible and intangible. It also included rights of action. The debtor's estate also included assets in foreign jurisdictions.⁴⁸ The statute of Henry VIII apparently laid down the foundation in English law for the principle that all the debtor's property be included in his bankrupt estate. From that point it appears that the finer details regarding this principle were defined by the relevant judicial authorities concerned.⁴⁹ So, for example, the question arose in *Cruttwell v Lye*⁵⁰ whether goodwill of a bankrupt's business should be included in his estate, thereby allowing it to be sold by his creditors, or whether it remains with the debtor to use in a subsequent business. Here the purchaser of the bankrupt's business tried to prevent the bankrupt from resuming his trade. The court discussed the general principle that anything that could be disposed of becomes part of the bankrupt's estate and passes to the assignee. The court refused the injunction because it would deprive the bankrupt of his "future means of existence". But in the earlier case of *Hesse v Stevenson*⁵¹ the court found that intangibles such as intellectual property rights (a patent right) were capable of forming part of the bankrupt's estate, thereby passing to his assignees upon bankruptcy.⁵² In *Weatherall v Geering*⁵³ the general rule was recognised that all

⁴⁶Bauer *Thesis* at 71.

⁴⁷Bauer *Thesis* at 71.

⁴⁸Bauer *Thesis* at 73; In *Phillips v Hunter* 2 H B 1 401; 126 Eng Rep 618 (1795) (as cited in Bauer *Thesis* at 73) the court found that the estate included debts owing to the bankrupt in foreign jurisdictions.

⁴⁹Bauer *Thesis* at 73-75.

⁵⁰17 Ves Jun 334; 34 Eng Rep 129 (1810) as cited in Bauer *Thesis* at 75.

⁵¹3 Bos & Pul 564; 126 Eng Rep 305 (1803) as cited in Bauer *Thesis* at 74.

⁵²Bauer *Thesis* at 73-4.

⁵³12 Ves Jun 504; 33 Eng Rep 191 (1806) (as cited in Bauer *Thesis* at 77).

contractual rights of the bankrupt become part of his estate, but that the assignees of the bankrupt could not compel specific performance of a pre-bankruptcy agreement if that agreement included a provision against assignment.

Furthermore, interpretation of the statute of Henry VIII soon clarified that the bankrupt's estate consisted only of such personal property to which the bankrupt had both legal as well as equitable ownership. Thus a general rule developed that property of third parties in possession of the bankrupt did not become part of the bankrupt's estate.⁵⁴ In *Toovey v Milne*⁵⁵ Chief Justice Abbot excluded trust money from the bankrupt estate when holding that money advanced to the bankrupt for a special purpose was "clothed with a specific trust".

Property in the hands of third parties, but belonging to the bankrupt, was also included in the bankrupt estate. In this regard the statute provided that parties could be called and examined if it was suspected that the bankrupt's property was being held by third parties. If it was then found that they were wrongfully holding such property to the detriment of the creditors, they were held liable for twice the value of such property, unless they disclosed fully and honestly the extent of the property in their possession.⁵⁶

This first bankruptcy statute in English law was therefore the foundation for further development of the modern law of collective proprietary execution.⁵⁷ Although it was incomplete and left many questions unanswered, it initiated the principles that would begin to define which assets formed part of the bankrupt estate and which would be excluded, either for the benefit of the bankrupt or for the benefit of third parties. After the statute of Henry VIII, several other statutes further developed the English bankruptcy procedure, but they often related mostly to issues such as the actual collection of assets belonging to the bankrupt estate, and the parties

⁵⁴Bauer *Thesis* at 78. *Brassey v Dawson* 2 Strange 978; 93 Eng Rep 980 (1173) held that land tax money in possession of a bankrupt tax collector did not become part of the bankrupt's estate as it was a debt owing to the King.

⁵⁵*Toovey v Milne* 2 B & Ald 682; 106 Eng Rep 514 at (1819) 515 (as cited in Bauer *Thesis* at 83).

⁵⁶Bauer *Thesis* at 86.

⁵⁷Bauer *Thesis* at 90. See generally Blackstone at 422 and further.

concerned, while only some attended to the actual status of the assets that comprised that estate.⁵⁸

The statute of 1 James I c 15 (1603-1604) made provision for the protection of third parties who made payments to bankrupts if the payments were made in good faith and without knowledge of the bankruptcy.⁵⁹ The statute of 21 James I, c 19 (1623-1624) introduced the concept of “reputed ownership”, meaning that property in the possession of the bankrupt upon bankruptcy which appeared to belong to him, but which was not his, became subject to his creditors’ claims. It was directed at situations where a bankrupt conveyed goods to another prior to bankruptcy, but retained their possession and power of disposition.⁶⁰ By the end of the seventeenth century the legal path had taken its final direction towards the protection of the rights of creditors to obtain satisfaction from the bankrupt’s property. All the debtor’s property at the time of bankruptcy, including property in his possession that ostensibly belonged to him, became available for the benefit of creditors. All after-acquired property of a bankrupt also became subject to creditors’ claims.⁶¹

5.1.3.2 Debtor relief in respect of assets

Improving the station of the debtor in the universe of bankruptcy in England was slow. History has shown that “swiftness” was considered of little importance in considering the interests of the debtor and his dependants. Only in 1705 the

⁵⁸See, eg, 13 Elizabeth, c 7 (1571) which is considered the second English bankruptcy statute, but was restricted to merchants. The distinction between traders and non-traders was formerly dependent upon the notion of such traders being engaged in the manufacturing, or the buying and selling of goods. So “non-traders” were any persons in employment, or working in a recognised profession or landowners or farmers. Therefore, as long as the bankruptcy laws did not apply to such persons, if they became insolvent, they were exposed to the rigours of the common law procedures of debt enforcement through the seizure and sale of their property. Apart from the severity of these procedures, a principle feature thereof was their non-collective approach; see Fletcher *Insolvency law* at 8. This statute of Elizabeth introduced acts of bankruptcy and regulated the administration, collection and distribution of the estate, and included a provision against fraudulent conveyances; see Dalhuisen *International insolvency* at 1-42 to 1-43. The statute of 1 James I c 15 (1603), was the third bankruptcy statute. The statute of 21 James I, c 19 (1623-24) provided for all bankrupt laws to be construed liberally in favour of creditors. The statute of 8 & 9 William III, c 18 (1697) was enacted to allow debtors to make arrangements with their creditors; see Bauer *Thesis* at 91 and further. See generally Duffy IPH “English bankrupts, 1571-1861” (1980) *The American Journal of Legal History* at 283 (hereafter Duffy).

⁵⁹Bauer *Thesis* at 132; See generally Duffy at 283.

⁶⁰Bauer *Thesis* at 132; Duffy at 287.

⁶¹Bauer *Thesis* at 152.

bankruptcy statute of Queen Anne initiated a meaningful improvement in the position of debtors.⁶² Bauer considers it “[p]erhaps the most far reaching change ever made by a bankruptcy statute”.⁶³ This statute made provision in favour of bankrupts for exempt property in exchange for surrendering the balance and a complete discharge of liability for his debts. However, only minor changes were made affecting the estate property of the bankrupt.⁶⁴ His estate continued to include all property at the time of bankruptcy. The discharge provisions released the bankrupt from his pre-bankruptcy debts, but the effect of this on after-acquired property was uncertain as the statute was silent on this matter.⁶⁵

The next important development in English law was the Statute of 5 George II, c 30 (1732) which attended to many aspects of bankruptcy law. It represented a departure from the stringent regulation of the bankrupt’s property in favour of his creditors, leaving him with virtually nothing.⁶⁶ Under this statute, as under that of Anne, the bankrupt had to surrender himself and disclose fully what property he had and the circumstances regarding prior transfers. However, this statute also made provision for certain exemptions. *Bona fide* transfers made in the way of “trade or dealings” and ordinary expenses incurred in respect of family, did not have to be disclosed.⁶⁷ This statute also made provision for exemptions of certain property from the bankrupt’s estate. The bankrupt’s necessary wearing apparel, and that of his wife and children did not have to be delivered to the commissioners of the estate. In all cases where debtors became bankrupt after the effective date of the statute, the bankrupt was allowed to keep exempt property consisting of his tools, household goods, furniture and wearing apparel.⁶⁸

This statute also made provision for the protection of after-acquired property if certain conditions were met, namely, that if creditors recovered at least fifteen shillings in the pound, the bankrupt’s after-acquired assets were not subject to

⁶²4 & 5 Anne c 4 (1705). See Duffy at 287.

⁶³Bauer *Thesis* at 153. Duffy at 287.

⁶⁴Bauer *Thesis* at 154.

⁶⁵Bauer *Thesis* at 159.

⁶⁶Bauer *Thesis* at 169; Duffy at 287.

⁶⁷5 George II, c 30, par 1 (1732). Duffy at 287.

⁶⁸Bauer *Thesis* at 170.

creditors' claims.⁶⁹ Under no circumstances, however, could the bankrupt be deprived of the aforementioned tools of his trade, necessary household goods and furniture, and the necessary clothing of his wife and children.⁷⁰

From this point on a considerable number of further bankruptcy statutes were introduced up to the time of the consolidating and amending Acts of 1824 and 1825,⁷¹ but it is not necessary to consider these further statutes for the purpose of this thesis. By the eighteenth century the law in England had not yet developed a general concept of bankruptcy as a manner of procuring relief and a possible discharge for the debtor. Likewise, there was as yet no thought of achieving a balance between social and individual interests in bankruptcy.⁷² Only during the nineteenth century did various bankruptcy statutes prepare the foundations for bankruptcy as it is known today.⁷³

The Bankrupting Act 1883⁷⁴ resulted as a direct response to public disapproval of the administration of bankrupts' estates. It was designed to stamp out abuse in respect of the realisation and distribution of assets, which allegedly had favoured "that class of the community which lived by preying upon bankrupt estates at the expense of debtors and creditors alike".⁷⁵ This new Act provided for an impartial and independent examination into the cause of each bankruptcy and the conduct of each bankrupt.⁷⁶ The basic foundations that had been laid down in respect of the assets in bankrupt estates in earlier legislation apparently received little attention in new or amending legislation.⁷⁷

⁶⁹5 George II, c 30 par 9 (1732).

⁷⁰Examples of cases dealing with the status of such after-acquired property are *Ex Parte Proudfoot* 1 Atk 252; 26 Eng Rep 162 (1743); *Kitchen v Bartsch* 7 East 52; 103 Eng Rep 21 (1805) and *Carleton v Leighton* 3 Mer 664; 36 Eng Rep 255 (1805); see Bauer *Thesis* at 171.

⁷¹"An Act to Consolidate and Amend The Bankrupt Laws" 5 George IV, c 98 (1824) and "An Act to Amend The Laws Relating to Bankrupts" 6 George IV, c 16 (1825). These laws form the foundation of modern English bankruptcy law. They repealed all prior bankruptcy laws and replaced them with a single statute; see Dalhuisen *International insolvency* at 1-43.

⁷²Fletcher *Insolvency law* at 9. See also Roestoff M 'n *Kritiese evaluasie van skuldverligtingsmaatreëls vir individue in die Suid-Afrikaanse insolvensiereg* LLD Thesis University of Pretoria (2002) at 87 in respect of the development of the idea of a composition between debtors and creditors.

⁷³In 1813 a Court for the Relief of Insolvent Debtors was created to alleviate the plight of the non-trader, followed by the further reforms in the Bankruptcy Acts of 1824 and 1825; see Fletcher *Insolvency law* at 9.

⁷⁴46 and 47 Vict C 52; see Stephen at 155.

⁷⁵Cork *Report* at 19.

⁷⁶Cork *Report* at 19.

⁷⁷Cork *Report* at 19.

In the 1883 Act the effect of a bankruptcy order was to vest the property of the debtor in the official receiver of the court pending the appointment of a trustee, at which time the property passed to, and vested in, the trustee.⁷⁸ This property included all the land, tenements and hereditaments of the debtor wherever situated in the United Kingdom or in Her Majesty's dominions.⁷⁹ Also included in the estate was all the debtor's personal estate and effects "present and in expectancy".⁸⁰ Thus it included all the debtor's property at the date of bankruptcy, and that acquired during the bankruptcy, and all the powers the debtor could exercise in respect of that property.⁸¹ Property of third parties reputedly owned by the bankrupt also passed to the trustee in certain cases, to protect creditors from fraud and fallacious appearances.⁸² Personal estate coming to the bankrupt through his wife also vested in the trustee, and if through her he was entitled to a life or other interest in real estates, the trustee could receive the rents derived from them.⁸³ But the trustee was not entitled to property of the wife that was settled on her for her separate use upon her marriage, or by means of the Married Women's Property Acts of 1870, 1874 and 1882, or otherwise.⁸⁴

The 1883 Act also provided for exemptions, but the concept of excluded property as distinct from exempt property does not seem to be made at this point in history.⁸⁵ However, some of the examples that will now be mentioned would probably have amounted to excluded property that never formed part of the bankrupt estate. Thus, income earned through personal labour after insolvency was excluded from the insolvent estate, as was an award made to the bankrupt resulting from a right of action for a personal wrong against the bankrupt.⁸⁶ Trust property held by the bankrupt as trustee was also excluded,⁸⁷ as was a debtor's military pay or other crown payments, the tools of his trade and the necessary

⁷⁸Ss 20 and 21 and see Stephen at 174.

⁷⁹Stephen at 175.

⁸⁰Stephen at 175.

⁸¹Stephen at 175.

⁸²S 44; Stephen at 175

⁸³Stephen at 175 note (o).

⁸⁴Stephen at 175.

⁸⁵See ch 9 below for a discussion on excluded and exempt property and the distinction between the two.

⁸⁶Stephen at 176.

⁸⁷S 44.

clothing belonging to him and his dependants, capped at a certain maximum amount.⁸⁸ The trustee could also exclude certain property that would be onerous to the estate by disclaiming his right to that property, thereby discharging him from any personal liability regarding such property.⁸⁹

The next Act to consider is the Act of 1914; a result of the Muir MacKenzie Committee in 1908. It was largely a tidying-up and consolidating exercise that did not materially alter the 1883 system.⁹⁰ The vesting provisions under this Act were the same as those under the 1883 Act, vesting all the property at the commencement of bankruptcy and that acquired during bankruptcy in the trustee.⁹¹ The doctrine of reputed ownership also applied to the 1914 Act.⁹²

The exempt property provided for in this Act included income earned for personal labour or services,⁹³ and trust property held by the bankrupt in his capacity as trustee. However, the trustee was entitled to claim excess income that was not required for the survival of the debtor and his family.⁹⁴ Tools of the trade and wearing apparel of the debtor and his family were also exempt to a specified maximum amount.⁹⁵ A right of action in tort in the nature of a personal injury was also excluded, as was military and crown pay, but a court could under certain circumstances order portions of such pay to vest in the trustee.⁹⁶

But until the trustee intervened, he did not have complete title to other personal property of the debtor, including leaseholds and real property acquired by the bankrupt during bankruptcy. Thus a *bona fide* purchaser for value of such after-acquired property was protected as against the trustee if the transaction took place

⁸⁸Stephen at 176-177.

⁸⁹S 55; Stephen at 177.

⁹⁰Jenks at 666.

⁹¹Jenks at 682.

⁹²S 38; Jenks at 682.

⁹³If in the nature of a salary or a pension. Income of a miner and prospective earnings of a professional person dependent on his own knowledge or skill was also excluded from vesting in the trustee – see Jenks at 684.

⁹⁴S 38; Jenks at 683.

⁹⁵S 38.

⁹⁶Jenks at 683-684.

before the trustee intervened to claim that property.⁹⁷ Provision was also made in this Act for the exclusion of onerous property from the bankrupt estate by means of a disclaimer by the trustee.⁹⁸

It is therefore clear that by the time the 1914 Act saw the light, considerably well-established policies and legislation in respect of assets included in bankrupt estates, as well as excluded or exempt assets existed. While there does not appear to have been a formal division between excluded property and exempt property, the above discussion shows that policies and legislation that made provision for on the one hand, excluded property that never formed part of the bankrupt estate and, on the other, exempt property that formed part of the estate, but could be exempted to a specified degree under specified circumstances existed. These policies regarding the inclusion, exclusion and exemption of estate property appeared to find their origins in the protection of the rights of third parties, the protection of creditor interests and the dignity of the debtor. At this juncture it appears that the idea of socio-economic and welfare interests of the debtor, or the interest of the state was not yet a well-formulated policy in the United Kingdom. It would appear that the more progressive policies that underpin the present insolvency legislation in that country were formulated over a lengthy period as from the 1914 Act and finally more earnestly identified in more detail by the *Cork Report*.⁹⁹

During the years that followed the 1914 Act there were various amendments to English bankruptcy legislation, but for the purpose of this thesis, the next relevant legislation to consider regarding the position of assets in bankrupt estates in England is the existing Insolvency Act of 1986. It is the result of the *Cork Report*,¹⁰⁰ which vigorously argued for a fundamental reform of insolvency law.

⁹⁷S 47 of the Act of 1914, which gave statutory effect to the rule in *Cohen v Mitchell* (1890) 25 QBD 262; see Jenks at 684.

⁹⁸See further s 54 and Jenks at 685.

⁹⁹See para 5.2 below.

¹⁰⁰Reference in para 5.1.2 above

5.2 Insolvency reform in the United Kingdom as envisaged by the Cork Report

5.2.1 General

The Cork Advisory Committee, chaired by Mr Kenneth Cork (later Sir), was established to consider the terms of the Draft European Economic Council Bankruptcy Convention and to advise the Department of Trade on the effect it would have on the United Kingdom. The result was *The Report of the Cork Advisory Committee* which became an important contribution to the movement for reform of insolvency legislation in the United Kingdom, as it suggested that a comprehensive review of insolvency law in the United Kingdom be undertaken.¹⁰¹ Consequently, a Review Committee on Insolvency Law and Practice was established in 1977, with Mr Cork again in the chair.

The final report¹⁰² of this committee argued vigorously for a fundamental reform of insolvency law in England and Wales. Its main focus was on the creation of a unified Insolvency Act for companies and individuals, and the creation of unified insolvency courts to administer the law.¹⁰³ This was eventually achieved when the Insolvency Act 1986 was enacted. However, the *Cork Report* is a voluminous document, comprehensively dealing with the suggested reform of all aspects of insolvency law in the United Kingdom, including the position relating to assets in insolvent estates. This chapter will consider some of the *Report's* proposals in respect of reforming the position of certain assets in bankrupt estates of individuals.

5.2.2 Assets and exempt property

A question that the *Cork Report* considered was the availability of assets for distribution among creditors.¹⁰⁴ A suggestion received by the Cork Committee was that the exempt property of a bankrupt must be brought in line with modern

¹⁰¹Fletcher *Insolvency law* at 15.

¹⁰²See the reference to the *Cork Report* in para 5.1.2 above.

¹⁰³*Cork Report* at 61.

¹⁰⁴*Cork Report* at 61.

conditions. In particular, there was a call for clarity of the law in respect of the matrimonial home.¹⁰⁵

Another issue in respect of assets in bankruptcy that received attention in the *Cork Report* was the insolvent's surplus income.¹⁰⁶ The consensus here appeared to be that too little emphasis was placed on surplus income as an available asset during the insolvency of the debtor. It was thought that far more emphasis should be placed on the prospect of the debtor's ability to pay his debts out of surplus future income.¹⁰⁷

Trust property in insolvent estates also received specific attention in the *Cork Report*.¹⁰⁸ Trust property held by the bankrupt for others never formed part of the bankrupt estate, simply because such property belonged to the beneficiaries of the trust and not to the bankrupt. Earlier Bankruptcy Acts provided that the commissioners should take "order and direction" of the property to which the bankrupt was possessed or entitled "in his own right".¹⁰⁹ Later Acts made express provision for the exclusion of trust property from the bankrupt estate.¹¹⁰ Thus, the general rule has always been that the trustee in bankruptcy cannot take a better title to property than that possessed by the bankrupt himself. This rule applied to express, implied and constructive trusts.¹¹¹ The Cork Committee was urged both by the public and by the trading community to maintain this principle in respect of trusts, and to pay particular attention to the interests of persons who had made payments in advance to an insolvent trader for goods not yet delivered or services not yet rendered, and to retention money and direct payments to sub-contractors under building contracts. The committee proposed that the law in this respect not be altered and that trust property be excluded from the bankrupt estate.¹¹²

¹⁰⁵*Cork Report* at 64.

¹⁰⁶*Cork Report* at 140.

¹⁰⁷*Cork Report* at 140.

¹⁰⁸At 239.

¹⁰⁹*Cork Report* at 239.

¹¹⁰See, eg, the Bankruptcy Act of 1869, which first made such express provision, and the Bankruptcy Acts of 1883 and 1914.

¹¹¹*Cork Report* at 239.

¹¹²*Cork Report* at 240-246.

The doctrine of reputed ownership was also considered by the Cork Committee. This doctrine implied that property of the bankrupt estate included, under some circumstances, property owned by a third party.¹¹³ The rationale behind the doctrine was to prevent a trader obtaining false credit by the apparent possession of ostensible ownership of property in the shape of trade goods which, in fact, belonged to other people.¹¹⁴ This doctrine in bankruptcy law had been criticised over a long period and its removal from bankruptcy law was recommended.¹¹⁵

Although insolvency proceedings are aimed at distributing the debtor's assets in favour of the creditors, a further aim of insolvency law is to assist the sequestrated debtor to achieve his rehabilitation so as to resume a position as a productive member of society. For this purpose it is necessary to provide for excluded or exempt property that will not vest in the trustee of the insolvent estate. The *Cork Report* therefore also considered the position in English law of exempt property and family assets.¹¹⁶

In this respect section 38 of the Bankruptcy Act of 1914 specifically excluded from the bankrupt estate trust property held by the bankrupt for another person, and the bankrupt's tools of his trade, and the necessary wearing apparel and bedding of himself, his wife and children, inclusively not exceeding the value of 250 pounds. The *Cork Report* thought the provisions stringent and needed restating, particularly in the light of changes in the general standard of living, including the opinion that there was a standard below which no person in the community should be expected to live.¹¹⁷

The *Report* consequently recommended, among other things, that "tools of trade" must relate to the exemption of "tools and equipment", construed widely enough "to include the equipment indispensable for trades, professions and callings of all kinds", including books and in exceptional cases a motor vehicle.¹¹⁸ The exempt assets must not, however, be of excessive quantity or value, and it must be within the trustee's

¹¹³The doctrine was first introduced by the Bankruptcy Act of 1623 during the reign of James I; *Cork Report* at 248.

¹¹⁴*Cork Report* at 248.

¹¹⁵See, eg, *Belcher v Bellamy* (1848) 2 Ex 303 and *Cork Report* at 248-250.

¹¹⁶*Cork Report* at 251.

¹¹⁷*Cork Report* at 251-252.

¹¹⁸*Cork Report* at 252.

discretion whether the items fall within the relevant criteria. But the debtor and any creditor should have a right of appeal to the court against the trustee's decision.¹¹⁹ Another recommendation was that there should be no automatic right for the debtor to retain any tools and equipment, which would eliminate the need for a monetary limit, bearing in mind that the value of such assets differed from trade to trade or among professions. Any figure chosen would be arbitrary and would be excessive in some instances, but inadequate in others.¹²⁰

In respect of clothing, furnishing and other personal items, the *Report* found that there was a change in living standards and in patterns of life. Thus, the need for personal mobility in modern life, for example, may require the exemption from a debtor's estate of some form of transport, depending on the circumstances. Further, for mostly practical reasons it was not considered prudent to require a prescribed list of categories of property, or a fixed value in this respect. It was recommended that the debtor retain the items agreed to by the trustee, with recourse to the court by an aggrieved debtor or creditor.¹²¹

An important issue considered by the *Cork Report* is the position of the family home as an asset, often the most valuable, in the bankrupt's estate. A shortage in domestic accommodation and the high expense of housing was a factor that was considered in formulating a policy in respect of exempting the family home from an insolvent estate.¹²² The crux of the *Report's* suggestion, stated briefly, was that a new Insolvency Act should give the court specific power to postpone a trustee's rights of possession and sale of the family home. Here the court would take into account the welfare of any children of the family and of any ailing or elderly adults in the family. In its recommendations the *Report* defined the "family home" as a dwelling in which there is or are living:

- the debtor and his wife;
- the debtor or his wife with (in either case) a dependent child or children;

¹¹⁹Cork *Report* at 251-252.

¹²⁰Cork *Report* at 252.

¹²¹Cork *Report* at 254-255.

¹²²Cork *Report* at 255.

- the debtor's wife;
- the debtor, and a dependent parent of the debtor or of his wife who has been living there as part of the family on the basis of a long-term arrangement.

The *Report* recommended that on an order for liquidation of assets or bankruptcy, the debtor's interest in the family home will vest in the trustee, but any dispute in respect of such interest must be resolved by the insolvency court.¹²³

The next issue concerning assets in the bankrupt estate that was considered by the *Cork Report* was that of claims between spouses.¹²⁴ Under the 1914 Bankruptcy Act¹²⁵ any assets of a woman married to a husband whose estate had been sequestrated, lent or entrusted to him for his trade or business was treated as assets of his estate. His wife could not claim any dividend as a creditor regarding such assets until the claims of her husband's other creditors had been satisfied.¹²⁶ The converse also applied where it was the husband lending or entrusting assets to his wife for the purpose of her trade or business, and she became bankrupt. The husband's claim as a creditor to a dividend in this instance was postponed to the claims of all other creditors of his wife.¹²⁷ The subtle difference between the two situations was, however, that the money or other estate lent or entrusted by a husband to a wife was not expressed to be treated as assets of her estate in her bankruptcy. This therefore preserved the position that existed prior to 1882, which treated the respective assets of the husband and wife differently. The *Report* conceded that the distinction between sexes was inappropriate. It agreed with the Law Commission that "[m]arriage is a form of partnership and, on normal partnership principles, neither partner should compete with the partners' creditors".¹²⁸ The *Report* therefore stated that either the

¹²³Cork *Report* at 256-257.

¹²⁴Cork *Report* at 259.

¹²⁵Section 36(2).

¹²⁶Under earlier legislation, before what can be called an improvement of the rights of women under the Married Women's Property Act of 1882, all the wife's assets were available to her husband's creditors, unless they were held in trust for her separate use. However, the husband's assets were not available to the wife's creditors unless she had pledged his credit – see the *Cork Report* at 259.

¹²⁷S 36(1) of the 1914 Bankruptcy Act.

¹²⁸Law Commission Report No 25 – Financial Provision in Matrimonial Proceedings, as cited in the *Cork Report* at 260.

provision¹²⁹ that property of the wife lent or entrusted to her husband for business purposes be treated as an asset in his bankrupt estate must be excluded from future legislation or, alternatively, a corresponding provision should be applied when the husband lent or entrusted money to his wife for business purposes.¹³⁰ It suggested that any statutory provisions must apply not only to husband and wife, but also to persons of the opposite sex living together as husband and wife.¹³¹

5.2.3 After-acquired property

Under the 1914 Bankruptcy Act property in the bankrupt estate included the debtor's property at the commencement of the bankruptcy as well as property acquired by, or devolving upon, the debtor between bankruptcy and discharge of the debtor.¹³² However, third parties were protected in that the title of the trustee to such after-acquired property was subject to the power of the bankrupt to enter into a transaction for value with a *bona fide* third party.¹³³ The report did not recommend any changes in this respect.

In respect of the vesting of after-acquired property it was always thought that kind of property did not vest absolutely in the trustee until he intervened to claim it prior to any transfer by the bankrupt.¹³⁴ But *In re Pascoe*¹³⁵ this was considered contrary to the clear language in section 38 of the 1914 Act. The principle¹³⁶ in *Cohen v Mitchell*,¹³⁷ the court found, applied only to transactions. It had nothing to do with the title to property as between the bankrupt and the trustee, "[b]ut merely with the title to property as between the trustee on the one hand and, on the other, the third party with whom the transaction by the bankrupt was carried out".¹³⁸ After-acquired property, the court held, vested in the trustee subject only, for as long as it remained in the possession of the bankrupt, to his power under section 47 to claim

¹²⁹As in s 36(2) of the 1914 Bankruptcy Act.

¹³⁰The Commission at 260 preferred this second alternative.

¹³¹Cork Report at 261.

¹³²S 38 of the 1914 Bankruptcy Act.

¹³³See *Cohen v Mitchell* (1890) 25 QBD 262 and s 47(1) of the 1914 Bankruptcy Act.

¹³⁴Based on *Cohen v Mitchell* (1890) 25 QBD 262 and subsequent decisions.

¹³⁵[1944] Ch 219.

¹³⁶Which was contained in s 47 of the 1914 Bankruptcy Act.

¹³⁷(1890) 25 QBD 262.

¹³⁸Cork Report at 263.

title to such property.¹³⁹ The result of the *Pascoe* case was that the trustee no longer had an option to claim or leave after-acquired property, and that onerous property, for example, an unprofitable lease, would vest in the trustee without intervention on his part and even against his wishes. This position was thought to be undesirable and the *Report* agreed that the position regarding after-acquired property be restored to what it was thought to be prior to *In re Pascoe*.¹⁴⁰ This would mean that if the trustee intervened to claim any after-acquired property, it would then vest in him, subject to any burdens affecting it, but until he did so, he would not be bound by any liability regarding any such burdens.¹⁴¹

In respect of personal earnings as an after-acquired asset, it has always been accepted that a portion of earnings necessary for the maintenance of the bankrupt and his family does not pass to his trustee. While the *Report* accepted this, it suggested that more emphasis should be placed on the payment of debts out of the debtor's surplus net income. The debtor's ability to make such payments, the *Report* states, should be examined and considered at an early stage of the administration of his affairs.¹⁴² The majority of the Cork Committee thought that creditors would resent a position where an insolvent may have acquired substantial assets before his discharge to which the creditors could make no claim. It was therefore recommended that there should be no general provision allowing the trustee to claim after-acquired property of a debtor subject to an order for liquidation of assets, as opposed to a debtor who had been declared bankrupt. In respect of a debtor subject to an order for liquidation of assets, it was proposed that only property in the nature of "windfalls" should be available for the benefit of the creditors. "Windfalls" were described as gifts, inheritance, gambling or prize money won in any form of lottery or competition before the date of the debtor's discharge.¹⁴³

¹³⁹Cork *Report* at 263.

¹⁴⁰Cork *Report* at 263.

¹⁴¹Cork *Report* at 263.

¹⁴²Cork *Report* at 264. Detail regarding the ability of the court to make orders concerning such payments from the debtor's personal income were provided for in s 51 of the 1914 Bankruptcy Act.

¹⁴³Cork *Report* at 267.

Many of the proposals of the *Cork Report* in respect of assets in the bankruptcy estate were included in the Insolvency Act of 1986.¹⁴⁴

5.3 The Insolvency Act of 1986¹⁴⁵

5.3.1 *The bankruptcy order in the United Kingdom and its consequences*

5.3.1.1 Some general and procedural aspects

In English law a bankruptcy order made by a court against a debtor results in the commencement of a unitary procedure, applying the same material provisions regarding a bankruptcy petition, whether it be presented by the debtor himself or by a creditor.¹⁴⁶ The bankruptcy order is drawn up by the Registrar of the court in the requisite form.¹⁴⁷ The date of the presentation of the petition, and the date and time of the making of the order must be stated in the order. It must also contain a notice calling the bankrupt to see the official receiver at a specific place after the notice has been served on the bankrupt,¹⁴⁸ and actions or proceedings against the bankrupt may be stayed in the order. The Registrar sends at least two sealed copies of the order to the official receiver and he must send one of them to the bankrupt.¹⁴⁹ The Chief Land Registrar is notified of the order by the official receiver, and then registers the order in the register of writs and orders affecting land. This serves as notification to the public as from the date of registration, after which all persons are deemed to have actual notice of the order regarding any land affected by it.¹⁵⁰ The order must also be published in the *London Gazette* and newspapers that the official receiver may decide upon.¹⁵¹

¹⁴⁴See Sealy LS and Millman D *Annotated guide to the insolvency legislation* (10th ed) (2007) at 1.

¹⁴⁵Hereafter the Act or the Insolvency Act.

¹⁴⁶Insolvency Rules 1986, rules 6.33 to 6.35 and rules 6.45 to 6.47 respectively for the creditor's petition and the debtor's petition which are worded in similar terms. See generally Gregory R and Sealy LS (gen ed) *Bankruptcy of individuals and partnerships* (1988) at 70 and further (hereafter *Gregory Bankruptcy*); Berry *Personal insolvency* at 156 and further; Sealy LS and Millman D *Annotated guide to the insolvency legislation* (4th ed) (1994) at 852 and further (hereafter *Sealy Legislation* (4th ed)); Fletcher *Insolvency law* at 149 and further; Keay AR and Walton P *Insolvency law: Corporate and personal* (2003) at 317 (hereafter *Keay Insolvency*); Frieze SA *Personal insolvency law – in practice* (2004) at 53 (hereafter *Frieze*); Doyle L and Keay A *Insolvency legislation: Annotations and commentary* (2005) at 1040 and further (hereafter *Doyle Legislation*); and generally Sealy LS and Millman D *Annotated guide to the insolvency legislation* (10th ed) (2007) (hereafter *Sealy Legislation* (10th ed)).

¹⁴⁷Rules 6.33(1) and 6.45(1) and see ss 264, 271 and 272 of the Act.

¹⁴⁸Rules 6.33(2) and 6.45(2); Fletcher *Insolvency law* at 149; generally see *Sealy Legislation* (10th ed).

¹⁴⁹Rules 6.34(1) and 6.46(1); *Doyle Legislation* at 1040-046; *Frieze* at 26 and further and 50; *Keay Insolvency* at 317.

¹⁵⁰Rules 6.34(2)(a) and 6.46(2)(a).

¹⁵¹Rules 6.34(2)(b) and (c) and 6.46(2)(b) and (c) and see rules 12.20 and 13.13(4).

5.3.1.2 Effects of the order

A bankruptcy order is of immediate effect on the day it is made. As a judicial act it is deemed to be effective from the moment at which that day commences.¹⁵² It takes precedence over all other non-judicial acts such as the debtor's private transactions completed on the same day.¹⁵³ The debtor loses the power to deal with his property when the bankruptcy order is made against him. This is because the official receiver takes on the position of receiver and manager of the bankrupt estate until it vests in a trustee.¹⁵⁴ However, automatic transfer of the title to the debtor's estate occurs only when the trustee has been appointed. In respect of the bankrupt's property, this is the most important effect of the bankruptcy order.¹⁵⁵

During the period before the appointment of the trustee, while the bankrupt remains the title holder to his property, he is in the position of an occupier of his business and private premises. He therefore remains personally liable for the costs of services to the premises.¹⁵⁶ So too, he remains the person with *locus standi* to launch legal proceedings to recover what is still his, but he may be required to provide security for costs prior to any action being instituted.¹⁵⁷ If he succeeds in such action, whatever is recovered must be given to the official receiver for the benefit of the creditors.¹⁵⁸ However, in most cases the bankruptcy order suspends any litigation against the debtor so as to maintain the principle of equality of creditors in bankruptcy, which is one of the principle consequences of a bankruptcy order.¹⁵⁹

¹⁵²Keay *Insolvency* at 317.

¹⁵³See Fletcher *Insolvency law* at 151.

¹⁵⁴Insolvency Act s 287; Sealy *Legislation* (10th ed) at 334.

¹⁵⁵Bar in special cases regulated by s 297 where vesting is immediate upon the making of the bankruptcy order; Fletcher *Insolvency law* at 151; Keay *Insolvency* at 317; Sealy *Legislation* (10th ed) at 341.

¹⁵⁶See, eg, *Re Smith* [1893] 1 QB 323 as cited in Fletcher *Insolvency law* at 152 note 24. The official receiver however has a duty to protect the estate prior to the trustees appointment. When the official receiver is appointed the bankrupt is prevented from dealing with any asset in the estate. See Keay *Insolvency* at 318.

¹⁵⁷*Semler v Murphy* [1967] 2 All ER 185.

¹⁵⁸*Rhodes v Dawson* (1886)16 QBD 548 at 554.

¹⁵⁹Insolvency Act s 285(3)(a) and see Crystal M, Phillips M and Davis G (editors) *Butterworths insolvency law handbook* (2006) at 165 (hereafter Crystal), and Fletcher *Insolvency law* at 152 and note 27 and the cases cited therein; Sealy *Legislation* (10th ed) at 331 and further.

The United Kingdom Insolvency Act of 1986 and the Rules make specific provision for the consequences of insolvency for estranged spouses.¹⁶⁰ Initially, if one of them was sequestrated, an obligation resulting from family or domestic proceedings was not provable against the bankrupt estate of the person in respect of whom the order was made.¹⁶¹ Furthermore, if a debtor was discharged from bankruptcy, he was not released from any bankruptcy debt that emanated from an order made in family or domestic proceedings, unless the bankruptcy court had ruled differently.¹⁶² So, if the court awarded a wife periodical payments, the husband's bankruptcy did not interrupt his liability for these payments. But if he fell behind with these payments, the wife could not prove a claim in respect of the arrears. All she could do was to obtain an order to have him committed for contempt.¹⁶³ Fletcher states that if a wife had been granted a maintenance order that her husband pay her a capital sum that had not yet been paid before the bankruptcy order, she would probably have to wait until he has been discharged from bankruptcy before the order could be enforced, because the husband's personal ownership and control over his assets is removed by the onset of bankruptcy.¹⁶⁴ But rule 12.3(2) was amended¹⁶⁵ to make these obligations (lump sums and costs awarded) resulting from family or domestic proceedings provable in respect of bankruptcy orders made on or after 1 April 2005. The debtor will thus be released from them on discharge. But obligations such as maintenance orders are not provable¹⁶⁶ and the debtor will not be released from them on discharge.

¹⁶⁰"Spouse" includes a civil partner or a former civil partner – Civil Partnership Act 2004; see the definition of "associate" in s 435 of the Insolvency Act 1986 which was substituted by the Civil Partnership Act 2004 section 261(1) – see Doyle *Legislation* at 533; "Associate" carries a very wide meaning and includes an individual's husband or wife or civil partner (s 435 (2)(a)) Crystal at 256.
¹⁶¹Rule 12.3(2)(a). S 281(8) of the Insolvency Act describes "family or domestic proceedings". Cf *Russel v Russel* [1998] BPIR 259. *Caldwell v Jackson* [2001] BPIR 966 at 974 held that the policy behind rule 12.3 requires the limitation in rule 12.3(2) stating what is not provable, to be read narrowly. See also *Levy v Legal Services Commission* [2000] BPIR 1065 and *Wehmeyer v Wehmeyer* [2001] BPIR 548.

¹⁶²S 281(5); Fletcher *Insolvency law* at 154. Prior to its amendment, rule 12.3(2)(a) stated as follows:

(2) The following are not provable –

(a) in bankruptcy ... any obligation arising under an order made in family ... proceedings [or under a maintenance assessment made under the Child Support Act 1991].

¹⁶³Fletcher *Insolvency law* at 154.

¹⁶⁴Fletcher *Insolvency law* at 154.

¹⁶⁵Insolvency (Amendment) Rules 2005.

¹⁶⁶Doyle *Legislation* at 1184.

5.3.1.3 Effect of the bankruptcy order on assets of the debtor

5.3.1.3.1 Introduction

This section considers the effect of a bankruptcy order on the bankrupt's assets that are situated within the jurisdiction of the English courts, thus relating to a bankruptcy order made by a court in England and Wales. It will therefore not include the position of assets outside this jurisdiction and which therefore may be subject to the provisions of the European Community Regulation on Insolvency Proceedings.¹⁶⁷ The principal consequence of a bankruptcy order in English law is probably that it divests the bankrupt of his property and automatically vests it in the debtor's trustee in bankruptcy when that trustee is appointed. Thereafter, as Fletcher¹⁶⁸ puts it:

In view of the complexities which can exist in relation to the holding and use of property, intricate and particularised provisions are necessary to ensure that this simple-sounding objective may be realised in practice.

English law also makes provision for the exclusion of certain assets of the debtor from his bankrupt estate, while under certain circumstances the trustee's right or title to certain assets may be either limited or extended. This section will also consider which assets of a debtor actually form part of his bankrupt estate and consequently vest in the trustee, and which assets are excluded from vesting in the trustee, or in respect of which the trustee's rights are curtailed or extended.

5.3.1.3.2 Property vesting in the trustee

Section 306(1) of the Act contains the basic principles in respect of the proprietary effects of a bankruptcy adjudication. This provision states that:

The bankrupts estate shall vest in the trustee immediately on his appointment taking effect or, in the case of the official receiver, on his becoming trustee.

Furthermore, the Act makes specific provision for the automatic vesting of property, by operation of law, as provided for by section 306(2), as follows:

¹⁶⁷Council Regulation (EC) No 1346/2000 of 29 May 2000 that came into force on 29 May 2002. See generally Crystal at 407 and further and Omar PJ *European Insolvency law* (2004).

¹⁶⁸*Insolvency law* at 195.

Where any property which is, or is to be, comprised in the bankrupt's estate vests in the trustee ... it shall so vest without any conveyance, assignment or transfer.

For a further understanding of this vesting, it is necessary to enquire what it is that vests, namely "property", and what is meant by "the bankrupt's estate". "Property" is broadly defined in the Act,¹⁶⁹ which states that it

includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.

This is a broad definition of "property". In *Bristol Airport PLC v Powdrill; Re Paramount Airways Ltd*¹⁷⁰ the court said of this definition that "[i]t is hard to think of a wider definition of property". Fletcher states that the use of the word "includes" in this comprehensive definition makes it a non-exclusive formulation, and the courts may therefore, should the need arise, have to determine whether some novel or unusual form of proprietary interest will be considered "property" for purposes of the Act.¹⁷¹ Conversely, he says, certain species of rights that are classified as merely personal rights do not constitute "property" forming part of the bankrupt estate.¹⁷²

The property of the bankrupt is succeeded to in title by the trustee subject to the condition that the trustee essentially steps into the shoes of the bankrupt debtor. This means that the trustee acquires the same title that the debtor actually had at the date of his adjudication. This includes any limitations or flaws in such title. The trustee cannot receive greater rights to the property than the bankrupt himself had.

¹⁶⁹S 436 of the Act.

¹⁷⁰[1990] Ch 744 at 759.

¹⁷¹Fletcher *Insolvency law* at 196. Doyle *Legislation* at 535. See ch 11 below in respect of novel forms of property, eg, a citizen's right to state grants, social security or benefits, which have been described as "state largesse".

¹⁷²Fletcher *Insolvency law* at 196; *City of London Corporation v Brown*, *The Times*, 11 October, 1989, (1990) 60 P & CR 42 (CA) held that non-assignable, secure periodic tenancy arising by virtue of s 86 of the Housing Act 1985 confers only personal rights that could not be regarded as "property" for the purpose of section 306; cf *Re Rae* [1995] BCC 102; *Griffiths v Civil Aviation Authority* [1997] BPIR 50 where personal and non-transferable rights to hold a licence did not vest in the trustee, and *Official Receiver v Environment Agency* [1999] BPIR 986 where a waste management licence was considered to be property for the purpose of s 436 by the Court of Appeal. See also *Performing Right Society Ltd v Rowland* [1997] 3 All ER 336, and the general discussion of the concept of "property" in *In re Oasis Merchandising Services Ltd: Ward v Aitken* [1997] 1 All ER 1009 (CA) which dealt with the nature of the right to take proceedings under section 214 of the Act, relating to wrongful trading in cases of company insolvency. See also Keay *Insolvency* at 317-318; Frieze at 89; Sealy *Legislation* (10th ed) at 479-480.

This is referred to as the trustee taking title “subject to equities”.¹⁷³ “Equity”, however, must have arisen prior to the commencement of bankruptcy if it is to prevail against the trustee.¹⁷⁴ This protection of persons who dealt with the bankrupt after the point at which the law considers him technically incompetent to transfer his title to his property is known as the rule in *Ex Parte James*.¹⁷⁵

5.3.1.3.3 The Human Rights Act 1998

The impact of the European Convention on Human Rights, enacted into English law by the Human Rights Act of 1998, reinforced the exclusionary principle in English bankruptcy law.¹⁷⁶ So, article 8 of the Convention which establishes rights requiring respect for a person’s private and family life, home and correspondence, has been held to create a distinction between the bankrupt’s general books, papers and records, and those that consist of correspondence of a private or personal nature.¹⁷⁷ Correspondence of a personal and private nature, although possibly valuable, are excluded from the insolvent estate. The trustee in bankruptcy may take possession of such personal items when they include material or information about the available estate and needed for its proper administration thereof, but he cannot retain them permanently or utilise them in favour of the creditors of the debtor.¹⁷⁸

5.3.1.4 Property included in the bankrupt estate

Section 283 of the Act and several related sections determine the composition of the bankrupt’s estate. Section 283(1) provides that the bankrupt’s estate for statutory purposes includes

¹⁷³Fletcher *Insolvency law* at 214.

¹⁷⁴The trustee’s title to the property is fixed by law at the commencement of bankruptcy.

¹⁷⁵*Re Condon, ex parte James* (1874) 9 Ch App 609. The foundation of this rule is the premise that as an officer of the court the trustee ought to act ethically by avoiding using his legal entitlement to retain property, which in a moral sense, belongs to another person. See also Frieze at 181 and Doyle *Legislation* at 397.

¹⁷⁶Fletcher *Insolvency law* at 197.

¹⁷⁷Fletcher *Insolvency law* 197.

¹⁷⁸*Haig v Aitken* [2000] 3 All ER 80 and 88-89; *Trustee of the Estate of Omar v Omar* [2000] BCC 434. The First and Sixth Protocols of the European Convention are now enacted (in English law) by sch 1 to the Human Rights Act of 1998. Art 1 regulates the right to protection of property and the peaceful enjoyment of possessions.

- (a) all property belonging to, or vested in, the bankrupt at the commencement of the bankruptcy: and
- (b) any property which by virtue of the provisions elsewhere in the Insolvency Act is comprised in that estate or is treated as falling within paragraph (a).¹⁷⁹

5.3.1.4.1 Property belonging to the debtor at the commencement of bankruptcy

It has been stated above that the debtor's estate vests in the trustee only when he is appointed.¹⁸⁰ However, the commencement of bankruptcy is the moment at which the content of the bankrupt's estate, which later so vests, is determined.¹⁸¹ Until such time as vesting in the trustee occurs, the estate is protected by virtue of section 284 which restricts the debtor's power to deal with the property, while provision is also made for the setting aside of transactions entered into prior to the bankruptcy petition being presented.¹⁸²

(a) Equitable interests

Mere equitable interests in property, such as the right to claim a payment or to seek specific performance to a contract, form part of the insolvent estate.¹⁸³ The trustee will, however, first want to determine whether it will be beneficial for the

¹⁷⁹By "elsewhere in the Act" this section also envisages, other sections of the Act that may be applied, eg, in the collection of assets for the benefit of, and to be included in, the bankrupt estate. Eg, the provisions of the Act that are used to set aside certain transactions (impeachable or voidable transactions) entered into by the bankrupt at different points in time are such provisions "elsewhere in the Act", that can be used to come by property that forms part of the bankrupt estate. However, most of these provisions are beyond the scope of this thesis. Property collected by the trustee by means of such provisions will therefore not be considered. Generally, only the assets of the bankrupt at the commencement of bankruptcy, and those acquired during bankruptcy but prior to the bankrupt's discharge will be considered in this chapter.

¹⁸⁰See para 5.3.1.3.1 above.

¹⁸¹The making of the bankruptcy order, is technically the date of the commencement of the bankruptcy, meaning the date of the order and not when the petition was presented – see s 278(a) and Crystal at 158 and Sealy *Legislation* (10th ed) at 319. The 1986 Insolvency Act altered the former position known as the "relation back" doctrine which determined the date of bankruptcy as the date upon which the act of bankruptcy on which the order was founded, was committed. Thus the commencement of bankruptcy could occur several months before the order was granted, thus creating confusion as to the composition of the insolvent estate of the debtor; Bankruptcy Act 1914 and see Fletcher *Insolvency law* at 198.

¹⁸²Ss 339-344 of the insolvency Act. See also Doyle *Legislation* at 372 and further in respect of restrictions of dispositions of property under section 284 of the Insolvency Act; Keay *Insolvency* at 318.

¹⁸³Fletcher *Insolvency law* at 198.

estate if he pursues such equitable interest. An equitable interest in the form of a beneficial entitlement granted by a trust or a settlement is also included in the estate. However, a forfeiture clause in the instrument of settlement may terminate the bankrupt's interest from a date before the moment of bankruptcy, thereby excluding such interest from the debtor's bankrupt estate.¹⁸⁴ A further discussion of forfeiture clauses follows below.¹⁸⁵

(b) Intangible property

Intangible assets are considered "property" in the bankrupt estate.¹⁸⁶ Included in this is the goodwill of a bankrupt's business. The title to any trademarks, patents, copyrights, secret formulas or other industrial or intellectual property falls within the insolvent estate. Entitlement to royalties and licence fees are also included and may be sold for the benefit of the creditors.¹⁸⁷ But the bankrupt is not prohibited, as in the voluntary sale of a business, from soliciting his former customers if he later resumes his former trade.¹⁸⁸ He may, however, enter into a voluntary covenant to this effect with the purchaser of his business.¹⁸⁹

Fletcher points out that goodwill that is personal to the bankrupt, such as that encountered with doctors, lawyers and architects will perforce be incapable of passing to a purchaser of such business or to the trustee.

(c) Choses in action

Also called "things in action" or "causes of action", the classic definition of this term was coined in *Torkington v Magee*¹⁹⁰ where it was described as "all personal rights of property which can only be claimed or enforced by action and not by taking physical possession".

¹⁸⁴Fletcher *Insolvency law* at 198. In this respect Doyle *Legislation* at 367 says the bankrupt's estate includes any power exercised by the bankrupt over property.

¹⁸⁵See para 5.3.1.5 below.

¹⁸⁶Fletcher *Insolvency law* at 199.

¹⁸⁷*Re Keene* [1922] 2 Ch 475 (compelling the debtor to reveal his secret formulas); *Performing Right Society Ltd v Rowland* [1997] 3 All ER 336; Fletcher *Insolvency law* at 199.

¹⁸⁸*Walker v Mottram* (1881) 19 Ch D 355; *Green and Sons (Northampton) Ltd v Morris* [1914] 1 Ch 562.

¹⁸⁹Fletcher *Insolvency law* at 199.

¹⁹⁰[1902] 2 KB 427, 430.

They are among types of intangible property in the definition in section 436. “Chose in action” denotes a personal right to claim property and not actual corporeal property itself. It includes the right to claim payment of money.¹⁹¹ All property in the nature of choses in action will therefore generally pass to the trustee.¹⁹² But there is an exception regarding torts of a “personal” nature. Here the debtor remains personally entitled to sue and to retain the fruits of the successful litigation, failing which, Fletcher says “[h]is incentive to vindicate the legal wrongs done to him would be much diminished”.¹⁹³ Torts envisaged here include claims for defamation¹⁹⁴ or injury to credit or reputation or for “wounded feelings”.¹⁹⁵ Where such causes of action arise after his adjudication, the debtor also retains the right to sue.¹⁹⁶

If the damages suffered are both “personal” and “proprietary” in nature, such as a claim for negligence that includes pain and suffering and loss of earnings, such claim vests in the trustee.¹⁹⁷ But if “personal” damages are then recovered, the trustee holds them on constructive trust for the bankrupt.¹⁹⁸ Categorising claims as “personal” or “proprietary” may lead to problems in identifying the nature of the respective parts of the claim for damages. So *In Re Kavanagh*,¹⁹⁹ where such uncertainty arose, the court awarded the trustee and the bankrupt an equal share of the proceeds.

Insurance benefits for permanent disability form part of the bankrupt estate if the policy fails to specify that any element of the payment is calculated by reference to the insured’s pain and suffering.²⁰⁰ Fletcher states that this principle has been respected and applied by the European Court of Human Rights in *Ringeisen v Austria*²⁰¹ to enable a successful applicant to receive and retain payment awarded

¹⁹¹Frieze at 93; Fletcher *Insolvency law* at 200.

¹⁹²Through the effect of ss 283, 306 and 436.

¹⁹³Fletcher *Insolvency law* at 200.

¹⁹⁴*Re Wilson, ex p Vine*, (1878) 8 Ch D 364; *Wilson v United Counties Bank Ltd* [1920] AC 102 (HL).

¹⁹⁵Doyle *Legislation* at 368; Frieze at 93; Fletcher *Insolvency law* at 200.

¹⁹⁶See further para 5.3.1.5 below.

¹⁹⁷Doyle *Legislation* at 369; Frieze at 93; Fletcher *Insolvency law* at 200.

¹⁹⁸*Ord v Upton* [2000] Ch 352; [2000] 1 All ER 193 (CA).

¹⁹⁹[1950] 1 All ER 39.

²⁰⁰*Cork v Rawlins* [2001] 4 All ER 50 (CA).

²⁰¹Case 2614/65, 1 EHRR 455, 504 and 513; 16 YBECHR 468; (1972) 21 ICLQ 377, 795; (1974) 23 ICLQ 193.

to him under article 50 of the European Convention of Human Rights as “just satisfaction” for the wrong done to him. It was ordered that payment be made in such a way that the money could be kept out of reach of the creditors in the applicant’s bankruptcy in Austria.²⁰²

(d) Insurance

If the bankrupt has effected a contract of insurance covering his potential liabilities to third parties and such liability is incurred by the insured either before or after bankruptcy, his rights against the insurer do not vest in the trustee. They are transferred to, and vest in, the third party concerned. This is a special statutory rule provided for by section 1 of the Third Parties (Rights against Insurers) Act of 1930.

(e) The home of the bankrupt

(i) Sections 335A to 338

In English law there are two situations that must be considered in respect of the bankrupt’s home. One must distinguish between the bankrupt who is the sole owner of the matrimonial home (possibly with rights of occupation in favour of an occupying spouse), and where there is joint ownership between the bankrupt and his present or former spouse.²⁰³ In the first situation, prior to 1986, the law vacillated between favouring and denying the spouse’s occupational rights as against the trustee. In the second situation execution of the trust of land resulting from joint ownership of the matrimonial home could be ordered by the court. This position was well settled prior to 1986.²⁰⁴ The courts had a discretion to order the sale of a property occupied by a spouse and children. But in practice the tendency was to allow the interests of creditors to take precedence over those of the wife and children.²⁰⁵

²⁰²Fletcher *Insolvency law* at 200.

²⁰³“Spouse” includes a civil partner or a former civil partner – Civil Partnership Act 2004; see the definition of “associate” in s 435 of the Insolvency Act 1986 which was substituted by the Civil Partnership Act 2004 s 261(1).

²⁰⁴The trustee in bankruptcy applies for this under (now) s 14 of the Trusts of Land and Appointment of Trustees Act 1996, which replaced the procedure under the (repealed) s 30 of the Law of Property Act 1925. See Fletcher *Insolvency law* at 204; Doyle *Legislation* at 435.

²⁰⁵See note 52 in Fletcher *Insolvency law* at 204.

The *Cork Report* proposed a revised measure concerning the conflicting interests regarding the matrimonial home. It suggested delaying the enforcement of creditors rights, but not cancelling them.²⁰⁶

In the 1986 Act the provisions relating to the family home are embodied in sections 336 to 338, and section 335A which was inserted by the Trusts of Land and Appointment of Trustees Act 1996.²⁰⁷ These provisions allow for the postponement of the sale of the family home for up to one year from the date on which it vested in the trustee. After that period the further postponement is allowed only in exceptional circumstances. The court of bankruptcy has exclusive jurisdiction regarding all proceedings involving the family home of the debtor.²⁰⁸

If the bankrupt is the sole beneficial owner of the matrimonial home, he is prevented from granting occupation to a spouse in the period between the presentation of the petition and the vesting of the property in the trustee.²⁰⁹ But the non-bankrupt spouse can acquire statutory rights of occupation under the Family Law Act 1996 that can create a charge on the estate or interest of the bankrupt. Such charge then remains effective despite the bankruptcy, and it binds the trustee and persons deriving title over the property through him.²¹⁰ The solvent spouse without a beneficial interest in the family home is therefore placed in a similar position to a spouse with such an interest, with respect to protected rights of occupation.²¹¹ An application to evict²¹² an occupying spouse from the home must be made to the bankruptcy court, which has

²⁰⁶*Cork Report* above at 255.

²⁰⁷In s 25(1), sch 3, para 23. See also Schofield G and Middleton J (eds) and others *Debt and insolvency on family breakdown* 2003 at 101 and further (hereafter Schofield).

²⁰⁸Ss 335A(1), 336(2)(b) and 337(4) Insolvency Act. Sealy *Legislation* (10th ed) at 376 points out that these provisions are part of a package to cater for the rights of both the trustee and the debtor and his family regarding the family home, often the most valuable asset of the debtor. S 335A applies in any case where a trustee applies for an order under s 14 of the 1996 Act. It therefore applies to *any* trust of land under which the bankrupt has an interest, irrespective of whether the beneficial co-owner is a spouse, a former spouse, an unmarried co-habitee or any other person – Doyle *Legislation* at 435. Regard must, however, be taken of the onus on the trustee to take certain action in respect of a dwelling as required by the provisions of ss 283A and 313A discussed in para (ii) below.

²⁰⁹S 336(1) Insolvency Act. Frieze at 136; Crystal at 192; Sealy *Legislation* (10th ed) at 377-378. The 1986 Act failed to define the term “spouse”, but in the 1996 Act it is defined to include a husband or wife, as well as any such party to a polygamous marriage, and “former spouse” must be construed accordingly – see Doyle *Legislation* at 438. See para (i) above regarding civil partnerships.

²¹⁰S 336(2) Insolvency Act.

²¹¹Fletcher *Insolvency law* at 205.

²¹²Under s 33 of the Family Law Act 1996.

the discretion to make an order it deems just and reasonable.²¹³ In doing so, the court takes the following into account:

- the bankrupt's creditors interests;
- any contributing conduct of the spouse or former spouse to the bankruptcy;
- financial resources and needs of the spouse or former spouse;
- the needs of any children; and
- all the circumstances of the case other than the needs of the bankrupt.

No express reference is made to any other dependants, such as the elderly or ailing, but the court may consider these dependents under the category "all the circumstances of the case".²¹⁴

During the first 12 months after the first vesting of the estate in the trustee the court has an unfettered discretion regarding the order it may make. But in any application that is made to the court after this one-year period the court must assume that the interests of the creditors take precedence over all other matters, unless exceptional circumstances exist.²¹⁵ While this allows for a "period of grace" for the parties to prepare for the giving up of their home, it also allows the trustee to confidently time the eviction and sale of the home after the one-year period.²¹⁶

Section 337 regulates the position where any persons under the age of 18 are occupying a dwelling together with the bankrupt when the petition was presented and at the commencement of the bankruptcy.²¹⁷ If the bankrupt has an

²¹³S 336(4) Insolvency Act; Frieze at 136; Sealy *Legislation* (10th ed) at 377-378.

²¹⁴Fletcher *Insolvency law* at 205; Keay *Insolvency* at 323; Doyle *Legislation* at 436. See *Cloughton v Charalamabous* [1998] BPIR 558 in respect of an elderly ailing spouse of a bankrupt whose age and poor health constituted exceptional circumstances.

²¹⁵S 336(5) Insolvency Act. For examples of what may or may not be considered exceptional circumstances see *Cloughton v Charalamabous* [1998] BPIR 558; *Re DR Raval* [1998] BPIR 389; and *Re Citro* [1991] Ch 142 and Schofield at 109.

²¹⁶Fletcher *Insolvency law* at 206; Keay *Insolvency* at 324; Fletcher, Keay and Doyle *Legislation* at 438.

²¹⁷Sealy *Legislation* (10th ed) at 337-338. Howell G *Family breakdown and insolvency* (1993) at 208 (hereafter Howell) makes the interesting point that the issue of the family home in this context presents a stark contrast between policies espoused by family law on the one hand, and insolvency law on the other. He says, "In family law, the welfare of the child is the paramount consideration. That, however, is simply not the case when bankruptcy intervenes and it is a question of seeking to balance the interest of the creditors against the interests of the child and family. That is not to say that there would not be sympathy on the part of the trustee in bankruptcy and some support under the law for the position of children. However, if the trustee in bankruptcy wishes to push the matter through, then the interests of the

occupational interest in that home resulting from his beneficial estate or interest in the property, section 337(2) gives him the following rights against the trustee:

- if occupying the home, a right not to be evicted or excluded from it except with court approval; and
- if not occupying, it, with the approval of the court, the right to enter into and occupy the property.

These rights constitute statutory matrimonial home rights in respect of the Family Law Act 1996, being a charge in the nature of an equitable interest binding on the trustee.²¹⁸ The trustee therefore must apply for leave to evict under section 33 of the Family Law Act 1996 as described above, and the court must consider the same factors stated above in exercising an order it thinks just and equitable.²¹⁹ Here too, barring exceptional circumstances, under section 337(6) of the Act the presumption in favour of creditors applies if the application to evict is brought after the twelve-month period, as described above.

The next situation to consider is where a trust of land has arisen because the matrimonial home is owned jointly by the bankrupt and his spouse or former spouse. Here the trustee must apply for an order²²⁰ allowing him to sell the property.²²¹ The solvent spouse's beneficial interest attaches to the proceeds of the sale. The trustee is then entitled to the amount representing the bankrupt's beneficial interest in the home. If the solvent spouse has had sole occupation of the home and has paid expenses such as repairs, improvements and mortgage bond instalments, these expenses must be taken into account in calculating that spouse's share in the property.²²² The above provisions regarding the sale of the land and the discretion of the court also apply here.²²³

creditors will prevail". See also *Mullard v Mullard* [1981] 3 FLR 330 CA which is authority for the proposition that it would not be right, under the Matrimonial Causes Act 1973, to prefer creditors claims over those of the other spouse and children where the one spouse has substantial debts where bankruptcy proceedings have not been instituted.

²¹⁸Ss 337(2)(b) and (3) of the Insolvency Act as amended by the Family Law Act 1996, s 66(1) and sch 8 part III; Fletcher *Insolvency law* at 206

²¹⁹But now in accordance with s 337(5) of the Insolvency Act. Conversely, the bankrupt must apply for leave to occupy.

²²⁰Under s 14 Trusts of Land and Appointment of Trustees Act 1996.

²²¹S 335A Insolvency Act.

²²²*Re Pavlou* [1993] 3 All ER 995.

²²³In terms of s 335A(2) and (3) which is the same as s 336(4) and (5).

If the trustee is unable to realise a dwelling because of the existence of an occupying interest of a spouse and or children as in any of the situations envisaged above, or for any other reason, the trustee may apply for a charging order regarding that property for the benefit of the bankrupt estate.²²⁴ The benefit of such a charge then forms part of the bankrupt estate. It attaches to the property until it can be enforced. The order must therefore provide for the property itself to cease to be part of the bankrupt estate and to revert in the debtor subject to the charge.²²⁵

(ii) *Section 283A*²²⁶

Section 283A regulates the position where the bankrupt's property is a dwelling house occupied by him, his spouse or former spouse.²²⁷ This property re-vests in the bankrupt if within three years from the date of the bankruptcy order the trustee has failed to take action. Taking action means realising the bankrupt's interest, applying for an order for possession or sale of the dwelling, application for a charging order under section 313 or coming to an agreement with the bankrupt for him to pay a specified sum to the trustee.²²⁸ This has become known as the "use it or lose it" rule, and it applies to all bankruptcies brought by petition on or after 1 April 2004.²²⁹ Section 283A(1) defines the property or properties to which the section applies, which includes any dwelling house which at the date of the bankruptcy order was "the sole or principal residence" of the bankrupt, his spouse, or a former spouse.

These provisions are intended to rectify a previous abusive practice whereby the trustee would take no action in respect of the bankrupt's home, but then often years later take steps to realise the property, including its enhanced value, usually to the surprise of the now discharged bankrupt. Action must be taken by the trustee irrespective of the state of the property market.²³⁰ But section 313 does

²²⁴S 313 Insolvency Act. Sealy *Legislation* (10th ed) at 359 and further.

²²⁵S 313(2) of the Insolvency Act and see rule 6.237.

²²⁶This provision was introduced by s 261 of the Enterprise Act 2002, with effect from 1 April 2004.

²²⁷These provisions must be read together with s 313, regarding a charge on the bankrupt's home, and s 313A concerning the application for the sale, possession or charge of a low value home. A "dwelling house" is defined in s 385 to include "any building or part of a building which is occupied as a dwelling and any yard, garden, garage or outhouse belonging to the dwelling house and occupied with it"; see Crystal at 222; Sealy *Legislation* (10th ed) at 328 and further.

²²⁸S 283A(3)(a)-(e) of the Act; Frieze at 96.

²²⁹Frieze at 96.

²³⁰Doyle *Legislation* at 371.

assist the trustee in that he may apply for a charge on a bankrupt's interest in a dwelling house where the trustee cannot, for any reason, take the relevant action in respect of the dwelling. Such a charge, which will secure the bankrupt's interest in the dwelling (as assessed by the court) will be enforceable even after the discharge of the bankrupt or the release of the trustee.²³¹ However, where the relevant dwelling is of low value, section 313A places restrictions on the actions of the trustee²³² in that the section 313 application can be dismissed by the court.²³³ If such application is dismissed, section 283A(4) provides that the interest will no longer form part of the bankrupt's estate and it will vest automatically in the bankrupt, subject to a contrary order by the court.

Section 283A thus excludes any interest of the bankrupt in a dwelling house from the bankrupt's estate at the end of the aforementioned three-year period, subject, of course, to the extensions provided for in section 283A(5) and (6). The onus is therefore on the trustee to take the necessary action to secure such interest in a dwelling within the prescribed period.

5.3.1.4.2 After-acquired property

(a) General

The date upon which the content of the bankrupt estate must be assessed is the date of the bankruptcy order. But property acquired by the bankrupt from the date of the commencement of the bankruptcy to the date of his discharge may be claimed by the trustee for the benefit of the creditors in terms of section 307 of the Insolvency Act.²³⁴ Section 307(1) enables the trustee to claim after-acquired property by notice in writing.

²³¹S 313 of the Act.

²³²Low value is described in s 313A(2) and (3), presently a value below £1 000 as prescribed by art 2 of the Insolvency Proceedings (Monetary Limits) (Amendment) Order 2004 (SI 2004/547). Art 3 of the Order stipulates, for the purposes of s 313A(3), that the court must disregard the value of the property equal to the value of any loan secured by mortgage or any other charge against the property, the value of any third party interest and the value of reasonable costs of sale – see Frieze at 139; Doyle *Legislation* at 415.

²³³S 313A(2) of the Act.

²³⁴This is one of the provisions envisaged by s 283(1)(b) that may be applied in the collection assets that will be considered to form part of the bankrupt estate. By "elsewhere in the Act" s 283(1)(b) also envisages, eg, sections of the Act that regulate impeachable and voidable transactions that may be applied to augment the property that comprises the bankrupt estate. However, a number of these provisions found "elsewhere in the Act" are beyond the scope of this thesis. Property collected by the trustee by means of such provisions will therefore not be considered. Generally, only the assets of the bankrupt at the commencement of bankruptcy, and those acquired during bankruptcy but prior to the bankrupt's discharge, will be considered in this chapter. See also Keay *Insolvency* at 321 and Sealy *Legislation* (10th ed) at 352.

This provision codifies the principle known as the rule in *Cohen v Mitchell*,²³⁵ which includes the rule that the trustee's claim to after-acquired property may be opposed under certain conditions.²³⁶ To defeat the trustee's claim, the property must have been disposed of by the bankrupt to another person transacting with him in good faith, for value and ignorant of the bankruptcy. Subject to this, the trustee's claim may be defeated whether or not the transaction occurs before or after the trustee serves the requisite notice²³⁷ on the bankrupt. A donation, however, may be claimed by the trustee irrespective of the circumstances under which it was received by the donee.²³⁸

There is a duty upon the bankrupt to notify the trustee within 21 days of property devolving upon him.²³⁹ The trustee has a 42-day period to serve a notice under section 307 claiming after-acquired property. The 42-day period commences on the day on which it first came to the knowledge of the trustee that the property in question was acquired by, or devolved upon, the trustee.²⁴⁰ If the bankrupt fails to comply with his duty to inform the trustee of after-acquired property, the 42-day period for service of the notice by the trustee only commences when the trustee finds out about the relevant property.²⁴¹ This 42-day period for the service of the section 307(1) notice may be extended with the leave of the court if good cause is established to justify the extension of the period.²⁴²

Upon the trustee's service of notice claiming after-acquired property, the property in question vests in the trustee with retrospective effect to the date when the property was first acquired.²⁴³ This doctrine of relation back is subject to the rights of *bona fide* third

²³⁵(1890) 25 QBD 262.

²³⁶Fletcher *Insolvency law* at 208. Prior to the 1986 Act, s 38(1) of the 1914 Act provided that all after-acquired property devolved automatically on the trustee before discharge.

²³⁷Under s 307(1).

²³⁸*Re Bennet* [1907] 1 KB 149.

²³⁹See s 333(2) and rule 6.200.

²⁴⁰See s 309(1)(a). Sealy *Legislation* (10th ed) at 352.

²⁴¹S 309(1)(a).

²⁴²See *Solomons v Williams* [2001] BPIR 1123 at 1136 F-H regarding factors to be taken into account in order to establish good cause for the extension of the time period.

²⁴³S 307(3) Insolvency Act. Only property that formed part of the bankrupt's estate as at the date of appointment of the trustee automatically vests in the trustee under s 306. Property acquired by or devolving upon the bankrupt after the commencement of the bankruptcy (which is defined in s 278(a) as the date of the bankruptcy order), is that of the bankrupt, unless the trustee claims it by virtue of s 307, or it is subject to an income payments order under s 310A or 310 – see Doyle *Legislation* at 401.

parties, as stated above, but apart from the latter the trustee's title to the relevant property prevails over that of third parties, irrespective of whether the third party transacted with the bankrupt prior to or after the trustee's notice of claim to the property.²⁴⁴

After-acquired property claimed by the trustee may be real or personal, varying from tangible to intangible and may include, among other things, a legacy.²⁴⁵ Under this heading, however, only insurance policies and income will be considered.

(b) Insurance policies as after-acquired property

The situation envisaged here is where the bankrupt, after bankruptcy effects a policy of insurance upon his own life or has kept such policy that he effected prior to his bankruptcy alive, without the trustee's knowledge.

Referring to case law, Fletcher says that the trustee will be considered the owner of the proceeds of the policy, as with any other property the debtor fails to disclose. The trustee may claim the policy or the proceeds as soon as he finds out about them,²⁴⁶ even after the discharge from bankruptcy.²⁴⁷ But if the premiums of such policy were paid by some other person, this person will be entitled to repayment of the relevant sum plus interest.²⁴⁸

So, where the payment of money under an insurance policy was accelerated because of the insured's permanent disablement, the Court of Appeal in *Cork v Rawlins*²⁴⁹ held that the money formed part of the insured's bankrupt estate, because no part of the sum payable related to pain and suffering.

If a life policy was effected by the bankrupt for his wife and/or children, a trust is

²⁴⁴Fletcher *Insolvency law* at 210.

²⁴⁵*Hunt v Fripp* [1898] 1 Ch 675.

²⁴⁶Fletcher *Insolvency law* at 210 who cites *Tapster v Ward* (1909) 101 LT 503; *Re Phillips* [1914] 2 KB 689.

²⁴⁷*Re Collier* [1930] 2 Ch 37 cited in Fletcher *Insolvency Law* at 210.

²⁴⁸Fletcher *Insolvency law* at 210.

²⁴⁹[2001] 4 All ER 50.

created which excludes the policy from the bankrupt's estate during the life time of that immediate family.²⁵⁰

(c) Income

The bankrupt is allowed to retain a portion of his income which is sufficient to maintain himself and his dependants. This is part of the policy in English law to allow the bankrupt to continue to care for himself and his dependants. The rationale behind this policy is that it will leave the dignity and self-respect of the bankrupt and his dependants intact and, secondly, that it reduces the social-welfare burden of the state if the bankrupt is able to maintain himself and his dependants.²⁵¹ The trustee may obtain an income payments order from the court as a measure by which to collect the surplus income to which he may be entitled for the benefit of the bankrupt estate, and income so collected specifically forms part of the bankruptcy estate.²⁵²

The Act defines "income" broadly. It includes every payment in the nature of income which is intermittently made to the bankrupt, or to which he becomes entitled to from time to time.²⁵³ It has been held that the test whether a payment is regarded as income is largely a matter of common sense,²⁵⁴ and for the purpose of section 310 it need not be an income produced by regular activity or business. In *Supperstone v Lloyd's Names Association Working Party and Others*²⁵⁵ Evans-Lombe J held that even if a fee payment is a "one off" it still constitutes income "from time to time" under section 310; that phrase meaning payments at any time during the relevant period and not only periodical or regular payments. Section 310(2) provides that an income payments order must not reduce the bankrupt's income below what is reasonably required for his and his family's maintenance. This will obviously be a factual question in every case. "Family" is defined in

²⁵⁰Schofield at 71.

²⁵¹Fletcher *Insolvency law* at 211-212; Sealy *Legislation* (10th ed) at 356 and further. Under the 1914 Act salary and income received by the bankrupt vested in the trustee (s 51(2)).

²⁵²By means of s 310(1) Insolvency Act. See also s 310(3) and (5).

²⁵³S 310(7).

²⁵⁴*Affleck v Hammond* [1912] 3 KB 162 at 169.

²⁵⁵[1999] BPIR 832; Schofield at 81; Keay *Insolvency* at 321.

section 385(1) as any persons who are living with the bankrupt and are dependent on him.²⁵⁶

5.3.1.5. Property excluded from the bankrupt estate

(a) General

Exceptions to the rule that all the debtor's property vests in the trustee exist by virtue of statutory provisions, case law and specific arrangements between the debtor and other persons. Some of these exceptions will now be considered.

(b) Exempt property and family assets

It has long been policy in English law that the bankrupt debtor should not be divested of certain assets that are essential for the maintenance of himself and his dependants. Thus personal clothing, domestic furniture, and tools and equipment used for earning a living are excluded from the bankrupt estate by statutory exemption.²⁵⁷

Recommendations of the *Cork Report*²⁵⁸ to make this category of exemptions more flexible were accepted and embodied in section 283(2) of the Act. Two separate categories now exist. First, tools, books, vehicles and other equipment necessary for use in the bankrupt's employment business and vocation are exempt.²⁵⁹ Second, clothing, bedding, furniture, household equipment and provisions necessary to satisfy the bankrupt and his family's basic needs.²⁶⁰ Whether necessity exists will be a factual question that may differ from case to case.²⁶¹

Exemption under the first category requires that the relevant item must be *necessary* for the *personal* use by the bankrupt to *earn his livelihood*. These three criteria must be present for the exemption to apply. The inclusion of a vehicle as an exempt asset is a movement in the direction of a more liberal policy or philosophy in English

²⁵⁶Sealy *Legislation* (10th ed) at 356 and further.

²⁵⁷Formerly s 38(2) of the Bankruptcy Act 1914. Doyle *Legislation* at 367.

²⁵⁸See ch 5.2 above.

²⁵⁹S 283(2)(a). Schofield at 76-77; Frieze at 90.

²⁶⁰S 283(2)(b). S 385(1) defines "family" as the persons(if any) who are living with the bankrupt and are dependent on him.

²⁶¹Fletcher *Insolvency law* at 228.

bankruptcy law.²⁶² Under the second category property that satisfies the *basic, domestic* needs of the bankrupt and his family may be exempt from the bankrupt estate. Here too, the exemption will hinge on the factual question in each particular case whether an item is necessary for basic domestic needs.

No monetary limit has been placed on any of the categories of exempt items. However, section 308 allows the trustee to claim any exempt property with a higher intrinsic value than the cost of providing a reasonable replacement of such items. Section 308(4) defines “reasonable replacement”, but essentially it is a matter of judgment in each set of circumstances. Here, the trustee’s decision may be challenged in court.²⁶³

In *Haig v Aitken*²⁶⁴ a trustee applied to court to claim the bankrupt’s private and personal correspondence as part of the bankrupt estate. The court refused the application, finding that it was not included in the definition of property for the purposes of section 283 of the Insolvency Act 1986. In this case the Human Rights Act also had to be considered. Article 8 of the European Convention on Human Rights, which regulates the right to respect for private and family life, was referred to by the judge to support a ruling that private and personal correspondence be excluded from the estate.

(c) Awards for personal damages

It was stated above that all property in the nature of choses in action, being personal rights, will generally pass to the trustee.²⁶⁵ But there is an exception regarding torts of a “personal” nature. Here the debtor remains personally entitled to sue and to retain the fruits of the successful litigation, failing which, Fletcher²⁶⁶ says, “his incentive to vindicate the legal wrongs done to him would be much diminished”. Torts envisaged

²⁶²In *Pike v Cork Gully* [1997] BPIR 723 a horsebox was held to be a tool of the trade, and Frieze at 90 therefore argues that any vehicle used by the bankrupt to travel to and from work might be excluded from the bankruptcy estate as a tool of the trade.

²⁶³S 303(1). See generally Fletcher *Insolvency law* at 229 and Doyle *Legislation* at 369.

²⁶⁴[2000] 3 All ER 80.

²⁶⁵Through the effect of ss 283, 306 and 436. See para 5.3.1.4.1 above.

²⁶⁶Fletcher *Insolvency law* at 200; Frieze at 90; Doyle *Legislation* at 368. See also *Heath v Tang* [1993] 1 WLR 1421 at 1423 A-B and *Beckham v Drake* (1849) 2 HL Cas 579 at 604.

here include claims for defamation²⁶⁷ or injury to credit or reputation or for “wounded feelings”.²⁶⁸ Also in *Davis v Trustee in Bankruptcy of the Estate of Davis*²⁶⁹ a claim for medical negligence that resulted in a personality change was considered a claim for personal injury. Where such causes of action arise after his adjudication, the debtor also retains the right to sue.²⁷⁰

If the damages suffered are both “personal” and “proprietary” in nature, such as a claim for negligence that includes pain and suffering and loss of earnings, such claim vests in the trustee.²⁷¹ But if “personal” damages are then recovered, the trustee holds them on constructive trust for the bankrupt.²⁷² Doyle points out that it would also be possible for the trustee to assign the cause of action to the bankrupt on condition that the bankrupt accounts to the trustee for the proceeds of the loss of income part of the claim.²⁷³ Categorising claims as “personal” or “proprietary” may lead to problems in identifying the nature of the respective parts of the claim for damages. So in *Re Kavanagh*,²⁷⁴ where such uncertainty arose, the court awarded the trustee and the bankrupt an equal share of the proceeds.

Insurance benefits for permanent disability form part of the bankrupt estate if the policy fails to specify that any element of the payment is calculated by reference to the insured’s pain and suffering.²⁷⁵ Fletcher states that this principle was respected and applied by the European Court of Human Rights in *Ringeisen v Austria*²⁷⁶ to enable a successful applicant to receive and retain payment awarded to him under article 50 of the European Convention of Human Rights as “just satisfaction” for the wrong done to him. It was ordered that payment be made in a manner that the money could be kept out of reach of the creditors in the applicant’s bankruptcy in Austria.²⁷⁷

²⁶⁷*Re Wilson, ex p Vine*, (1878) 8 Ch D 364; *Wilson v United Counties Bank Ltd* [1920] AC 102 (HL).

²⁶⁸Fletcher *Insolvency law* at 200; Frieze at 93; Doyle *Legislation* at 368.

²⁶⁹[1998] BPIR 572.

²⁷⁰Doyle *Legislation* at 368.

²⁷¹ Fletcher *Insolvency law* at 200; Frieze at 93; Doyle *Legislation* at 369.

²⁷²*Ord v Upton* [2000] Ch 352; [2000] 1 All ER 193 (CA).

²⁷³Doyle *Legislation* at 369.

²⁷⁴[1950] 1 All ER 39.

²⁷⁵*Cork v Rawlins* [2001] 4 All ER 50 (CA).

²⁷⁶Case 2614/65, 1 EHRR 455, 504 and 513; 16 YBECHR 468; (1972) 21 ICLQ 377, 795; (1974) 23 ICLQ 193.

²⁷⁷Fletcher *Insolvency law* at 200.

(d) Trust property

If the debtor holds property in trust for another person, that property is not included in his bankrupt estate.²⁷⁸ This is not only the position in respect of an express trust, but also in other relationships that have the characteristics of a trust. For example, where there is a relationship between parties which in law creates a fiduciary responsibility, certain monies in the hands of the bankrupt debtor may be included in a trust in favour of the persons in respect of whom he holds such fiduciary position.²⁷⁹ This would be the case where solicitors holding a client's money or bankers who possess money that is to be used on behalf of a client. For this exception to apply, the bankrupt must be a "bare" trustee of the property concerned. If he also enjoys a beneficial interest in the trust estate, the property does not fall within the exemption created by section 283(3)(a), which applies to property held on trust for "any *other person*".²⁸⁰

(e) Legacies and forfeiture clauses

If a bankrupt has benefited from a legacy before the commencement of his bankruptcy, the legacy will vest in the bankrupt estate. If the bankrupt becomes entitled to the legacy after the commencement of the beneficiary's bankruptcy, the legacy will be treated as after-acquired property to be utilised for the benefit of the creditors.²⁸¹ A legacy can be protected from forming part of a bankruptcy estate if the testator removes the beneficiary from his will if he learns of the impending bankruptcy. Alternatively, the testator must create a protective trust whereby a beneficiary may benefit from the will, only if he is not a bankrupt at the time of the death of the testator, losing his rights if he is a bankrupt at that time.²⁸² A further protective mechanism is the creation of a discretionary trust whereby the trustees appointed in the will must decide whether or not a particular beneficiary must benefit from the will.²⁸³

²⁷⁸S 283(3)(a). Only the position generally applicable to trusts is discussed here. Unusual instances where the courts have declared certain assets impressed with a trust, such as the rule in *Ex Parte Waring (Re Brickwood, ex part Waring (1815) 19 Ves Jun 345; 34 ER 546)* and the position of mixed funds (the rule in *Devaynes v Noble, Clayton's Case (1816) 1 Mer 572; 35 ER 781*) that may include trust funds, will not be considered. A power of appointment over settled property, which is similar to a trust, will also not be discussed. For a more comprehensive discussion of these issues, see Fletcher *Insolvency law* at 219 to 220; Frieze at 90; Doyle *Legislation* at 367.

²⁷⁹Fletcher *Insolvency law* at 218.

²⁸⁰Fletcher *Insolvency law* at 219.

²⁸¹Frieze at 94.

²⁸²Frieze at 94.

²⁸³Frieze at 94.

Forfeiture clauses relate to beneficial interests to which the debtor may be entitled either before or after bankruptcy, but which are forfeited if the beneficiary becomes bankrupt. However, three particular conditions must be met for such clauses in instruments of settlement to be effective.

First, Fletcher points out, because of the possible effects of the principle of “relation back” of the trustee’s title to the date of the bankruptcy order, the forfeiture clause must be expressed to operate on the presentation of the bankruptcy petition by or against the beneficiary, such as may lead to his adjudication.²⁸⁴ The settlement may, for example, include a clause stating that the interest will be forfeited if the beneficiary does or suffers anything whereby he would be deprived or liable to be deprived of the beneficial enjoyment thereof.²⁸⁵

Second, a gift over is required of the forfeited interest. Failing this, the forfeiture clause will not prevent the interest from vesting in the trustee.²⁸⁶

Third, the forfeiture clause cannot be structured so as to take effect upon the bankruptcy of the settlor himself. This is because the owner of property cannot avoid his creditors’ legal rights against his property by means of qualifying his own interest in it, in the event of his bankruptcy by way of a settlement or contract.²⁸⁷

If the trustees of *the settlement* themselves have terminated the beneficiary’s absolute interest prior to the latter’s bankruptcy, the trustee in bankruptcy will enjoy no claim to that asset. But if in the latter instance the settlement states that continued payments must be made to the bankrupt beneficiary on a discretionary basis, his right to such payment after adjudication is limited to the amount needed for his necessary maintenance. The surplus will be available to his creditors.²⁸⁸

In the construction of wills and settlements providing for forfeiture clauses in the event of a beneficiary’s (grantee’s) bankruptcy, the court, to give effect to the

²⁸⁴Fletcher *Insolvency law* at 223.

²⁸⁵Fletcher *Insolvency law* at 223.

²⁸⁶Fletcher *Insolvency law* at 224.

²⁸⁷Fletcher *Insolvency law* at 224.

²⁸⁸Fletcher *Insolvency law* at 224.

settlor or testator's intentions as to who should have the benefit of that property, "has construed the clauses creating the limitation over in the event of bankruptcy in such a way as to apply them to a bankruptcy already existing, either at the date of the will or the settlement or at the time when the grantee's interest would, but for the bankruptcy, have fallen into his possession".²⁸⁹

(f) Rights to pensions

As with certain exempt items, the policy to allow the bankrupt to keep a portion of his estate to maintain himself and his dependants also applies to certain pensions. The trustee's right in respect of pensions may be subject to special statutory provisions governing the pension in question. For example, statutes regulating pensions of members of the armed forces make any assignment of such pensions void, but they are capable of passing to the trustee in bankruptcy.²⁹⁰ Other legislation, however, expressly prohibits the pension benefit from passing to the trustee or from being burdened in any manner at all in the event of the bankruptcy of the beneficiary.²⁹¹ These provisions merely exclude the benefits from vesting in the trustee and it would appear that a court is not precluded from making an income payments order in respect of such benefits.²⁹² But these provisions relate to public servants and officials.

Issues of principle arise in respect of personal pension schemes and occupational pension schemes. Self-employed individuals provide for their future retirement by way of private or personal pension schemes.²⁹³ Payment may result from old age or incapacity, by way of periodical or lump-sum payments. Employers, in turn, provide for occupational pension schemes as part of the employment package. The question to be considered is whether any part of these pensions, be it capital

²⁸⁹Berry *Personal insolvency* at 182; see also *Re Evans, Public Trustee v Evans* [1920] 2 Ch 304, CA which was applied *In re Walker, Public Trustee v Walker* [1939] Ch 974 [1939] 3 All ER 902 where a forfeiture clause prevented the vesting of an annuity in the bankrupt where the bankrupt had obtained his discharge after the testator's death, but before the annuity became first payable.

²⁹⁰See, eg, the Army Act 1955 s 203, Air Force Act 1955 s 203 and Naval Discipline Act 1957 ss 159(4) and (4A).

²⁹¹See, eg, the Police Pensions Act 1976 s 9; Social Security Administration Act 1992 s 187(1).

²⁹²Under s 310 of the Act; see Fletcher *Insolvency Law* at 230; Sealy *Legislation* (10th ed) at 355. See also, generally, Frieze at 91.

²⁹³Fletcher *Insolvency Law* at 230; Sealy *legislation* (10th ed) at 355. See also, generally, Frieze at 91.

or current or future payments, should be available to the creditors of the bankrupt.²⁹⁴ In respect of personal pension schemes, the courts in England have ruled²⁹⁵ that the debtor's contractual²⁹⁶ rights to the benefits are considered property as envisaged by the Act²⁹⁷ and therefore vested in the trustee. With this personal pension scheme the beneficiary will not be able to withhold the benefits from creditors of a bankrupt estate by means of a forfeiture clause or a prohibition on assignment.²⁹⁸ This would be in conflict with the principle of bankruptcy that one cannot use protective trusts created by one's own disposition if that person is also the principle beneficiary, as a means to avoid the claims of creditors in bankruptcy.²⁹⁹ But this objection will not apply to an occupational pension scheme because the employer is the settlor, and not the bankrupt employee.³⁰⁰

The inconsistencies in this field of law were addressed in the Pensions Act 1995 and the Welfare Reform and Pensions Act 1999. Among other things, it was recognised that the case law had a very harsh impact on bankrupts who could lose their whole pension despite the fact that they may have existed for decades.³⁰¹ The 1995 Act then resulted from the *Report of the Pension Law Review Committee*.³⁰² This report proposed applying the system of exemption of future pension entitlements, as embodied in the aforementioned public sector statutory schemes, to all types of occupational pension schemes.³⁰³ This would mean that pension entitlements would not vest in the trustee in bankruptcy, but the trustee would be able to obtain an income payment order under section 310 of the Insolvency Act so as to claim any excessive pension payments received by the bankrupt. Section

²⁹⁴Fletcher *Insolvency law* at 230; Sealy *Legislation* (10th ed) at 355. See also, generally, Frieze at 91.

²⁹⁵See *Re Landau* [1998] Ch 223; *Krasner v Dennison*, *Lawrence v Lesser* [2000] 3 All ER 234 (CA); *Patel v Jones* [2001] BPIR 919; *Rowe v Sanders* [2002] BPIR 847; *Re the Trusts of the Scientific Investment Pension Plan* [1998] BPIR 410 and *Malcolm v Benedict Mackenzie* [2004] EWCA Civ 1748, [2005] BPIR 176. As mentioned in this paragraph, a vast majority of pension interests have now been excluded from bankruptcy estates by legislation, so recent case law in this respect is diminishing in importance. For pre-existing and ongoing cases, the important case law remains this mentioned in this footnote. See Frieze at 90-91; Doyle *Legislation* at 399 and 406.

²⁹⁶Under s 283(1) of the Act.

²⁹⁷S 436 of the Act.

²⁹⁸See Frieze at 90-91; Doyle *Legislation* at 399 and 406.

²⁹⁹See sub-para (e) above.

³⁰⁰See Frieze at 90-91; Doyle *Legislation* at 399 and 406.

³⁰¹See Keay *Insolvency* at 322.

³⁰²Cm 2342 – I (September 1993) chaired by Prof R Goode.

³⁰³Cm 2342 – I paras 4.14.33 to 4.14.35 (pp 458-459).

95 of the Pensions Act 1995 initially dealt with this proposal by inserting sections 342A, B and C into the Insolvency Act of 1986, which were intended to empower the court to order restitution of excessive payments made to an occupational pension scheme by, or on behalf of, the bankrupt within five years preceding the presentation of the bankruptcy petition on which adjudication took place.³⁰⁴

The case of *Re Landau*³⁰⁵ resulted in the second revision of the law in this field, in the form of the Welfare Reform and Pensions Act 1999. Section 15 of this Act replaced sections 342A, B and C of the Insolvency Act.³⁰⁶ The effect of the *Landau* case is reversed by sections 11 to 14 of the 1999 Act. Regarding personal pension schemes, sections 11 and 12 exclude from a bankrupt estate pension rights under an approved pension arrangement,³⁰⁷ but it is effective only to petitions presented after the coming into force of section 11, which was 29 May 2000.³⁰⁸ Section 12 allows the Secretary of State to provide for similar exemption in respect of pension arrangements that are unapproved within the meaning of the Act.³⁰⁹ An agreement between the trustee and the bankrupt regarding the exclusion to exclude those rights from the bankrupt estate in circumstances where they would otherwise not be excluded is provided for by the Occupational and Personal Pension Schemes (Bankruptcy) Regulations 2002.³¹⁰

Thus, regarding both personal and occupational pension schemes, the funds lodged in them will not automatically vest in the trustee for the benefit of creditors, but excessive contributions to those schemes could be clawed back by the trustee.

³⁰⁴See Fletcher *Insolvency law* at 231.

³⁰⁵[1998]Ch 223 (Ferris J)

³⁰⁶Sealy *Legislation* (10th ed) at 387.

³⁰⁷Broadly defined in s 11(2).

³⁰⁸See s 342A-F Insolvency Act which regulates pensions.

³⁰⁹The 1999 Act does however provide for reclaiming excessive contributions to a pension policy or scheme by the introduction of s 342 C of the 1986 Insolvency Act.

³¹⁰Howell G *Family breakdown and insolvency* (1993) at 208 (hereafter Howell) makes the interesting point that the issue of the family home in this context presents a stark contrast between policies espoused by family law on the one hand, and insolvency law on the other. He says, "In family law, the welfare of the child is the paramount consideration. That, however, is simply not the case when bankruptcy intervenes and it is a question of seeking to balance the interest of the creditors against the interests of the child and family. That is not to say that there would not be sympathy on the part of the trustee in bankruptcy and some support under the law for the position of children. However, if the trustee in bankruptcy wishes to push the matter through, then the interests of the creditors will prevail". SI 2002/427; see Doyle *Legislation* at 368.

Furthermore, the trustee will be able to apply for an income payments order in respect of pension payments to the bankrupt after adjudication, so as to claim excess funds that are not required for the bankrupt and his dependants' reasonable domestic needs.³¹¹

5.4 Conclusion

In early English law a distinction was initially made between bankrupts and other debtors. Only traders, as debtors, could go bankrupt. Insolvency, as a debt enforcement procedure was an individualistic remedy generally applying only to traders.

During the twelfth and thirteenth centuries execution could be taken only against the assets of the debtor. Imprisonment of persons for debt was a relatively late development in England, developing in the late thirteenth century. As an improved debt collection procedure developed, exemption laws also developed to protect certain assets essential for the livelihood of the debtor, namely oxen and plough animals.

Execution on the person was introduced in the late thirteenth century, first to protect foreign merchants, later allowing for the imprisonment of debtors in most circumstances. Execution against the debtor's property was originally limited to personal property and profits, or rents of real property. Execution against the debtor's land was introduced much later. The leniency of English law towards debtors resulted in an abuse of the system by debtors. This, in turn, led to a more creditor-friendly system, with various writs eventually enabling creditors to bring their debtors into court upon imprisonment and to deprive them of their goods in payment of their debts.

The earliest debt collection remedies of a collective nature were introduced by legislation, essentially that of Henry VIII in 1542-1543. This legislation allowed for the imprisonment of the debtor and the sale of his property. The proceeds were divided proportionately among his creditors. Both personal and real property could now be collected. Real property could also be sold if it could be lawfully departed

³¹¹Fletcher *Insolvency law* at 232; Keay *Insolvency* at 322.

with at the moment of collection. Henry VIII's legislation laid the foundation in England for the principle that all the debtor's property be included in his insolvent estate. The principle of exempt property, which existed to some extent, then developed further over a period of time, always considering the debtor's future means of existence, and the rights of third parties and the Crown. So, over a lengthy period, the interpretation of the Statute of Henry VIII clarified, in a piecemeal fashion, what assets belonged in the bankrupt estate and what was excluded from it.

By the end of the seventeenth century the bankrupt estate included all the debtor's property, thereby putting creditor protection firmly in place, leaving the debtor with virtually nothing. But in the eighteenth century some respite came for the debtor when legislation passed by Anne and George II provided for specific exemptions to keep the debtor and his family clothed and working.

The Bankruptcy Act of 1883 finally developed the concept of personal bankruptcy along the lines of modern English bankruptcy. So, in the United Kingdom there was a very slow progression in the development of a collective debt collection procedure. Even slower to develop was the idea of including all the debtor's property in his insolvent estate, bar certain exempt property. These were concepts that had already developed in Roman law almost a thousand years before. From its earliest conception, however, a policy of debtor protection developed, as in Roman law, essentially espousing the idea of keeping the debtor and his dependants clothed and productive, thereby leaving him less vulnerable, and less of a burden on society and the state. As will be shown below, this policy of including the bulk of the property in the bankruptcy estate for the benefit of the creditors has remained firmly in place in modern English law, but the composition of that estate has been eroded by the development of a policy to treat the debtor in bankruptcy in a more humane fashion, founded on the idea of allowing the debtor a speedy recovery from bankruptcy so as to pursue a productive position in society.

The next important development in England that was to have an effect on policies

relating to assets of insolvent estates in English law, was the Cork Committee's proposal for reform.

Many of the reforms in the 1986 and later legislation have their origins in the *Cork Report* which was of the view that the English insolvency law system failed a modern society in which the utilisation of credit was indispensable for the well-being of that society.³¹² Proposals of the *Cork Report* espoused the idea, in accordance with the wider principle, as far as possible, of seeking the rehabilitation of the debtor.³¹³ Recognising the importance of the welfare of the debtor and the acceptance that the debtor must be treated in a more humane fashion is the underlying philosophy at the root of the lengthy and ongoing reform process regarding, among other things, assets in bankruptcy estates in England.³¹⁴

The Insolvency Act provides for the automatic vesting of the bankrupt's estate in the trustee as soon as he is appointed. This basically includes all the debtor's property at the commencement of the bankruptcy and *potentially* a substantial portion of property acquired by the debtor after the latter date and prior to his discharge from bankruptcy. The property that is so vested is defined extremely broadly in the Act, in a non-exclusive fashion, which will allow the courts to determine, should the need arise, whether a particular proprietary interest complies with the definition. But the Act also provides generously for exempt property, together with suitable provisions to determine the extent to which certain property should be exempt from, or included in, the bankrupt estate. These provisions are considerably supple and can be adequately manipulated to apply to the different circumstances of different debtors, while not ignoring the interests of the creditors. This is why, in respect of after-acquired property being included

³¹²*Cork Report* at 9 and further. Since the 1980s there has been a substantial increase in credit granting, in turn resulting in increasing numbers of over-burdened debtors in the United Kingdom. See Ford J and Wilson M "Personal debt and insolvency" in: Rajak H (1993) *Insolvency law theory and practice* at 93.

³¹³*Cork Report* at 53.

³¹⁴Particularly in the nineteenth century the notion took root that in a civilised society a debtor deserved more consideration, and perhaps compassion, than he had in the past. In considering the changing approach to the imprisonment for debt during that century, Jacob at 296 comments that "During the course of the nineteenth century, it became apparent that the approach indicated above was not quite right, if indeed it was civilised at all, and that in a civilised society the debtor, including a judgment debtor ought to be treated with some consideration, if not some compassion".

in the estate, the word “*potential*” was used above. On the one hand, the trustee is given extensive powers, but limited time, to claim the lion’s share of the bankrupt’s after-acquired property (and excess exempt property), of which the bankrupt must notify the trustee. On the other hand, the bankrupt is certain that a substantial share, and possibly all his after-acquired assets, can contribute to a new healthy estate and a fresh financial start. At worst, the bankrupt and his dependants retain a considerable estate and, where relevant, a home. This legislation appears to have achieved an acceptable balance between all stakeholders.

The *Cork Report* points out that insolvency law is not a mechanism to serve only creditors in the division of the debtor’s assets, but an important instrument in the entire debt collection procedure, which includes the interests of debtors.³¹⁵ The progressive changes that were introduced to the 1986 Act are evidence of this. The new arrangements regarding the family dwelling and the changes in respect of exempt assets are to a great extent debtor-orientated,³¹⁶ but not, it seems, at the expense of the creditors in the bankruptcy estate. The new measures are well thought out along the lines of an equitable arrangement for all the parties concerned. For example, the idea is that the debtor and his dependants be treated in a more humane way by putting an end to the automatic vesting of after-acquired assets in the trustee, but simultaneously keeping them available for the benefit of creditors if claimed under circumstances considered reasonable towards all the stakeholders involved. By abolishing the automatic vesting of income of the bankrupt, it is hoped that the debtor will not become a “debt slave” to his creditors.³¹⁷ Although safeguards are included in the legislation, allowing the trustee always to protect the interest of creditors, these safeguards appear to be reasonable towards the debtor, for example, by placing time limits by which to claim certain assets. Added to this, the relaxing of the requirements for the automatic discharge of the debtor after only a year seems to be a liberal measure

³¹⁵Cork *Report* at 62.

³¹⁶Flynn D “Are the institutions of insolvency achieving their purpose? Bankruptcy and individual voluntary arrangements (IVAs) in England and Wales” in: Rajak H *Insolvency law theory and practice* (1993) at 110.

³¹⁷This idea is now also espoused in art 3 of the European Convention on Human Rights.

aimed at allowing the debtor a fresh start quickly, and probably with some assets of his own that have accrued as after-acquired assets that were not claimed by the trustee during bankruptcy.³¹⁸

This change in the underlying philosophy of bankruptcy law appears to be appropriate and well timed considering the substantial impact that human rights jurisprudence now has in Europe, and consequently in England, as well as an acceptance that credit granting is a reality that is here to stay and is inextricably linked to the entire debt collection regime. From a human rights stance, failing to change course in insolvency law would inevitably have resulted in much uncertainty and probably fruitless litigation stemming from bankruptcy instruments that may be considered, in modern society, excessively harsh. In respect of credit granting, it has to be accepted that societies will probably not survive without a well-regulated credit system, but when parties using that system fail in their commitments, a well-regulated and fair debt collection process that fits into a modern world must be in place to deal with the consequences of failed debtor creditor relationships.

The modern English bankruptcy system, at least in respect of its treatment of assets in individuals' insolvent estates, appears to be relatively successful. South African law reform can borrow fruitfully from the material already existing in English legislation. It is submitted that, adapted to South African circumstances, aspects of the English system may assist in eradicating many problem areas regarding assets in the estates of insolvent South African individuals.

³¹⁸If a debtor was adjudged bankrupt prior to the Insolvency Act 1986 coming into force he was granted an automatic discharge on 29 December 1989. If he was adjudged after December 1986 on a petition presented under the old law, he is entitled to an automatic discharge three years after his adjudication. In cases presented on or after 1 April 2004, automatic discharge is granted after one year from the date of the bankruptcy order (s 279(1)), and under certain circumstances the discharge may be granted before the lapsing of one year (s 279). The new provision in s 279 was introduced by the Enterprise Act 2002 with effect from 1 April 2004.

Chapter 6: United States Bankruptcy

6.1 Introduction

Bankruptcy law in the United States is unique in the world. Perhaps most startling to outsiders is that individuals and business in the United States do not seem to view bankruptcy as the absolute last resort, as an outcome to be avoided at all costs. No one wants to wind up in bankruptcy, of course, but many US debtors treat it as a means to another, healthier end, not as the End.¹

This quote partly illustrates the reason for electing to include the American bankruptcy system in a comparative study in this thesis. The American bankruptcy regime is indeed unique, being founded on policies and principles that appear to be extremely liberal if compared with the South African insolvency law system and that of most other countries. While the basic fabric of American bankruptcy is essentially the same as that of most insolvency laws the world over, that fabric is intertwined and held together with threads of a nature very different from its international counterparts. As with most bankruptcy systems, American law attempts to regulate the position of the bankrupt person in relation to his creditors and the position among those creditors *inter se*.

From this point on, however, the golden threads that hold together the fabric of the different systems differ considerably. In most systems the golden thread in insolvency law, from its commencement to its end, is that of “advantage to creditors”.² In South Africa, a policy on which insolvency law hinges is that of the advantage to the creditors as a group, with very little sympathy for the position of the debtor. The word “unfortunate” in relation to the debtor is foreign to South African insolvency law policy.³ In America, however, the golden thread in consumer bankruptcy has traditionally been the idea of a “fresh start” for the “unfortunate” debtor. Although some commentators are predicting the death of this consumer bankruptcy policy in the United States,⁴ and despite

¹Skeel DA *Debts Dominion: A history of Bankruptcy law in America* (2001) at 1 (hereafter Skeel).

²De la Rey EM *Mars The law of insolvency in South Africa* (8th ed) (1988) at 52, 108 (hereafter Mars (1988)); Smith CH *The Law of Insolvency* (3rd ed) (1988) at 26, 50 (hereafter Smith *Insolvency law*).

³Mars (1988) at 52, 108; Smith *The law of insolvency* at 26, 50; Bertelsmann E, Evans RG, Harris A, Kelly-Louw M, Loubser A, Roestoff M, Smith A, Stander L and Steyn L *Mars The law of insolvency in South Africa* (9th ed) (2008) (hereafter Mars (2008)) at 48 and further; see ss 6 and 10 and 12 of the South African Insolvency Act 24 of 1936 and, eg, *Van Rooyen v Van Rooyen* [2000] 2 All SA 485 SE.

⁴Klein G “Consumer bankruptcy in balance: The national bankruptcy commission’s recommendations tilt towards creditors” (1997) 5 *AM Bankr Inst L Rev* at 293; see Tabb CJ “The death of consumer bankruptcy in the United States?” (2001) *Bankruptcy Developments Journal* at 1.

recent creditor-driven legislative amendments, it remains a debtor-friendly system compared to other bankruptcy systems. By comparison with other systems internationally, debtors in America are treated relatively kindly, particularly in respect of the assets that they may keep out of the estate, or exempt from the reach of their creditors.

Today American bankruptcy is governed by federal legislation embodied in the Bankruptcy Reform Act of 1978 which came into effect on 1 October 1979.⁵ It is generally referred to as the “Bankruptcy Code”, found in Title 11 of the United States Code. Apart from the code, bankruptcy is also influenced by state law and a variety of non-bankruptcy legislation. The code was the first radical reassessment of bankruptcy legislation in America in almost a century. Before the code, bankruptcy was regulated primarily by the Bankruptcy Act of 1898, the first comprehensive bankruptcy legislation in America.⁶ Bankruptcy legislation in America is rooted in the United States Constitution, which empowered Congress to establish uniform bankruptcy law throughout the United States.⁷

The 1978 amendments were supposed to simplify the complex nature of the 1898 Act, but failed to do so. The code was, in fact, just a somewhat different complex statute that required several amendments to cure its flaws.⁸ However, for the purpose of the bankruptcy estate, the 1978 amendments were important because they introduced a small degree of clarity in respect of property included in the bankruptcy estate, and that which is excluded and exempt from the estate. Although the provisions in respect of exempt property in the code resulted from a compromise between various interested parties, and they were hurriedly formulated, they (and the provisions regarding estate assets) surprisingly survived the several amendments virtually unscathed. The bankruptcy estate, excluded property and exempt property are identified in the text of this chapter, so as to allow for comparison with similar

⁵Pub L No 95-598, 92 Stat 2459 as amended (1978).

⁶Woodard LE *The practitioner's guide to consumer bankruptcy* (1996) at 6 (hereafter Woodard).

⁷Art I, s VIII of the United States Constitution. A brief history of the development of bankruptcy law in America follows in para 6.2 below.

⁸The most notable problems related to the jurisdiction of the Bankruptcy Court and to the Bankruptcy Court judge. These problems were alleviated by amendments in 1984. The recession of the late 1980s early 1990s affected the values of assets, and debtors' liabilities rose dramatically, prompting further amendments to the Code in 1994 – see Woodard at 6.

provisions in South African law, and to consider the possible compatibility of American policy regarding estate property with that proposed in law reform in South Africa. The most radical changes in respect of exempt property are embodied in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,⁹ which places domiciliary and dollar limits on some categories of exempt property.

There has been a steady movement to steer bankruptcy policy in America away from the debtor-friendly approach, towards a creditor-friendly policy. In doing so, methods have been created to make the entry into the bankruptcy process burdensome for the debtor, as well as for insolvency practitioners.¹⁰ This thesis essentially concerns itself with the position of the assets of the bankruptcy estate *vis-à-vis* the debtor and the creditors at the point where bankruptcy has already formally commenced and the debtor or creditors are utilising the procedures available to them. Here too policy changes favouring creditors are slowly whittling away the traditionally debtor-friendly policies upon which American bankruptcy law rested. In this chapter various aspects relating to assets in bankrupt estates, or those excluded from them, will be considered, and in later chapters, compared with the position in South African insolvency law, bearing in mind the lessons that may be learnt from this comparison for the purpose of the proposed reform of insolvency law in South Africa.

The code applies to both juristic persons and natural persons, and it offers different methods of debt alleviation.¹¹ In the present chapter of this thesis only individual consumer bankruptcy is considered. More specifically, the position of estate property in the Code's chapter 7 and chapter 13 proceedings is assessed.

6.2 A brief history of bankruptcy law in the United States of America

6.2.1 Introduction

Early American bankruptcy procedures found their origins in the older English practices of debt slavery and imprisonment.¹² The earliest English bankruptcy Acts

⁹Discussed in para 6.4.5 below. Hereafter also referred to as BAPCPA.

¹⁰See para 6.4.5 below.

¹¹See chs 7, 11, 12 and 13 of the code.

¹²Warren E and Westbrook JL *The law of debtors and creditors: Text, cases and problems* (3rd ed) (1996) at 207 (hereafter Warren and Westbrook); White JJ and Nimmer TR *Cases and materials*

from the thirteenth century permitted creditors to levy on and sell, a debtor's possessions, while imprisonment eventually was also a remedy. All bankruptcy proceedings, from the original bankruptcy statute from the reign of the first Elizabeth, until the time of the American Revolution, were involuntary or creditor-initiated; a creditor's collection device whereby all property of the debtor was attached for equal division among creditors.¹³ Generally, it could be used only against traders.¹⁴ Concessions to the debtor developed slowly in English law. A bankruptcy law of 1705 permitted the debtor to retain a few necessary clothes. Further concessions in English law followed painfully slowly over a lengthy number of years.¹⁵ American colonies adopted the English system of debtor imprisonment and few states had insolvency laws giving a debtor release from imprisonment or discharge of his debts.¹⁶ Initially, the American system followed the English practice which distinguished between "insolvent laws" and "bankrupt laws". Insolvent laws were applicable to non-traders while bankrupt laws applied only to traders.¹⁷

6.2.2 Early insolvency law

American "insolvency" law was a separate and later development, designed for relief of debtors. Insolvency was always voluntary, allowing debtors to place all their possession in the hands of their creditors and the court, thereby being

on bankruptcy (3rd ed) (1996) at 53 (hereafter *White Cases*); Ferriell J and Janger EJ *Understanding bankruptcy* (2007) at 135 and further (hereafter Ferriell); Tabb CJ "The history of bankruptcy laws in the United States" (1995) *ABI Law Review* at 6. For further literature on the background of American bankruptcy law, see also Warren C *Bankruptcy in the United States history* (1935) (hereafter *Warren History*), which is an assimilation of all the congressional debates on bankruptcy from the late eighteenth to the early twentieth century. There was a geographical split between northeastern lawmakers who tended to favour federal bankruptcy legislation and the southern and western lawmakers who opposed it. This is emphasised by Warren who submits that American bankruptcy law evolved through creditor centered and debtor centered stages, eventually achieving a more balanced approach; Countryman V "A history of American bankruptcy law" (1976) *Com LJ* 226 at 228; Cohen J "The history of imprisonment for debt and its relation to the development of discharge in bankruptcy" (1982) *Journal of legal history* 153 at 157 and further. Tabb CJ "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 326.

¹³Skeel at 6; Tabb CJ "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 327-328.

¹⁴Warren and Westbrook at 207.

¹⁵White at 53; See ch 5 above for a more detailed discussion of the history of bankruptcy in the United Kingdom.

¹⁶Warren and Westbrook at 207; Tabb CJ "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* at 340.

¹⁷See Plank TE "The constitutional limits of bankruptcy" (1996) *Tennessee Law Review* 487 at 534.

“discharged” from the debtor’s prison, but not being released from their debts.¹⁸ This significant development occurred in the early nineteenth century when certain states enacted constitutional provisions prohibiting imprisonment for debt.¹⁹ However, combining discharge and bankruptcy elements into a unified debtor-creditor statute was a process that took time and was marred by several unsuccessful attempts. Although the United States Constitution²⁰ provides for the recognition of a unified bankruptcy Act, it took more than a century to create a bankruptcy statute that satisfied competing constituencies.²¹ There were periodic struggles between mercantile and debtor interests over the enactment of “bankruptcy” or “insolvency” laws. Certain farmers detested the idea of involuntary bankruptcy, while certain merchants wanted a discharge to be contingent on creditor agreement by specified majorities. Many believed that the “bankruptcy” and “insolvency” could not stand together, being a Bill to serve both God and Mammon.²²

6.2.3 Spirit of change

The first American Bankruptcy Act of 1800²³ largely followed its English counterpart, but the spirit of change brought together “insolvency” and “bankruptcy”, although the Act’s main purpose was to assist creditors.²⁴ Among other things, it provided for only involuntary bankruptcy, for a form of discharge of a co-operative debtor, and for exemption of the necessary wearing apparel, bed and bedding of the debtor and his spouse and children. The importance of this Act was that it was the first actual federal legislation in American bankruptcy.²⁵ This Act was meant to be a temporary measure for five years and was actually repealed after only three. This paved the way for the

¹⁸Bankrupt traders could however forfeit their assets in return for a discharge of their debts; Warren and Westbrook at 207.

¹⁹White at 54; For further literature on the background of American bankruptcy law, see Coleman PJ *Debtors and creditors in America: Insolvency, imprisonment for debt, and bankruptcy, 1607-1900* 1974 and Warren *History* as in para 6.2.1 above.

²⁰United State Constitution art I para 8 cl 4. See Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* at 344.

²¹Warren and Westbrook at 208.

²²Warren and Westbrook at 208.

²³Bankruptcy Act of 1800, ch 19, 2 Stat 19 (1800).

²⁴See Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* 325 at 327-328.

²⁵Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* 325 at 345.

American Bankruptcy Act of 1841,²⁶ the next watershed event in the American bankruptcy arena. This Act aimed to protect debtors directly.²⁷

This 1841 Act featured *voluntary* proceedings, for the first time in American law, for *both* merchants and non-merchants whose debts totalled less than US\$2 000. A more debtor-friendly approach was now adopted by ending debtor imprisonment in the absence of fraud. It also extended further exemptions to debtors, thereby permitting them furniture and other necessary items, as well as clothes, but limited to US\$300 in value, irrespective of the dividend received by creditors.²⁸ Generally, discharge was permitted unless opposed by a majority of creditors.²⁹ By its simple innovations of introducing voluntary bankruptcy for all people, this Act achieved a fundamental transformation in the underlying policies of American bankruptcy law.³⁰ But its radical nature made it unpopular among creditors and it was repealed within a year. Its effect on policy, however, endured.³¹

In 1867 America's third Bankruptcy Act³² provided for both voluntary and involuntary proceedings for merchants, non-merchants and corporate debtors. It was a compromise between debtor and creditor interests.³³ This Act granted further exemptions in respect of the debtor's personal property. However, it also allowed the debtor to keep certain property exempted by federal non-bankruptcy law and by the law of the state in which he was domiciled in 1864.³⁴ Discharge could be denied a debtor who acted illegally or dishonestly. Consent of the majority of creditors was still a requirement for a discharge. Creditor opposition and administrative problems led to the repeal of this legislation.³⁵

²⁶Bankruptcy Act of 1841, ch 9 5 Stat 440 (1841).

²⁷Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 325 at 349.

²⁸Countryman V "Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century" (1983) *Catholic University Law Revue* 809 at 815.

²⁹White JJ at 54.

³⁰Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 350.

³¹Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 350-351, 353.

³²Bankruptcy Act of 1867, ch 176, 14 Stat 517 (1867).

³³Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 355.

³⁴Countryman V "Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century" (1983) *Catholic University Law Revue* 809 at 815; Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 355.

³⁵White JJ at 54

The Bankruptcy Act of 1898 followed and with various amendments remained in effect until 1978. Property of the estate under the Bankruptcy Act of 1898 was construed by the courts as only the assets owned by the debtor at the time of the filing of the bankruptcy petition, at which time it vested in the trustee.³⁶ “Property”, as envisaged in section 70 of the Bankruptcy Act was to enjoy a broad interpretation. But the courts excluded any property that was not transferable under relevant non-bankruptcy law,³⁷ property exempted under state law,³⁸ certain causes of action and some property encumbered by liens.³⁹ The 1898 legislation provided for exemptions to be based on state law, and creditor consent or a minimum dividend was no longer a requirement for discharge.⁴⁰ The debtor was therefore entitled to any exemptions provided by federal non-bankruptcy law and by the laws of the state of domicile at the time of the filing of the petition.⁴¹ This was all aimed at providing the debtor with sufficient assets to survive in the future and the courts often assisted in this endeavour by excluding assets from the bankruptcy estate to ensure that no obstacles would be in the way of the debtor’s fresh start.⁴² This 1898 Act was amended a number of times, and as a result of the Great Depression, was extensively revised by the Chandler Act of 1938, which added chapters on corporate reorganisation,⁴³

³⁶Dickerson AM “From jeans to genes: The evolving nature of property of the estate”(1999) *Bankr Dev J* 285 at 292.

³⁷See *Countryman V* “The use of state law in bankruptcy cases (Part I)”(1972) *NYU L Rev* 407 at 432.

³⁸See *Lockwood v Exchange Bank* 190 US 294 (1903) and *In re Lamb* 272 F Supp 393 (ED La 1967).

³⁹Dickerson “From jeans to genes: The evolving nature of property of the estate”(1999) *Bankr Dev J* 285 at 292.

⁴⁰*Countryman V* “Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century” (1983) *Catholic University Law Revue* 809 at 817; Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* 32 at 364.

⁴¹*Countryman Modest Proposal at Countryman V* “Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century” (1983) *Catholic University Law Revue* 809 at 817. The 1898 Act’s incorporation of state exemption laws resulted in much dissatisfaction because the exemption policy, as an element of the fresh start principle, differed from state to state, as did the many different exemption laws. Thus, when the bankruptcy laws were to be revised in the 1970s, it was suggested that a new bankruptcy Code itself should include a uniform list of exemptions for bankruptcy cases. But the version eventually accepted in the new Code gave the debtor a choice between exemptions specified in the Code, on the one hand, or, on the other, those in other federal law and in the law of the state of the debtor’s domicile. But it contained the qualification that the respective state legislatures could “opt out” of the choice by excluding debtor’s domiciled in the respective states from electing to use the bankruptcy list of exemptions specified in the Code – see *Countryman V* “Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century” (1983) *Catholic University Law Revue* 809 at 818.

⁴²Dickerson “From jeans to genes: The evolving nature of property of the estate”(1999) *Bankr Dev J* 285 at 292-293.

⁴³Ch X.

arrangements,⁴⁴ real property arrangements⁴⁵ and wage earners' plans.⁴⁶ But an important consequence of the 1898 Act was to deny the creditors the control over the debtor's access to a discharge. The only remaining check on discharges were the statutory limitations, and this contributed greatly to the "modern" American pro-debtor discharge policy.⁴⁷

In the 1970s Congress appointed a Federal Commission on Bankruptcy Laws of the United States which presented a proposed draft of a new bankruptcy Act to Congress in 1973.⁴⁸ The Senate and the House of Representatives worked with the draft for a number of years⁴⁹ and an amalgam of the commission's proposals and the versions of the House and the Senate led to the enactment of the Bankruptcy Reform Act of 1978.⁵⁰ Until 1978 the federal bankruptcy law was referred to as the Bankruptcy Act, or the 1898 Act, but the current bankruptcy law, originally formulated in 1978, is referred to as the "Bankruptcy Code". This new code was soon attacked by various creditor groups who condemned its provisions. So, for example, the consumer credit industry urged the adoption of stricter consumer bankruptcy provisions, while grain farmers, shopping centre landlords and others also complained.⁵¹

What must be mentioned for the purpose of this thesis, is that the code was the first complete revision of the bankruptcy law since 1898. It substantially expanded, among other things, the rights of the consumer debtor, making chapter 13 thereof a more desirable option for debtors, and expanding the number and variety of assets exempt from the creditors' reach. The incorporation of state exemption laws into the federal bankruptcy case had always been criticised,⁵² so it was eventually amended by

⁴⁴Ch XI.

⁴⁵Ch XII.

⁴⁶Ch XIII; See Warren and Westbrook at 210-211; White at 54.

⁴⁷Tabb "The historical evolution of the bankruptcy discharge" (1991) *Am Bankr LJ* 325 at 364.

⁴⁸Report of the Commission on the Bankruptcy Laws of the United States, HR Doc No 93-137, parts I and II 93d Cong 1st Sess (1973).

⁴⁹See H Rep NO 595, 95th Cong, 1st Sess, reprinted in 1978 US Code Cong & Ad News 5963: S Rep No 598, 95th Cong, 2nd Sess, reprinted in 1978 US Code Cong & Ad News 5787.

⁵⁰Hereafter referred to as the Code. Warren and Westbrook at 210-211; White at 54-55; Ferriell at 138; Moss DA and Johnson GA "The rise of consumer bankruptcy: Evolution, revolution or both?"(1999) *Am Bankr LJ* at 311.

⁵¹Warren and Westbrook at 211.

⁵²See, eg, Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 405 note 28 and Vukowich WT "The bankruptcy commission's

including federal exemptions in the new code, but giving the debtor the option to elect either the federal exemptions or the relevant state exemptions, but also permitting the respective states to exclude this choice of exemptions by legislation that provides exclusively for state exemptions, meaning that federal exemptions are then unavailable to that state's residents.⁵³ The result is section 522(b)(2) of the code allowing the debtor to choose between federal or state exemptions, unless state law does not authorise this (the opt-out clause). This arrangement remained intact in the 2005 amendments to the code,⁵⁴ despite criticism and calls for uniformity of state exemptions in bankruptcy.⁵⁵ But the legislation in respect of exemptions in the Code was hastily drafted, leading to interpretational problems as to what is meant by the provision that exempt property is "any property that is exempt under ... State or local law that is applicable on the date of the filing of the petition".⁵⁶ However, an analysis of this interpretational problem is beyond the scope of this thesis.⁵⁷

In the corporate field, the code melted down chapters X, XI and XII of the Bankruptcy Act into a chapter 11 proceeding. It also altered the avoidance provisions and, most significantly, it extended the power of the trustee in bankruptcy to use and inhibit the creditors' control of property that was subject to a preferred security interest. White and Nimmer submit that history may tell that the code subtly, but significantly, shifted power from secured creditors to others in bankruptcy proceedings.⁵⁸

After the enactment of the code there was a sharp increase in the number of business and bankruptcy filings. From 1977 to 1981 the total number of bankruptcies increased

proposals regarding bankrupt's exemption rights" (1975) *Cal L Rev* 1439 at 1441- 1446.

⁵³Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions" (2006) *Emory Bankruptcy Developments Journal* at 406.

⁵⁴See para 6.4.5 below.

⁵⁵Brown WH "Political and ethical considerations of exemption limitations: The 'opt-out' as child of the first and parent of the second" (1997) *Am Bankr LJ* at 149; Engledow WM "Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* 275 at 276-78; Ponoroff L "Exemption limitations: A tale of two solutions" (1997) *Am Bankr LJ* at 221. It should be noted that there are actually two classes of exemptions, being those under s 522 and then exemptions under certain non-bankruptcy federal laws, eg, such as certain social security payments to the elderly. For present purposes only those under s 522 will be considered.

⁵⁶S 522(b)(3)(A) and see Bartell "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 407.

⁵⁷For a comprehensive discussion hereof see Bartell as referred to in this paragraph.

⁵⁸White at 55.

from 214 000 to more than 500 000. By June 1991 the rate of filings, of which the vast majority (approximately 75%) were chapter 7 filings,⁵⁹ had risen to more than 800 000. Fewer than 2 000 of these were involuntary bankruptcies (ie initiated by creditors against debtors). The rate of chapter 11 cases doubled from 1977 to 1981 and doubled again in 1982 to over 16 000. By 1994 the total number of cases annually had grown to 832 829. Of those, 567 240 were chapter 7 cases, 249 877 were chapter 13 and 14 773 were chapter 11.⁶⁰ Whether the increase in filing has resulted from the generosity of the code, to the change in society's notions about the morality of avoiding one's debt or to the wider availability of lawyers is uncertain and much disputed.⁶¹

Be that as it may, several amendments to the code inevitably followed, the most substantial being the Bankruptcy Abuse Prevention Consumer Protection Act of 2005.⁶² It must be taken into account that American bankruptcy law originates not only from the code, but also from analogous sections of the Act of 1898, federal and state consumer legislation and the Bankruptcy Rules.⁶³ American bankruptcy law is further derived from state common law and statutory law. For example, the law pertaining to garnishments, attachments and executions tends to be state common law. In a similar vein, certain traditional creditors' rights are found primarily in state case law and in state statutory law.⁶⁴

6.3 Policies of American bankruptcy law

6.3.1 General

The primary concern of all insolvency law systems relates to the conflicting positions that debtors and creditors find themselves in when the economic activity that they have entered into with each other has not resulted in its intended consequences, when the financially overburdened debtor is unable to service his debts.⁶⁵ Then the purpose of insolvency legislation should essentially be to

⁵⁹A brief explanation of the Code and its Chapters is given in para 6.4.2 below and further.

⁶⁰White at 56.

⁶¹White at 56.

⁶²Hereafter BAPCPA, discussed in para 6.4.5 below.

⁶³White at 57.

⁶⁴White at 57.

⁶⁵Jackson TH *The logic and limits of bankruptcy law* (1986) at 1 (hereafter Jackson).

balance and satisfy the needs of all the stakeholders, who include the insolvent debtor, the creditors, insolvency practitioners, the government and the commercial community in general.⁶⁶ In respect of American law Jackson states:⁶⁷

It is likewise fashionable to see bankruptcy law as embodying substantive goals of its own that need to be “balanced” with (among others) labor law, with environmental law, or with the rights of secured creditors or other property claimants.

But in the United States the purpose, or underlying theory of insolvency law was traditionally twofold, namely the equal treatment of creditors and the rehabilitation of the debtor, allowing for a “fresh start”.⁶⁸ In recent years, however, varying economic and social theories have been formulated to serve as the basis or purpose of an insolvency law system in the United States.⁶⁹ These theories will not be considered in detail, but will be referred to if relevant in this brief analysis of American bankruptcy policy, which policy, it would appear, is completely and inextricably linked to the bankruptcy estate and the assets relating to that estate. This policy underlies the substantive law governing, among other issues, estate assets.⁷⁰ American bankruptcy policy largely stems from the ideals of bankruptcy law expressed by Congress’s legislative history and court opinion. Academic debate is often divided in assessing what bankruptcy policy is or ought to be.⁷¹ However, the most glaring dichotomy in the policy debate is probably between those who believe the purpose of bankruptcy procedure is to maximise creditor returns with the least interference with creditor rights under non-bankruptcy law,⁷² and those who believe a wider social policy is to be served by bankruptcy law.⁷³ Generally, it would appear that bankruptcy policy espoused by Congress and the courts has been more “traditionalist” in nature.⁷⁴ Thus American bankruptcy policy

⁶⁶South African Law Commission *Review of the law of insolvency* Project 63 (2000) Report, Vol 1 Explanatory Memorandum, and vol 2 Draft Bill at 10. See also Jackson at 1.

⁶⁷Jackson at 1. See also, generally, Ferriell J at 7 and further.

⁶⁸Jackson TH and Scott RE “On the nature of bankruptcy: An essay on bankruptcy sharing and the creditors’ bargain” (1989) *Virginia Law Review* at 155; Blum BA *Bankruptcy and debtor/creditor – examples and explanations* (3rd ed) (2004) at para 5.1 (hereafter Blum).

⁶⁹Jackson TH and Scott RE “On the nature of bankruptcy: An essay on bankruptcy sharing and the creditors’ bargain” (1989) *Virginia Law Review* 155 at 155; see also Ferriell at 1.

⁷⁰Blum at 5.5.1.

⁷¹Blum at 5.5.1.

⁷²The “law and economics” movement.

⁷³The “traditionalists”; Blum at 5.5.1.

⁷⁴Blum at 5.5.1.

concerns itself both with a system that efficiently protects creditor's rights under non-bankruptcy law, and with a striving for social goals that account for vulnerable debtors, workers and the community in general.⁷⁵

The result is a complex interaction of the policies.⁷⁶ A particularly apt example of this has been the introduction of exempt property in the code in 1978, a tug of war that had to be reconciled and prioritised.⁷⁷ To complicate matters further, Congress is routinely lobbied by varying interest groups that may influence legislation, or amending legislation, from faithfully achieving the intended policy goals.⁷⁸ The perceived policy of bankruptcy law, probably in any system, would therefore rather reflect its ideals and possibly not the realities of bankruptcy law.⁷⁹ A further important consideration is the fact that bankruptcy law does not exist in a vacuum. It rubs shoulders and clashes with many other legal and socio-political disciplines and problems, thereby being influenced by public policy issues and legal policies of a much broader nature. So, for example, policies upon which common law rules or other statutes have been founded may have to be weighed up against and reconciled with bankruptcy law.⁸⁰

The discussion of policy issues that follows will attempt to restrict itself to themes relating to the bankrupt estate and the entitlement regarding assets that comprise that estate. These, of course, are not entirely self-contained, so they overlap with one another and with other bankruptcy policy themes. The more difficult debate in this respect will concern the question whether American bankruptcy law is succeeding in achieving the policies envisaged by all the role players in the bankruptcy arena, and more specifically, by the code.

⁷⁵Blum at 5.5.1.

⁷⁶Blum at 5.5.1.

⁷⁷Brown WH "Political and ethical considerations of exemption limitations: The 'opt-out' as child of the first and parent of the second" (1997) *Am Bankr LJ* at 149; Engledow WM "Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* 275 at 276-78; Ponoroff L "Exemption limitations: A tale of two solutions" (1997) *Am Bankr LJ* at 221.

⁷⁸Blum at 5.5.1.

⁷⁹Blum at 5.5.1.

⁸⁰Blum at 5.5.1.

6.3.2 Bankruptcy as a remedial mechanism

As in most bankruptcy law systems, bankruptcy in America is a remedial mechanism.⁸¹ As Blum⁸² puts it, bankruptcy relief is often sought at the point when the debtor's financial affairs are near collapse and therefore the aims of bankruptcy are essentially modest. It is not a vehicle that will give parties their full recourse under non-bankruptcy law. The aim is rather to manage economic strain and to preserve whatever may be available for the parties involved.⁸³ Gross⁸⁴ states that the policies underlying American bankruptcy law can be understood by a much wider audience than only the legal fraternity, and should interest a wide spectrum of people, including educators, economists, historians, business people, sociologists and philosophers, to mention only a few.

6.3.3 Protecting debtor and creditor interests

In previous discussions of the early development of this field of law it was shown that bankruptcy was initially a remedy only for the benefit of creditors *vis-à-vis* their debtors, where the parties were traders. All property of the debtor could be taken by the creditors to satisfy their debts, while imprisonment of the debtor pending payment of outstanding debts was also an option at various points in history.⁸⁵ Protection of the interests of the honest debtor is a relatively modern concept in bankruptcy law history.⁸⁶

Today, however, the policy that bankruptcy must serve to protect both debtors and creditors is well accepted.⁸⁷ It assists creditors in the collection and distribution of the debtor's assets in a controlled and regulated environment, but simultaneously allowing the debtor a form of respite from relentless creditors and the opportunity of starting over.⁸⁸ But this policy is an ideal. A perfect balance of diverse interests is an ideal which in reality will differ from one situation to another. Therefore, the more

⁸¹Blum at 5.5.2; Ferriell at 3.

⁸²Blum at 5.5.2.

⁸³Blum at 5.5.2.

⁸⁴Gross *K Failure and forgiveness: Rebalancing the bankruptcy system* (1997) at 4 (hereafter *Gross Failure*).

⁸⁵See para 6.2 above.

⁸⁶See para 6.2 above.

⁸⁷See para 6.2.3 above. See also Ferriell at 3 and further.

⁸⁸Blum at 5.5.1.

flexible these bankruptcy rules are, the more likely they will be to suit the varying interests of the different players. A perfect balance, however, seems unlikely.⁸⁹

The code adequately reflects this dual purpose of bankruptcy law in providing, for example, for voluntary and involuntary petitions,⁹⁰ the regulation of estate property in the interest of both debtors and creditors by the inclusion, the exclusion and the exemption of estate property, to mention but a few. But reality has also shown that the extent to which the interests of the various interested parties will be protected may be swayed by a variety of societal and economic interests and role-players. This has been witnessed by the many amendments of bankruptcy legislation over the years.⁹¹ But even after the creditor-friendly amendments in BAPCPA, this policy of protecting both debtors and creditors, it seems, essentially remained intact.

6.3.4 Equal treatment of creditors

Bankruptcy law in the United States regulates the mandatory collective debt collection procedure that the creditors as a group depend on. It is based on the policy of equal treatment of creditors in the repayment of the maximum amount possible.⁹² Filing of a petition puts an end to individual actions against the debtor, thereby avoiding the unequal distribution of the debtor's assets.⁹³

However, most bankruptcy estates produce very little or no assets for the benefit of the creditors, and Herbert questions the efficacy of insolvency law as a debt collection mechanism. Mainly secured creditors benefit by depending on their security, and to do so they do not need the support of the judiciary.⁹⁴ Gross points out that one of the problems with the collectivisation model, which some say espouses maximum creditor recovery, is that it explains bankruptcy only from a creditor point of view. Bankruptcy, she says, is much more than maximising creditors' recovery only in dollars and cents, as it also concerns the debtor's rehabilitation, which may not benefit creditors' short-

⁸⁹Blum at 5.5.1.

⁹⁰Blum at 5.5.1.

⁹¹Blum at 5.5.1.

⁹²Gross *Failure* at 142.

⁹³Gross *Failure* at 137.

⁹⁴Herbert MJ *Understanding bankruptcy* (1995) at 6 (hereafter Herbert).

term recovery.⁹⁵ Although Gross finds the equal treatment of creditors model flawed, she considers it a good starting point. But she feels that notions of equality of *outcome* need to be introduced.⁹⁶

But at this point one is reminded that bankruptcy policy overlaps, and while Herbert's and Gross's observations are valid, it is also true, as mentioned, that the bankruptcy is a remedial tool with modest aims.⁹⁷ So, although creditors as a group are treated in accordance with their respective ranking, this differentiation is based on existing legal rights of respective creditors.

6.3.5 Preserving the estate

The idea that bankruptcy must preserve what is left of the debtor's estate by preventing the debtor from further diminishing it is linked to all the other policies of bankruptcy law. Bankruptcy is meant to be advantageous to creditors not only because it protects their interests *inter se*, but also because it provides otherwise unavailable tools for the preservation and possible enhancement of the estate.⁹⁸

But preservation of the estate also assists the debtor. In both chapter 7 liquidation cases and chapter 13 rehabilitation, preservation of the estate possibly increases, or at least provides a pool of excluded assets, exempt assets and assets that the debtor may keep under a reorganisation.⁹⁹ These assets are then the foundation upon which the fresh start policy in American bankruptcy is based.¹⁰⁰

6.3.6 Fresh Start

One of the fundamental principles upon which American bankruptcy law rests is the policy of providing the honest debtor with an opportunity to shed his debts and

⁹⁵Gross *Failure* at 138.

⁹⁶Gross *Failure* at 144.

⁹⁷See para 6.3.2 above.

⁹⁸Blum at 5.5.1.

⁹⁹Blum at 5.5.1.

¹⁰⁰Blum at 5.5.1 – preservation of the estate also serves a social purpose where the estate of a business is preserved and that business is rescued, thereby helping employees, customers and the general community. Also in respect of individuals, by allowing the debtor to keep some assets the state is released of social responsibilities towards the debtor and his dependants.

thereby giving him a fresh start.¹⁰¹ Inextricably linked to the fresh start principle are the policies to preserve the estate, and to exclude and exempt part of the debtor's property from the bankruptcy estate so as to assist him in achieving the fresh start.¹⁰² In the often cited case of *Local Loan Co v Hunt*¹⁰³ the court stated that

One of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes".

Various commentators have different ideas regarding the rationale behind the fresh start policy. For example, Jackson approaches it as a form of limited liability of individuals, with the creditors being in a dominant position when transacting with debtors, thus placing the risk of non-payment upon the creditors.¹⁰⁴ This encourages better monitoring of credit granting by creditors.¹⁰⁵ He says the discharge system thus contains a built-in checking system.¹⁰⁶ But Jackson states that a discharge should always be available at some cost so as to avoid its abuse in a credit-orientated society. Obtaining a discharge should entail some sacrifice on the debtor's part, such as the forfeiture of assets in favour of creditors, and possible negative consequences regarding credit worthiness in the future.¹⁰⁷ Gross, however, is of the opinion that the fresh start principle is based on the idea of society's willingness, by way of bankruptcy procedure, to forgive non-paying debtors and thereby allowing for their rehabilitation.¹⁰⁸ But Gross's reasoning is questionable. Perhaps she is losing sight of the fact that society has no other choice than to use bankruptcy as the only possible workable debt collection procedure, bar taking the law into one's own hands, a practice that is perhaps not so uncommon. It is doubtful whether forgiveness is on the mind of the creditor or society in respect of debt collection. If the rationale were forgiveness, then why go through the laborious bankruptcy procedure at all? Is one forgiving if one continues to question or curtail the debtor's credit-worthiness in the future? The rationale behind the fresh start policy is linked, it appears, rather to the policy to

¹⁰¹Waxman NW *Gilbert law summaries – bankruptcy* (4th ed) (2001) at 1; Woodard at 184; Gross *Failure* at 91.

¹⁰²See the discussion hereof in para 6.3.5 below.

¹⁰³292 US 234, 244 (1934).

¹⁰⁴Jackson at 229.

¹⁰⁵Jackson at 231.

¹⁰⁶Jackson at 231.

¹⁰⁷Jackson at 249.

¹⁰⁸Gross *Failure* at 93.

consider bankruptcy as remedial, the aim being to manage the debtor's financial distress in the interest of all the role-players. This, of course, is aside from the idea that the debtor who has a fresh start is less of a burden on society.

Of course the fresh start policy may also have unfortunate consequences, such as creditors increasing the cost of lending to cover the risk of bankruptcy consequences, while creditors actually carry the burden of the fresh start policy when the exempt assets in fact diminish the debtor's estate.¹⁰⁹ But, it would appear, the fresh start policy, with its advantages and disadvantages, is saved by the over-riding policy in bankruptcy law to find a suitable balance that protects or satisfies the interests of not only debtors and creditors, but also society in general and the government.

6.4 United States bankruptcy law today

6.4.1 General

As a result of the developments described above, United States bankruptcy laws today, in fact, address two different kinds of bankruptcy, namely individual debtor bankruptcy (also referred to as consumer bankruptcy) and the financial distress of corporations.¹¹⁰ Although these two fields overlap to some extent, they do raise different policy issues. This thesis concentrates primarily on the insolvency of individuals and, more specifically, on the effect that bankruptcy has on the assets of the bankrupt individual in America, but if relevant, issues relating to corporate bankruptcies will also be referred to. The central concept in personal bankruptcy in the American framework is the discharge.¹¹¹ When a debtor receives a discharge, his existing obligations end and creditors can no longer look to the debtor to collect the discharged obligation.¹¹²

Before proceeding to discuss the issues governing the assets of the bankrupt estate when the bankruptcy of an individual debtor ensues, it may at this point be

¹⁰⁹Blum at 5.5.1.

¹¹⁰See generally, Gross K *Failure*; Warren and Westbrook; White; Whitford WC "The ideal of individualized justice: Consumer bankruptcy as consumer protection and consumer protection in consumer bankruptcy" (1994) *Am Bankr LJ* at 397.

¹¹¹Skeel at 6; Whaley DJ and Morris JW *Problems and materials on debtor and creditor law* (1998) at 4.

¹¹²Skeel at 6.

appropriate to give a brief overview of the structure of the Bankruptcy Code, in order to place the position of consumer bankruptcy in perspective.

6.4.2 A brief explanation of the structure of the Bankruptcy Code

The Code,¹¹³ in Title 11 of the United States Code, is divided into chapters, designated as such in Arabic numerals (for example chapter 11) to distinguish it from the 1898 Act which used Roman numerals (for example chapter XI). The Code is numbered in uneven numbers, for example, chapters 1, 3, 5, 7 and so on. The even numerals have been reserved for additions to the code, with chapter 12, included in 1986 for family farmers, currently taking up the only even number.¹¹⁴

The sections in the first three chapters of the Code are of general application to the chapters that follow. Chapter 1, for example, is devoted to definitions, rules of construction, general powers of the bankruptcy court and the qualification of debtors who are eligible for each of the types of proceedings available. Chapter 3 governs the most important administrative and procedural sections in the Code. Sub-chapter I of chapter 3 governs the commencement of a case, describing how a voluntary and involuntary procedure commences. “Officers” are dealt with in sub-chapter II, which provides, among other things, who may serve as trustees. Sub-chapter III deals with a variety of procedural rules. Sub-chapter IV is one of the more significant provisions of the Code, containing provisions on adequate protection, the automatic stay, executory contracts and unexpired leases.

Chapter 5, entitled “Creditors, the Debtor, and the Estate” contains provisions relating to creditors, their claims and administrative expenses. Section 522, dealing with property excluded from the estate, establishes a set of federal exemptions which a debtor may choose in lieu of any state exemptions available. This is a radical departure from the American tradition and from the Bankruptcy Act of 1898, because prior to the code a debtor was limited to state exemptions, no federal set

¹¹³Bankruptcy Reform Act of 1978.

¹¹⁴See, generally, Scott MD and King LP 2002 *Collier pamphlet edition: Part 1 Bankruptcy code* (2001); King LP 2002 *Collier portable pamphlet: Full text of the bankruptcy code and rules* (2001); Warren and Westbrook at 215; White at 58; Gross *Failure* at 25.

of exemptions existed. These federal exemptions are considerably more generous than the exemptions accorded a debtor under the laws of many states.¹¹⁵ Discharge is dealt with in sections 523 and 524, and includes issues in respect of the reaffirmation of a particular debt and whether it can or should be excepted from the discharge. Section 541 defines the property of the estate and the trustee's avoiding powers are also provided for in chapter 5.

Chapter 7 is entitled "Liquidation" and is the first chapter providing for a specific form of bankruptcy, previously known as a "straight" bankruptcy. In a nutshell, the trustee simply collects the debtor's assets, sells them and distributes the proceeds to the creditors.¹¹⁶ Chapter 7 can be distinguished from a chapter 11 plan of reorganisation which may keep a business in operation, and from a chapter 13 wage earners' plan whereby an individual can propose certain periodic payments. Most bankruptcy proceedings in the United States are commenced under chapter 7, and many of the chapter 11 and 13 proceedings end up as chapter 7 proceedings.¹¹⁷ Section 727, read together with sections 523 and 524, sets out the rules denying a debtor any right to a discharge under certain circumstances.

Chapter 9 makes special provision for the bankruptcy of a municipality and other governmental unit.

Chapter 11 is central to reorganisation in business bankruptcies, making provision for "a plan" for failing businesses which attempt to remain in operation and work out their difficulties.

Chapter 12 was enacted by Congress in 1986 and is a specialised version of chapter 13, modelled exclusively for farmers. Chapter 12 developed because most farmers had too large a debt to be eligible for chapter 13 relief, while they were

¹¹⁵Scott MD and King LP 2002 *Collier Pamphlet edition: Part 1 Bankruptcy code* (2001) at 434-462; King LP 2002 *Collier portable pamphlet: Full text of the bankruptcy code and rules* section 112 to section 121; Warren and Westbrook at 215; White at 58. Exemptions in other non-bankruptcy federal laws also exist, such as social security payments to the ill or elderly, but these will not be considered any further at this point.

¹¹⁶White at 59. *Gross Failure* at 25.

¹¹⁷White at 59. See, generally, *Gross Failure* at 25 and further.

often adversely affected by chapter 11 proceedings.¹¹⁸ Chapter 12 enables the farmer to keep his farm after reorganisation under circumstances where he probably could not keep it under a chapter 11 proceeding.

Chapter 13 is a new development in the Code which provides for the adjustment of debts of an individual with regular income. It is used by most consumers wishing to keep their non-exempt property and try to pay back some part of their debts over time.¹¹⁹

Chapter 15 deals with ancillary and other cross-border cases. It was inserted by BAPCPA.

The jurisdictional and procedural provisions governing bankruptcy are dealt with in Title 28 of the United States Code, while Title 18 thereof defines and establishes criminal sanctions and offences in bankruptcy.

6.4.3 *The paths of personal bankruptcy*

It has already been noted above that the central concept in personal bankruptcy in the American framework is the discharge. From the above exposition of the structure of the code it can be seen that debtors may follow one of two paths to obtain a discharge. The first path is the straight liquidation envisaged in chapter 7 of the code. In summary, the debtor's assets are handed over to a bankruptcy court, the assets are then sold by the trustee and the proceeds distributed first, amongst the debtor's secured creditors, and if assets remain, pro rata among the unsecured creditors. In practice, these individual debtors filing for bankruptcy under chapter 7, in fact, have no non-exempt assets, leaving no need to conduct a sale and the debtor receives a discharge very quickly.¹²⁰

The second path that the debtor may follow is the proposal of a rehabilitation plan under chapter 13. Here the debtor retains his assets and proposes the repayment

¹¹⁸White at 60.

¹¹⁹Warren and Westbrook at 216. For a comprehensive discussion of the impact of BAPCPA on chapter 13 cases, see Hildebrand III HE "Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on chapter 13 Trustees" (2005) *The Am Bankr LJ* at 373.

¹²⁰Skeel at 5-6. Gross *Failure* at 25 and further.

of a portion of his debts over a period of three to five years. This is an attractive option for a debtor who has property that he wishes to retain.¹²¹

The core of personal bankruptcy in the United States therefore lies in three concepts, namely, the straight liquidation, the rehabilitation plan, and the discharge offered under both, and the third, an important concept, exemptions. Exempt property is not available to creditors. Exemptions are intended to protect enough of the debtor's assets to allow him to recover from his financial quagmire and to achieve a "fresh start". Exemptions have been, and still are, the cause of contention between state and federal legislators.¹²² As mentioned above,¹²³ Congress simply incorporated exemptions into bankruptcy under the old Bankruptcy Act, thereby allowing different states to provide for their own, different exemptions. The Code currently allows a debtor to choose between his state exemptions and a set of federal exemptions, unless the debtor's state requires all debtors to use the state alternative.¹²⁴ Exempt property will be discussed in more detail below.¹²⁵

Under the Code either a debtor or his creditors may invoke the bankruptcy laws, but BAPCPA has introduced certain limitations or obstacles to the pathways into bankruptcy.¹²⁶ In the past most debtors filed for bankruptcy voluntarily as creditors had little incentive to file for an involuntary proceeding due to the fact that the law was rather generous to debtors. Creditors therefore rather tried to collect their debts outside of bankruptcy.¹²⁷ BAPCPA has attempted to alter this situation.

6.4.4 A brief description of the pathway through a chapter 7 or a chapter 13 proceeding

What follows here is a brief description of the different procedures under the Code to attain bankruptcy of an individual debtor, and where relevant, the amendments

¹²¹See the discussion in para 6.4.5. below regarding the amendments to the Code by BAPCPA.

¹²²Skeel at 6.

¹²³See para 6.2.3 above.

¹²⁴The majority of states appear to have opted out. Countryman V "Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century" (1983) *Catholic University Law Review* 809 at 819; Skeel at 7.

¹²⁵See para 6.6 below.

¹²⁶See para 6.4.5 below.

¹²⁷Skeel at 7.

introduced by BAPCPA will be mentioned. Both consumer and business bankruptcy may proceed by what is known as liquidations and payout plans.

Chapter 7, entitled “Liquidation”, contemplates an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor’s estate, reduces them to cash, and makes distributions to creditors, subject to the debtor’s right to retain certain exempt property and the rights of secured creditors. The advantage here for the debtor is that he receives a discharge, leaving him free of all pre-existing debts. Thus, liquidation “achieves the two classic objectives of bankruptcy: fair distribution of the debtor’s assets for the benefit of all creditors and a ‘fresh start’ for the debtor”.¹²⁸

Amendments to the Bankruptcy Code enacted into the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 require the application of a “means test” to determine whether individual consumer debtors qualify for relief under chapter 7. If such a debtor’s income is in excess of certain thresholds, the debtor may not be eligible for chapter 7 relief. BAPCPA has also created further restrictions on the use of the chapter 7 procedure by adding to the duties of the trustee and the debtor, and the dismissal of cases that prove to be an abuse of the provisions of chapter 7.¹²⁹

The alternative to chapter 7 is the payout plan for consumers under chapter 13 and for business (and some consumers with very large debt) under chapter 11. Here the debtor can propose to keep his assets in return for payments of his debt over a period of time in the future. The advantage here is that the debtor need not liquidate his assets, often at reduced prices, and it may grant creditors higher returns. Particularly in consumer bankruptcy, where most cases tend to be “no asset” cases, this procedure may be advantageous to creditors.¹³⁰ However, as in the chapter 7 cases, BAPCPA has imposed certain burdensome requirements on debtors and practitioners before relief will be forthcoming.¹³¹

¹²⁸ Warren and Westbrook at 219.

¹²⁹See, eg, ss 704(10)-(12) and 707(b)(2)(A), and the discussion of BAPCPA in para 6.4.5 below.

¹³⁰ Warren and Westbrook at 219.

¹³¹See Hildebrand III HE “Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on chapter 13 Trustees” (2005) *The American Bankruptcy Law Journal* at 373 for a full

Proceedings by way of chapter 7 or chapter 13 commence by filing a petition and paying a filing fee.¹³² While foreclosure actions by a creditor could be the motivation behind a chapter 13 proceeding, creditor action is less likely to be the direct reason for the institution of a chapter 7 proceeding. The petition is usually filed by the debtor, and it is rare for a creditor to file an involuntary petition against a debtor.¹³³ The filing of the petition constitutes the commencement of the case and an automatic stay¹³⁴ is imposed and, most significantly, it creates the “bankruptcy estate”¹³⁵. After the filing there will be a first meeting of creditors which will probably be attended by the debtor, his lawyer and the court-appointed trustee. Creditors rarely attend this meeting, knowing that the typical consumer will have no unsecured or non-exempt assets. The trustee may, after the meeting of creditors, attempt to recover assets that have been conveyed to others for the benefit of the creditors.¹³⁶ In ordinary consumer cases this is, however, rare. It is also rare for an individual creditor to challenge the discharge of the debtor, or to claim that a particular debt be excepted from the discharge, or that particular property should not qualify as exempt property. The case is concluded by a discharge months after the filing of the petition and the debtor can continue with life, free of most debts.¹³⁷

In a chapter 13 consumer case the debtor must file a petition and propose a plan for the payment of his creditors. The premise here is that the debtor has a regular income and more assets than the chapter 7 debtor, thereby attracting the attention of the creditors. Here the need for negotiation and for the proposal of a plan may require more effort from the trustee, and the creditors too may be more involved.¹³⁸

discussion of the impact of BAPCPA on ch 13 cases.

¹³²A proceeding may be voluntary (BC s 301) when a debtor files a petition under ch 7, 11,12 or 13, while an involuntary petition (BC s 303(a)) may be filed only under ch 7 or 11 against a person who qualifies as a debtor under the applicable chapter.

¹³³ Whaley at 49.

¹³⁴BC s 362.

¹³⁵BC s 541.

¹³⁶BC s 544 or 547.

¹³⁷See Scott MD and King LP 2002 *Collier pamphlet edition: Part 1 Bankruptcy code* (2001) at 105 and further; Whaley at 49 and further; Warren and Westbrook at 219 and further; and White at 69.

¹³⁸White at 70.

6.4.5 **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005**

This Act brought about fundamental changes to the bankruptcy law affecting consumers. It was signed by the then President, George Bush on 20 April 2005, but it generally applies to cases filed on or after 17 October 2005, because most of the BAPCPA amendments take effect only in respect of cases filed 180 days after enactment.¹³⁹ With respect to consumer debtors, Congress apparently intended with this legislation to force debtors to make substantial lifestyle changes in cases where their income exceeded state median income before they could receive the benefits of bankruptcy.¹⁴⁰ BAPCPA's consumer provisions restrict methods of asset protection and state by state shopping for advantageous exemptions.¹⁴¹ It has made it difficult to establish domicile for pre-bankruptcy exemption planning unless it is long-range planning, particularly in respect of homestead exemptions.¹⁴² But this Act has been criticised by many. So, for example, Sommer¹⁴³ said the following about this Act shortly before its enactment:

From its Orwellian title, an example of deceptive advertising if ever there was one, to the last of its 512 pages, the bankruptcy bill recently passed by Congress presents numerous challenges to attorneys who represent consumer debtors. How such terrible legislation came to be passed by Congress is a story of money, political mean-spiritedness, and intellectual dishonesty, but that is a story for another article.

However, this Act came about because of the long-held perception that the integrity of the bankruptcy process in the United States was being tarnished by shrewd and unscrupulous debtors who were exploiting the system. So, for example, the National Bankruptcy Review Commission¹⁴⁴ in its report criticised the opt-out exemption system when stating:

¹³⁹USC s 101.

¹⁴⁰See Tabb CJ "The death of consumer bankruptcy in the United States?" (2001) *Bankruptcy Developments Journal* at 1.

¹⁴¹Ahern III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 586; See also Hildebrand III HE "Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on chapter 13 Trustees" (2005) *Am Bankr LJ* 373 at 373.

¹⁴²Ahern III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* at 586.

¹⁴³Sommer HJ "Trying to make sense out of nonsense: Representing consumers under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" (2005) *Am Bankr LJ* at 191. See generally also Jacoby MB "Ripple or revolution? The indeterminacy of statutory bankruptcy reform" (2005) *Am Bankr LJ* 169 at 169; Vance CE "Nine traps and one slap: Attorney liability under the new bankruptcy law" (2005) *Am Bankr LJ* at 283; Howard M "Exemptions under the 2005 bankruptcy amendments: A tale of opportunity lost" (2005) *Am Bankr LJ* at 397.

¹⁴⁴Created by Congress in the Bankruptcy Reform Act of 1994.

The opportunities for pre-bankruptcy planning created by the exemption opt-out have called the integrity of the bankruptcy system into question, particularly in the context of a small handful of high-visibility debtors. People with no other familiarity with the bankruptcy system can cite celebrities who have shielded millions of dollars in an expensive homestead in certain states, a behaviour that is erroneously attributed to federal law, even though the federal exemptions would not have allowed this shielding to occur.¹⁴⁵

Ahern states that debtors were perceived to be exploiting the system by paying cash for houses in states with unlimited homestead exemptions, then moving 180 days before filing for bankruptcy, the sole purpose being to utilise these liberal exemptions.¹⁴⁶ Some states have homestead exemptions without dollar limits, which is considered by some to be too generous.¹⁴⁷ This situation was abused because residents in these states could exempt vast amounts of their estates by investing everything in their homes, or they would convert non-exempt assets on the eve of bankruptcy by selling them and using the cash to buy a homestead, or paying down the mortgage on an existing home.¹⁴⁸

Continued criticism of the abuses of the exemption system was heard by Congress in 2005, then leading to the enactment of BAPCPA, through which it was hoped to end the abuses so that the bankruptcy process would be used by persons needing it, and not those hoping to exploit it.¹⁴⁹

The following discussion of the relevant provisions relating to the bankruptcy estate, its content, and the exclusions and exemptions from it includes the BAPCPA amendments, and if relevant, it will be indicated whether, and to what extent, particular provisions have been affected by BAPCPA.

¹⁴⁵As cited in Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 590; See Hildebrand III HE "Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on chapter 13 Trustees" (2005) *Am Bankr LJ* 373 at 373 and further.

¹⁴⁶Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 590.

¹⁴⁷Blum at 13.2.

¹⁴⁸See Blum at 13.2.

¹⁴⁹Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 591.

6.5 The bankruptcy estate

6.5.1 General

In the United States the filing of a bankruptcy petition by a debtor establishes an estate,¹⁵⁰ a separate legal entity, which holds and controls all assets owned by the debtor.¹⁵¹ Simultaneously with the creation of the bankruptcy estate, a chapter 7 individual debtor starts accumulating a new estate.¹⁵² If an individual debtor wants to file a single petition together with his spouse, he may file a joint case.¹⁵³ For a joint case, debtors must be legally married, as mere cohabitation does not qualify¹⁵⁴ and a joint petition may be used only in a voluntary case.¹⁵⁵ The debtors' estates in a joint case may be consolidated by the court. This entails the pooling of their assets and liabilities, particularly if their assets and liabilities are held together.¹⁵⁶ Here the court will consider whether there is a substantial identity between the property and debts, and dealing of financial affairs between the debtor and spouses, and whether consolidation, or the denial thereof, will have harmful consequences.¹⁵⁷

Section 541 in sub-chapter III of the code provides for the property that is included in the bankruptcy estate. It is a broad and all-encompassing provision that includes "all legal and equitable interests of the debtor in property as of the commencement of the case" including "property, wherever located and by whomever held".¹⁵⁸ The code does not define what constitutes property, but the courts construe property broadly to encompass everything of value, even if the property, or the debtor's interest in the property is "novel".¹⁵⁹

¹⁵⁰A case is commenced under section 301, 302, or 303, being a voluntary case, joint cases and an involuntary case respectively.

¹⁵¹See s 541(a) "[T]he commencement of a case ... creates an estate"; See generally Ferriell at 223 and further. See also Dickerson "From jeans to genes: The evolving nature of property of the estate" (1999) *Bankr Dev J* at 285; Blum at 12.1.

¹⁵²Blum at 12.1.

¹⁵³S 302(a). See Ferriell at 224 and 228.

¹⁵⁴*In re Malone* 50 BR 2 (Bankr ED Mich 1985).

¹⁵⁵*In re Benny* 842 F 2d 1147 (9th Cir 1988).

¹⁵⁶S 302(b); see Waxman para 149.

¹⁵⁷*In re Reider* 31 F 3d 1102 (11th Cir 1994).

¹⁵⁸S 541(a)(1). See, generally, Gross at 44.

¹⁵⁹See Dickerson at 293. It must be noted that determining the bankruptcy estate may be affected by the interplay between federal bankruptcy law (the Code), and non-bankruptcy law. Eg, entitlements granted to a party under non-bankruptcy law may exclude an asset from an estate, or

For the purpose of consumer bankruptcy, the content of the bankruptcy estate may differ, depending on whether it is a chapter 7 estate, or a chapter 13 estate.

6.5.2 *The chapter 7 and chapter 13 estate*

A chapter 7 estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case.¹⁶⁰ This includes the proceeds, product, offspring, rentals, or profits of, or from, property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.¹⁶¹ Also included is every interest of the debtor and the debtor's spouse in community property as of the commencement of the case that is under the sole, equal, or joint management and control of the debtor.¹⁶² Any interest in property that the trustee recovers under the trustee's avoidance power¹⁶³ is also included.¹⁶⁴ Also included is any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date by bequest, devise or inheritance, or as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree, or as a beneficiary of a life insurance policy or of a death benefit plan.¹⁶⁵

All the property included in a chapter 7 estate under section 541 is also part of a chapter 13 estate.¹⁶⁶ Here too, bankruptcy filing creates a bankruptcy estate as a legal entity distinct from the debtor. However, chapter 13 also includes all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapters 7, 11, or 12 of this title, whichever occurs first.¹⁶⁷ Here rehabilitation is aimed at the

the Code may disallow such exclusion, depending on the correct and relevant analysis. However, this aspect will not be considered in further detail – see in this respect Jackson at 93.

¹⁶⁰S 541(a)(1).

¹⁶¹S 541(a)(6). See Dickerson at 285 and further.

¹⁶²S 541(a)(2). Community property is defined under applicable state law. See the further discussion of community property in para 6.5.4 below

¹⁶³See ss 329(b) , 363(n) , 543 , 550 , 553 or 723.

¹⁶⁴S 541(a)(3).

¹⁶⁵S 541(a)(5).

¹⁶⁶Chapters 11, 12 and 13 are referred to as "rehabilitation" chapters, whereas ch 7 is entitled "liquidation". S 541 applies to all the rehabilitation chapters as well.

¹⁶⁷S 1306(a)(1).

preservation of the estate for the debtor. Its liquidation is not the goal as in the chapter 7 estate, and the break between the debtor's bankruptcy estate and his fresh start estate is not as final.¹⁶⁸ Earnings from services performed by the debtor after the commencement of the case, but before the case is closed, dismissed, or converted to a case under chapters 7, 11, or 12 of this title, whichever occurs first, are therefore also included in the chapter 13 estate.¹⁶⁹ The debtor is able to re-acquire pre-petition property from the estate by committing post-petition acquisitions, for example, future earnings, to the payment of claims.¹⁷⁰ Thus, the debtor in chapter 13 effectively uses property or post-petition income that would have been excluded or exempt from a chapter 7 estate, and thereby saves property that would have been liquidated under chapter 7.¹⁷¹ Pending the confirmation of a chapter 13 plan, the debtor can usually keep and use estate property. Once the plan has been confirmed, the debtor is re-vested with all property that has not been disposed of in the plan.¹⁷² Should the plan ultimately succeed, this becomes the debtor's property in his new estate. But if the plan fails and is converted to chapter 7, the property is surrendered to the trustee for liquidation.¹⁷³

6.5.3 Legal and equitable interests of the debtor as estate property

All legal and equitable interests in property at the time when the petition is filed are included in the bankruptcy estate. These include real or personal, and tangible or intangible interests.¹⁷⁴ Some of these legal interests that may form part of the estate include bank deposits, personal injury claims,¹⁷⁵ rights to compensation for pre-petition employment services and licences, copyrights and patents, to mention only a few.¹⁷⁶ Examples of equitable interests that may be included in the estate are a beneficial interest in the corpus of a non-spendthrift trust¹⁷⁷ and an equitable right to redeem foreclosed property.¹⁷⁸

¹⁶⁸Blum at 12.1.

¹⁶⁹S 1306(a)(2).

¹⁷⁰Blum at 12.1.

¹⁷¹Blum at 12.1.

¹⁷²S 1306(b).

¹⁷³Blum at 12.1.

¹⁷⁴S 541(a)(1).

¹⁷⁵*Tignor v Parkinson* 729 F 2d 977 4th Cir 1984.

¹⁷⁶Waxman para 295.

¹⁷⁷*In re Dias* 37 BR 584 (Bankr D Idaho 1984).

¹⁷⁸*In re Sapphire Investments* 19 BR 492 (Bankr D Ariz 1982).

6.5.4 Other estate property

Apart from the legal and equitable interests in property at the time the petition is filed, the following may also be included in the bankruptcy estate:

(1) Community property

Community property is defined by applicable state law. All such community property of the debtor and his spouse at the date of bankruptcy forms part of the bankrupt estate if that property is under the debtor's sole or joint control or is liable for a claim against the debtor and his spouse.¹⁷⁹ Community property forming part of the estate must be segregated from other estate property. In the distribution of such property special rules apply. Payments of claims for administrative expenses under section 503 are made either from community property, or from other estate property, depending on the requirements of justice.¹⁸⁰ Other than these administrative expenses, other claims and claims in respect of section 507¹⁸¹ must be paid by the distribution of the community property or the proceeds thereof (and other property). With respect to claims specified in section 507 or in section 726(a), being certain priority claims, the community property or its proceeds must be applied as follows:

- (A) Community claims against the debtor or his spouse must be paid from the community property, except to the extent that the community property is solely liable for the debts of the debtor.¹⁸²
- (B) The part of the community claims against the debtor that is not paid under Subsection (A) above, must be paid from the community property that is solely liable for the debts of the debtor.¹⁸³
- (C) To the extent that all claims against the debtor including community claims against him are not paid under subparagraph (A) or (B) above such claims must be paid from estate property other than community property.¹⁸⁴
- (D) To the extent that community claims against the debtor or his spouse are not

¹⁷⁹S 541(a)(2).

¹⁸⁰See s 726(c) and *In re Merlino* 62 BR 836 (Bankr WD Wash 1986).

¹⁸¹These claims relate amongst other things to allowed unsecured claims for domestic support obligations owing to or recoverable by certain spouses and children, wages and salaries, and so forth – see s 507 for the complete list.

¹⁸²S 726(c)(2)(A).

¹⁸³S 726(c)(2)(B).

¹⁸⁴S 726(c)(2)(C).

paid under subparagraph (A) to (C) above, those claims must be paid from the remaining property of the estate.¹⁸⁵

(2) Property recovered by the trustee

If the trustee recovers or preserves for the benefit of the estate any interest in property, it may be included in the estate. An avoidance of a preferential or fraudulent transfer of a debtor's interest in property is an example.¹⁸⁶

(3) Property acquired after the filing of the petition

Property acquired within 180¹⁸⁷ days after the bankruptcy date by way of an inheritance, bequest, devise, property settlement, divorce decree or beneficial interest in a life insurance policy or death benefit plan is included in the estate.¹⁸⁸

In the *Chenoweth* case,¹⁸⁹ where a testator died five months after bankruptcy filing, but the will was probated 196 days after the date of bankruptcy, the inheritance constituted property in the bankruptcy estate.

(4) Proceeds of estate property

Offspring, product, profits, rental or proceeds derived from estate property become property of the bankruptcy estate. In this respect, however, an individual debtor's post-petition earnings are not included in the estate.¹⁹⁰

(5) Post-bankruptcy acquisitions

Property acquired by the *estate* after the date of bankruptcy is included in the estate.¹⁹¹ For example, a contract entered into after bankruptcy by the trustee or a debtor in possession constitutes property of the estate.

¹⁸⁵S 726 (c) (2)(D).

¹⁸⁶S 541(a)(3) and (4); *In re First Capital Mortgage Loan Corporation* 917 F 2d 424 (10th Cir 1990).

¹⁸⁷Or becomes entitled to acquire within 180 days.

¹⁸⁸S 541(a)(5).

¹⁸⁹*In re Chenoweth* 3 F3d 1111 (7th Cir 1993).

¹⁹⁰This will be discussed further in para 6.6 below.

¹⁹¹S 541(a)(7).

6.5.5 Invalid ipso facto or “bankruptcy” clauses

The debtor’s property that is included in, or becomes part of, the bankruptcy estate is not affected by “bankruptcy” clauses. These are clauses in a contract or a deed, or in non-bankruptcy law placing conditions or restrictions on the debtor’s transfer of the property.¹⁹² In the same vein, provisions intending to modify, terminate or forfeit the debtor’s interest in property due to, among other things, the debtor’s insolvency will not exclude the property from the bankruptcy estate. Under section 541(c)(1) these clauses are unenforceable.¹⁹³

However, in respect of certain trusts there is an exception to this principle relating to “bankruptcy” clauses. A restriction on the transfer of a debtor’s beneficial interest in a trust is enforceable, if such restriction is enforceable under applicable non-bankruptcy law.¹⁹⁴ This exception applies to traditional spendthrift trusts and Employment Retirement Income Security Act of 1986 qualified pension plans.¹⁹⁵

But the income from a testamentary spendthrift trust that is *paid or owing* to a debtor-beneficiary within 180 days of the date of bankruptcy is included in the estate despite the corpus of the trust being excluded from the bankruptcy estate.¹⁹⁶

6.6 Excluded and exempt property

6.6.1 General

From its inception, the policy in American law of excluding certain property from the bankruptcy estate has been justified on two grounds.¹⁹⁷ First it provides for financial rehabilitation because it allows the debtor to keep some property in order to assist him to continue to be productive within his society. Second, as economies grew, exemptions fulfilled a wider humanitarian goal of saving debtors and their

¹⁹²Waxman para 306.

¹⁹³See Waxman para 306.

¹⁹⁴S 541(c)(2). See Waxman para 307.

¹⁹⁵*Patterson v Shumate* 504 US 753 (1992); see also para 6.6.2.5 below.

¹⁹⁶S 541(a)(5); *In re Hecht* 54 BR 379 (Bankr SDNY 1985).

¹⁹⁷Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 402; Sedler RA “Functionally restrictive substantive rules in American conflicts law” (1976) *S Cal L Rev* 27 at 30.

dependants from destitution.¹⁹⁸ But an economic justification is inextricably linked to this humanitarian policy. A destitute debtor would require state financial assistance. Exemptions, however, allow the debtor to withhold some property from his creditors, thereby placing the cost of maintaining the debtor on the creditor, instead of the state.¹⁹⁹

Resnick²⁰⁰ has gone further, suggesting that the following policies play a role in the development of exemption law:

- allowing the debtor enough property for his physical survival;
- protecting the dignity and the cultural and religious identity of the debtor;
- financial rehabilitation of the debtor earning a future income;
- protecting the debtor's family from destitution; and
- moving the burden of minimal financial support of the debtor and his family from society to the creditors of the debtor.

The earliest bankruptcy laws in the United States did contain limited uniform exemptions, but state law exemptions were not recognised.²⁰¹ The Act of 1867,²⁰² however, approached the matter differently by including the aforementioned federal exemptions, but going further by allowing the bankrupt to exempt any other property that was considered exempt property under the exemption laws of the state where the debtor was domiciled at the time when the proceedings started, but not exceeding the maximum exemption allowed under such state's law.²⁰³

¹⁹⁸Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 402; Yablon M "Why Annie gets to keep her gun: An analysis of firearm exemption in bankruptcy proceedings" (2005) *Emory Bankruptcy Developments Journal* 553 at 554.

¹⁹⁹Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 402; Deutsch DE "Exemption reform: Examining the proposals" (1995) *Am Bankr Inst L Rev* 207 at 207; Engledow WM "Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* 275 at 279.

²⁰⁰Resnick AN "Prudent planning or fraudulent transfer? The use of nonexempt assets to purchase or improve exempt property on the eve of bankruptcy" (1978) *Rutgers L Rev* 615 at 621.

²⁰¹Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 404.

²⁰²Act of 2 March 1867 ch 176 14 Stat 517 (establishing a uniform system of bankruptcy throughout the United States).

²⁰³Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 404.

The Bankruptcy Act of 1898²⁰⁴ was the first permanent United States bankruptcy law, and it eliminated federal exemptions entirely. It provided that it (the 1898 Act) would not affect the allowance to bankrupts of the exemptions prescribed by the state laws of the state in which the debtor was domiciled for the six months or the greater portion thereof immediately prior to the filing of the petition.²⁰⁵ This controversial approach resulted in the United States Supreme Court, in *Hanover National Bank v Moyses*²⁰⁶ rejecting the claim that the failure to provide uniform federal exemptions constituted Congress acting beyond its power to enact a “uniform” system of bankruptcy law under the Bankruptcy Clause to the United States Constitution.²⁰⁷ The court found that creditors were not disadvantaged as they “contracted with reference to the rights of the parties thereto under existing [state] exemption laws”,²⁰⁸ and the constitutional uniformity that was required was “geographical, and not personal”.²⁰⁹ It held that Congress’s incorporation of state exemption law was constitutionally permissible since it allowed all creditors access to exactly that property they could have reached outside of bankruptcy.²¹⁰

This incorporation of state exemption laws into the federal bankruptcy case was criticised by many commentators.²¹¹ It was eventually amended by including federal exemptions in a new Bankruptcy Code, but giving the debtor the option to elect either the federal exemptions or the relevant state exemptions. But it also permits the respective states to exclude this choice of exemptions by legislation that provides exclusively for state exemptions, meaning that federal exemptions are then unavailable to that state’s residents.²¹² The result is section 522(b)(2) of

²⁰⁴Bankruptcy Act of 1898 ch 541 30 Stat 544.

²⁰⁵See Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 404; Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* 325 at 363.

²⁰⁶186 US 181 1902.

²⁰⁷US Const art 1 para 8 cl 4; Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 404.

²⁰⁸186 US at 189; Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 404.

²⁰⁹186 US at 188; Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 404.

²¹⁰At 189.

²¹¹See, eg, Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 405 note 28 and Vukowich WT “The bankruptcy commission’s proposals regarding bankrupt’s exemption rights” (1975) *Cal L Rev* 1439 at 1441-1446.

²¹²Bartell LB “The peripatetic debtor: Choice of law and choice of exemptions”(2006) *Emory Bankruptcy Developments Journal* at 406.

the code allowing the debtor to choose between federal or state exemptions, unless state law does not authorise this (the opt-out clause). This arrangement remained intact in the 2005 amendments to the code, despite criticism and calls for uniformity of state exemptions in bankruptcy.²¹³

In the United States the definition of “exempt property” has generally included apparel, bedding, cookware, dishes and stoves. But some states are more generous than others when defining exempt property. So, for example, also musical instruments, bicycles, fuel for six months, typewriters and wedding rings, to mention only a handful, have in some states been regarded as essential items available for exemption in bankruptcy.²¹⁴ Section 522 provides for a list of federal exemptions,²¹⁵ but most states have elected to opt out of these exemptions, replacing them with state exemptions. The result is a vast array of exempt property in the various states, with many states construing their exemption legislation liberally. All this has resulted in considerable uncertainty concerning the boundaries of exempt property.²¹⁶ This, in turn, has resulted in much litigation.²¹⁷

²¹³Brown WH “Political and ethical considerations of exemption limitations: The ‘opt-out’ as child of the first and parent of the second” (1997) *Am Bankr LJ* at 149; Engledow WM “Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* 275 at 275, 276-78; Ponoroff L “Exemption limitations: A tale of two solutions” (1997) *Am Bankr LJ* at 221. The exemptions that were introduced in the Bankruptcy Reform Act of 1978 were born from conflicting opinion on whether or not to include in the code a uniform set of exemptions applicable to all individuals, no matter where the individual may be domiciled. S 522(d) is a compromise between those advocating uniform bankruptcy laws, and those in favour of non-bankruptcy exemption laws – Blum at 13.2. As stated above, the legislation in respect of exemptions in the Code was however hastily drafted, leading to interpretational problems as to what is meant by the provision that exempt property is “any property that is exempt under ... State or local law that is applicable on the date of the filing of the petition”.

²¹⁴Yablon M “Why Annie gets to keep her gun: An analysis of firearm exemption in bankruptcy proceedings” (2005) *Emory Bankruptcy Developments Journal* 553 at 555.

²¹⁵S 522(d)(1)-(11).

²¹⁶Yablon M “Why Annie gets to keep her gun: An analysis of firearm exemption in bankruptcy proceedings” (2005) *Emory Bankruptcy Developments Journal* 553 at 556. See also Blum at 13.2, who points out that the 1997 National Bankruptcy Review Commission’s majority recommendation of the non-uniform system of exemptions, noting, *inter alia*, that deference to state law resulted in unnecessarily generous treatment of some debtors, and poor protection of others. The majority called for the repeal of the “opt-out” provision and the replacement thereof with a standardised provision in the Code. To date hereof Congress has ignored the Commission’s attempts at reforming the exemption system – see Blum at 13.2. Only in respect of homestead exemptions, were provisions provided by BAPCPA in respect of domiciliary limits on that exemption – see the discussion hereof in para 6.6.3.2.1 below.

²¹⁷See, eg, *In re Erickson* 815 F 2d 1090 (7th Cir 1987) concerning inconsistencies in the meaning of a baler and a haybine as exempt property in Wisconsin legislation; *In re Tiberia* 227 BR 26 (Bankr WDNY 1998) regarding the uncertainty as to the meaning of a “wedding ring” as exempt property under New York legislation.

Because of this diversity of material in respect of bankruptcy estate property and exemptions, some aspects thereof will be considered in more detail than others. The idea is to enquire and discover the system in place in the United States, and to learn from that system what may be useful for law reform in South Africa.

It was stated above what property is generally included in the bankruptcy estate.²¹⁸ However, it was previously stated that a chapter 7 debtor begins creating a new estate at the same time as the bankruptcy estate is created.²¹⁹ Included in the new estate are earnings, post-petition acquisitions and exempt property that has been released to the debtor. These assets form the foundation of the debtor's fresh start. They cannot be touched by pre-petition creditors who are stayed from reaching them pending the debtor's discharge and, after discharge are permanently prevented from collecting pre-petition debts.²²⁰

So it is important to note that certain property is excluded from that bankruptcy estate from the date of the filing of the bankruptcy petition and is therefore beyond the reach of the creditors. Exempt property does not form part of this category of property. Once it has been established what property is included in the estate of the individual debtor, it is possible to consider what part of the bankrupt estate may be subject to exemptions to which the individual may be entitled.²²¹ It is therefore necessary first to identify property that is excluded from the bankruptcy estate before discussing exempt estate property.

6.6.2 Excluded property

6.6.2.1 General

The most important categories of property that are excluded from the bankruptcy estate relate generally to future earnings, education savings accounts, employee

²¹⁸See also Scott MD and King LP 2002 *Collier pamphlet edition: Part 1 bankruptcy Code* (2001) at 531 where it is stated that s 541(1) includes as property of the estate all the debtor's property, even exempt property needed for a fresh start. After the property has come into the estate the debtor may exempt property if permitted to do so under s 522.

²¹⁹See para 6.4 and further above.

²²⁰Blum at 12.1.

²²¹Exemptions in terms of s 522 (b); see also Waxman para 316.

benefit plans, spendthrift trusts and pawned property. The most important of these categories that relate to individual debtors will now be considered in more detail.

6.6.2.2 Future earnings

The debtor's ability to work, thereby producing a future source of income is arguably his most valuable asset, but it is generally excluded from the bankruptcy estate.²²²

Apart from chapter 12 or 13 cases, earnings from personal services performed by an individual debtor after the commencement of the bankruptcy are excluded from the bankruptcy estate.²²³ The aspect of future earnings is inextricably linked to the "fresh start" policy in American law. This, together with the exemptions at the disposal of the debtor, determines the extent of the debtor's "fresh start".²²⁴ In *Local Loan Co v Hunt* the Supreme Court held that quite apart from exemption law, a creditor could not collect his claim that had been discharged in bankruptcy, out of post-bankruptcy earnings of the debtor. This applied even if before bankruptcy such future earnings had been validly assigned under state law to the creditor. To permit this would be in conflict with the bankruptcy policy to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh".²²⁵ In *In re Clark*²²⁶ a football player's salary that would correspond to nine month's post-petition games was excluded from the bankruptcy estate.

6.6.2.3 Certain powers

When the debtor can exercise a power solely for the benefit of another entity, that power is excluded from the estate. But if the power can be exercised for the debtor's own benefit, it is not excluded.²²⁷

²²²See Jackson at 90.

²²³S 541(a)(6).

²²⁴Countryman V "Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century" (1983) *Catholic University Law Review* vol 809 at 817-818.

²²⁵292 US 234 at 244 (1934).

²²⁶*In re Clark* 891 F 2d 111 (5th Cir 1989).

²²⁷S 541(b)(1).

6.6.2.4 Certain leases

An interest of a debtor as a lessee under a lease of non-residential real property is excluded from estate property if that interest has terminated because of the expiration of the stated term of the lease either before the date of bankruptcy, or during the case.²²⁸

6.6.2.5 Education savings accounts

Funds placed in an education individual retirement account²²⁹ or a qualified state tuition programme²³⁰ more than 365 days before the filing of the bankruptcy petition are excluded, provided the designated beneficiary of such account is a child, step-child, grandchild or step-grandchild of the debtor. Further, to be included, the funds must not be pledged as collateral, the deposits must not exceed the amounts permitted by the Internal Revenue Code, and for any single beneficiary, deposits made within 720 days of the filing of the petition must not exceed US\$5 000.²³¹

6.6.2.6 Employee benefit plans

If an employer withholds or receives certain amounts from wages for payment of contributions to certain benefit plans, these are excluded.²³² These are payments as contributions to an employee benefit plan that is subject to Title I of the Employee Retirement Income Security Act of 1974²³³ or to a governmental plan under section 414(d) of the Internal Revenue Code of 1986,²³⁴ as well as contributions to a deferred compensation plan under section 457 of the latter code. Also excluded are payments of contributions to a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986 and to a health insurance plan regulated by state law.²³⁵

²²⁸S 541(b)(2), and see *In re Neville* 118 BR 14 (Bankr EDNY). This is however not an exclusion for the benefit of the debtor and does not create an exemption in favour of the debtor, but rather frees the lessor from the automatic stay and from other bankruptcy provisions that could interfere with the enforcement of rights against the debtor.

²²⁹Defined in s 530(b)(1) Internal Revenue Code 1986.

²³⁰Defined in s 26 USC s 529(b).

²³¹S 541(b)(5) and (6) – inserted by BAPCPA. See Yerbich JT *Consumer Bankruptcy – Fundamentals of chapter 7 and chapter 13 of the US Bankruptcy Code* (2nd ed) (2005) at 26 (hereafter Yerbich).

²³²S 541(b)(7) – inserted by BAPCPA.

²³³29 USC s 1001 and further.

²³⁴26 USC.

²³⁵See Yerbich at 26.

6.6.2.7 Spendthrift trusts

A beneficial interest of a debtor in a “spendthrift” trust²³⁶ is excluded from the bankruptcy estate. This includes a beneficial interest in pension or profit sharing trusts containing an anti-alienation provision.²³⁷

As stated above, the debtor’s property that is included in, or becomes part of, the bankruptcy estate is not affected by “bankruptcy” clauses. These are clauses in a contract or a deed, or in non-bankruptcy law placing conditions or restrictions on the debtor’s transfer of the property. So too, provisions intending to modify, terminate or forfeit the debtor’s interest in property due to, among other things, the debtor’s insolvency will not exclude the property from the from the bankruptcy estate. Under section 541(c)(1) these clauses are unenforceable.

However, in respect of certain trusts there is an exception to this principle relating to “bankruptcy” clauses. A restriction on the transfer of a debtor’s beneficial interest in a trust is enforceable, if such restriction is enforceable under applicable non-bankruptcy law.²³⁸ This exception applies to traditional spendthrift trusts and Employment Retirement Income Security Act qualified pension plans.²³⁹

But the income from a testamentary spendthrift trust that is *paid or owing* to a debtor-beneficiary within 180 days of the date of bankruptcy is included in the estate despite the corpus of the trust being excluded from the bankruptcy estate.²⁴⁰

6.6.2.8 Pawned property

Also excluded from the bankruptcy estate is tangible personal property sold or pledged as collateral for a loan or advanced by a person licensed under state law.

²³⁶11 USC s 541(c)(2).

²³⁷This included those established under Employment Retirement Income Security Act (26 USC s 401 and further), Civil Service Retirement (5 USC s 8346(a)), Federal Employees Retirement System (5 USC s 8470(a)), Federal Thrift Plan (5 USC s 8437(e)(2)), Retired Serviceman’s Family Protection Plan Annuities (10 USC s 1440) and qualified pension plans of the state or a political subdivision of the state, such as a municipality or a city (26 USC s 457). See Yerbich at 26.

²³⁸S 541(c)(2).

²³⁹*Patterson v Shumate* 504 US 753 (1992).

²⁴⁰S 541(a)(5); *In re Hecht* 54 BR 379 (Bankr SDNY 1985).

But this applies only if the property is in the possession of the pledgee or transferee, there is no obligation on the debtor to repay the advance, redeem the collateral or buy the property back at a stipulated price, and neither the debtor or the trustee has taken any measures to redeem under the contract or state law in a timely manner under state law and section 108(b).²⁴¹

6.6.3 Exempt property

6.6.3.1 General

Individual debtors are entitled to certain property exemptions which generally allow the debtor to survive bankruptcy with some assets which, in turn, assist him in gaining a “fresh start”.²⁴² Generally, exemptions are provided for, or regulated by, the Bankruptcy Code, or under the relevant state law and non-bankruptcy federal law. These exemptions do not apply to partnerships and corporations. They apply only to individual debtors in cases under Chapters 7, 11, 12 and 13, and may not be waived in favour of an unsecured creditor.²⁴³

Exempt property is considered part of the bankruptcy estate, but except in certain circumstances, is exempt from liquidation.²⁴⁴ The debtor therefore retains this property at the end of the case free from the claims of creditors, other than secured creditors and certain specified debts such as tax obligations and domestic support obligations.²⁴⁵ Generally, an exemption in property cannot trump a valid consensual security interest in that exempt property. A debtor effectively waives his right to the exemption when granting such security interest to the consensual lienholder. Statutory liens, conferred by legislation to protect persons who have enhanced or preserved the value of the relevant property are generally also immune from exemption claims.²⁴⁶ However, certain judicial liens that attach to exempt property can be avoided by the

²⁴¹S 541(b)(8) – inserted by BAPCPA. This is, however, not an exclusion for the benefit of the debtor and does not create an exemption in favour of the debtor, but rather frees the pawnbroker from the automatic stay and from other bankruptcy provisions that could interfere with the enforcement of rights against the debtor.

²⁴²See Waxman at para 609 and further.

²⁴³Ss 103(a) and 522(e).

²⁴⁴See Ferriell at 415.

²⁴⁵S 522(c). Yerbich at 27.

²⁴⁶See Blum at 13.5.1.

debtor. Judicial liens, Blum states, “are acquired by the very process of seizure or judgment against which exemptions are meant to protect the property”.²⁴⁷ This is regulated by the code in order to effectuate the primacy of the debtor’s exemptions over judicial liens. The debtor is therefore empowered to avoid such lien to the extent that it impairs the debtor’s exemption.²⁴⁸

But a debtor can no longer avoid a lien if such lien favours support obligations, since section 522(f)(1)(A), which allows for the avoidance of certain liens, has been amended to favour the protection support obligations to spouses and dependents.²⁴⁹ This is because public policy favours such support obligations, prompting Congress to bar debtors from avoiding maintenance and support obligations by filing for bankruptcy. Consequently, the Bankruptcy Reform Act of 1994 and BAPCPA²⁵⁰ provided for amendments giving such interests special status and preventing debtors from avoiding their responsibilities. So, a judicial lien securing a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of, such child or spouse, in connection with a separation agreement, divorce decree or other order of a court or administrative determination can no longer be avoided.²⁵¹

State exemption laws apply mostly only to individuals. They typically exempt a personal residence, personal clothing, household goods and furnishings, health aids, government-furnished aid and benefits, tools of the trade, vehicles and jewellery. Some exemption laws also cover life insurance policies, support payments, retirement plans (if not excluded from the estate or otherwise exempt under federal law) and personal injury claims. Most of these exemptions have a value limitation placed on them.²⁵²

The debtor does not have an automatic right to claim exemptions. He must file an inventory of exempt property, failing which, a dependant of the debtor may do so.²⁵³

²⁴⁷See Blum at 13.5.1.

²⁴⁸ S 522(f)(1)(A) and see Blum at 13.5.1.

²⁴⁹See s 522(f)(1)(A) and see Blum at 13.5.2.

²⁵⁰See American Bankruptcy Institute *Mini Code 2006 Edition with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (issued October 2005) at 94 (hereafter *Mini Code*).

²⁵¹*Mini Code* at 94 and Blum at 13.5.2.

²⁵²See, generally, s 522 as amended by BAPCPA.

²⁵³S 522(l). The schedule of claim of exemptions must be filed with the bankruptcy petition or within 15 days after the order for relief. Rules 1007 and 4003(a) require this, and the claim of exemptions

Some states allow the debtor a choice between two exemption schemes, namely federal or state.²⁵⁴ But in the “opt-out states”, only state exemptions and federal non-bankruptcy laws may be used by the debtor.²⁵⁵ Certain domiciliary requirements at the time that the bankruptcy petition is filed must be consulted to determine whether the exemptions are available under the particular state’s exemption laws.²⁵⁶ If the debtor chooses state exemptions, he must have been domiciled in the state for a minimum of 730 days before the filing date of the petition. If he has not been so domiciled in the current state for that period, the exemption laws of the state in which the debtor resided for 180 days, or the greater portion of the 180 days preceding the 730-day period apply. If neither of these domiciliary requirements are met, and the debtor would be ineligible for any exemption, the debtor can elect to use the section 522(d) federal exemptions.²⁵⁷ So, for example, if the debtor resided in State A for the past 12 months, in State B for the preceding 12 months, and State C for the year before that, the exemption laws of State C would apply. But only the exemptions of State C could be used if State C is an opt-out state.²⁵⁸

Thus, if a choice is permitted, both options should be considered to determine the most advantageous option for the debtor. Exemptions are meant to benefit the debtor and electing the law most beneficial to the debtor is a requirement.²⁵⁹ Also, the state in which the debtor is domiciled must see to it that its citizens retain the exemptions to which they are legally entitled to under its exemption laws so that the debtor may emerge from bankruptcy without the need for state welfare and may continue as productive citizens.²⁶⁰ Having said this, it must also be noted that exemptions are not meant to provide the debtor with a windfall, but to protect the public from having to support a destitute family.²⁶¹

is found in Schedule C of official form 6.

²⁵⁴S 522(b) as amended by BAPCPA.

²⁵⁵Ahern, III LR “Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on ‘asset protection’ after 2005” (2005) *Am Bankr Inst L Rev* 585 at 587.

²⁵⁶ See also Howard M “Exemptions under the 2005 bankruptcy amendments: A tale of opportunity lost” (2005) *Am Bankr LJ* at 398; Hildebrand III HE “Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on chapter 13 Trustees” (2005) *Am Bankr LJ* 373 at 383-384 and Rivera BP “State homestead exemptions and their effect on federal bankruptcy laws”(2004) *Real Property, Probate and Trust Journal* at 71.

²⁵⁷S 522(b)(3)(A) as amended or inserted by BAPCPA; Yerbich at 28.

²⁵⁸Yerbich at 28.

²⁵⁹Yerbich at 28.

²⁶⁰*In re O’Hara* 162 F 325 at 327 (MD Pa 1908).

²⁶¹*In re Hill*, 163 BR 598, 601 (Bankr ND Fla 1994); *Brown v Swartz (In re Swartz)* 18 BR 454, 456 Bankr Mass 1982.

It should also be noted that although the creditors in effect carry the burden of the welfare of the bankrupt via the exempt property of the debtor, the relevant state must also protect the expectations of the creditors by limiting the debtor's exempt property to that provided by the state's laws.²⁶²

As stated above, the exemptions may emanate from various different legislative sources. Some of these exemptions will now be considered.

6.6.3.2 Federal bankruptcy exemptions

If a state has not opted out, the Bankruptcy Code allows the following maximum exemptions of a debtor's interest in property:²⁶³

6.6.3.2.1 Homestead

The debtor may exempt his aggregate interest to a maximum of US\$18 450 in value, in real or personal property that the debtor or a dependant uses as a residence.²⁶⁴ A homestead exemption usually applies only to the principal dwelling of the debtor or one of his dependants.²⁶⁵ The 2005 amendments to the Bankruptcy Code have created certain limits on pre-bankruptcy transfers which would otherwise have drastically increased a debtor's exemption rights.²⁶⁶ The value of the homestead exemption is reduced to the extent that the value is attributable to non-exempt property that was transferred by the debtor with the intention of delaying, hindering or defrauding a creditor within the ten-year period prior to the filing of the petition.²⁶⁷ Prior

²⁶²*Bassin v Stopher (In re Bassin)* 637 F 2d 668 at 670 (9th Cir 1980); *In re Morzella* 171 BR 485 at 488 (Bankr D Conn 1994); *In re Sticha* 60 BR 717 at 719 (Bankr D Mn 1986).

²⁶³S 522(d). There was no fluctuation in the value limits of the exemptions in s 522(d) for almost twenty years since their enactment in 1978. Thus inflationary pressure made them increasingly worthless. They were, however, updated in the Bankruptcy Reform Act of 1994 which added s 104(b) to the Code. This section delegates to the Judicial Conference of the United States the responsibility of adjusting the dollar amounts of the exemptions every three years. This adjustment is based on the Consumer Price Index. However, the dollar amounts of these exemptions in the Code are deliberately set at a modest level. So, eg, the debtor's federal homestead exemption is relatively small at just over US\$18 000. The exemption will therefore not cover the debtor's entire interest therein, unless his equity in the homestead (or other exempt assets) is very small. If property is partially exempt, the non-exempt portion of the debtor's interest goes to the estate. The property itself will not be returned to the debtor, only the value of the exemption will be paid to the debtor from the proceeds of the property – see Blum at 13.3.

²⁶⁴S 522(d)(1) as amended by BAPCPA.

²⁶⁵*Ferriell* at 103.

²⁶⁶See the new ss 522(o) and 522(p), which then also affect the different state homestead exemptions.

²⁶⁷S 522 (o). *Yerbich* at 29; *Ferriell* at 428. See also *In re Agnew* 355 BR 276 (Bankr D Kan 2006).

to the amendments, a court could feel constrained to allow an exemption despite evidence of apparent fraud by the debtor because the debtor's state exemption law contained no provision to prevent such fraudulent action.²⁶⁸ The amendment should now prevent this from happening. What follows are the further relevant amendments in the 2005 legislation.

(a) Amendments by BAPCPA of state homestead exemptions²⁶⁹

Various interested parties and commentators were of the opinion that the homestead exemption and asset protection schemes were abused prior to the enactment of BAPCPA, and that one of the objectives of BAPCPA was to eradicate this abuse.²⁷⁰ So, for example, in the past debtors exploited the system by buying houses for cash in states with unlimited homestead exemptions, then moving to these states 180 days before filing for bankruptcy to use these unlimited exemptions.²⁷¹

Certain limitations on state homestead exemptions came into effect upon the enactment of the BAPCPA on 20 April 2005. These can be divided into monetary limits and domiciliary limits.

Domiciliary limits

BAPCPA altered the previous domiciliary limits specific to homestead exemptions to put an end to the exploitation of lenient state laws. Prior to BAPCPA the applicable state law was that of the state where the debtor was domiciled 180 days immediately prior to the date of the filing of the petition, or the state where the

²⁶⁸See, eg, *In re Reed* 12 BR 41 (Bankr ND Tex 1981).

²⁶⁹What follows in respect of these amendments must also be read into the paragraph in respect of state homestead exemptions in para 6.6.3.3 on state exemptions.

²⁷⁰See Howard M "Exemptions under the 2005 bankruptcy amendments: A tale of opportunity lost" (2005) *Am Bankr LJ* at 397-400; Tabb CJ "The death of consumer bankruptcy in the United States?" (2001) *Bankruptcy Developments Journal* 1 at 42-42; Norwood JM and Jennings MM "Before declaring bankruptcy, move to Florida and buy a house: The ethics and judicial inconsistencies of debtors' conversions and exemptions" (1999) *SW UL Rev* at 439; Engledow WM "Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* 275 at 276-278.

²⁷¹Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 590; see also Barstow W "In Florida, Simpson may find a financial haven" (1995) *St Petersburg Times* at A1; Klein G "Consumer bankruptcy in balance: The National Bankruptcy Commission's recommendations tilt towards creditors" (1997) *AM Bankr Inst L Rev* 293 at 309.

debtor resided for the greater part of such 180 days. BAPCPA has extended this period to a window of at least 730 days.²⁷² If that domicile period was not continuous, the law to be applied will be the place where the debtor was domiciled for the 180-day period preceding the 730-day period, or where the debtor was domiciled for a longer portion of that 180-day period than any other place.²⁷³ If a debtor finds himself ineligible for any exemption under the above provisions of section 522(b)(3)(A), as a default result under section 522(b)(3), the federal exemptions under section 522(d) may be applied and the debtor can elect to exempt the property specified under that section.²⁷⁴

Monetary Limits

Under state law the value of the debtor's interest in the homestead exemption is capped at US\$125 000 if the residence in which a homestead exemption is claimed was acquired within 1 215 days preceding the filing date of the petition.²⁷⁵ But any amount of such interest does not include any interest transferred from a debtor's previous principle residence (acquired before the start of the 1 215-day period) into the current principal residence of the debtor, if the previous and current residences are situated in the same state.²⁷⁶

Furthermore, such cap of US\$125 000 on the debtor's interest also applies if he has been convicted of a felony²⁷⁷ and the filing would be an abuse under the Bankruptcy Code. The cap also applies if the debt originated from a violation of federal or state securities law, or fraud, deceit or manipulation in a fiduciary capacity or in connection with the purchase or sale of a registered security, or civil penalty under RICO, or any criminal act, international tort, or willful or reckless

²⁷²S 522(b)(3)(A); Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 591.

²⁷³S 522(b)(3); Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 592.

²⁷⁴See Ahern, III LR "Homestead and other exemptions under the bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'asset protection' after 2005" (2005) *Am Bankr Inst L Rev* 585 at 592.

²⁷⁵11 USC s 522(p)(1).

²⁷⁶S 522(p)(2)(B).

²⁷⁷A crime punishable by confinement of a period of more than one year (see 18 USC s 3156).

misconduct that caused serious physical injury or death to another individual in the preceding 5 years.²⁷⁸

The cap does not apply to the extent that the interest in the residence is reasonably necessary to the support of the debtor and or his dependents.²⁷⁹

6.6.3.2.2 Motor vehicle

A maximum exemption of US\$2 950 is allowed for one motor vehicle.²⁸⁰

6.6.3.2.3 Household goods and other items

The debtor's interest to a maximum value of US\$475 in any specific item, or US\$9 850 in aggregate value, in wearing apparel, household goods and furnishings, appliances, books animals, crops or musical instruments. These items must be held primarily for the personal, family or household use of the debtor or his dependants.²⁸¹

6.6.3.2.4 Jewellery

A maximum exemption of US\$1 225 in value in jewellery held primarily for the personal, family or household use of the debtor or his dependants.²⁸²

6.6.3.2.5 Wildcard exemption

An exemption in a debtor's interest in any property to the maximum value of US\$975, plus up to US\$9 250 of any unused amount of the homestead exemption.²⁸³ The purpose of this exemption is primarily to benefit non-homeowner debtors.²⁸⁴

²⁷⁸S 522(q).

²⁷⁹S 522(q)(2).

²⁸⁰S 522(d)(2). A debtor's exemption rights are limited in that they do not affect creditors' consensual liens. They apply only to the debtors equity in his property – see, eg, *In re Galvan* 110 BR 446 (BAP 9th Cir 1990). This means that a debtor with a home valued at US\$150 000 but which is mortgaged for US\$150 000 will be deprived of his exemption over that home because he has no equity in it – see Yerbich at 28 and Ferriell at 97.

²⁸¹S 522(d)(3).

²⁸²S 522(d)(4).

²⁸³S 522(d)(5).

²⁸⁴Waxman para 618.

6.6.3.2.6 Tools of the trade

An exemption is given to the maximum of US\$1 850 in value in any implements, professional books, or tools of the trade of the debtor or the trade of the debtor's dependants.²⁸⁵

6.6.3.2.7 Life insurance

Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract may be exempt.²⁸⁶

6.6.3.2.8 Loan value – life insurance

An exemption to a maximum of US\$9 850 in the loan value or in accrued interest or dividends of any unmatured life insurance contract owned by the debtor. For the purpose of this exemption, the insured must be either the debtor or an individual of whom the debtor is an independent.²⁸⁷ For the purpose of this section a dependant includes (but is not limited to) a spouse, regardless of whether the spouse is actually dependent.

6.6.3.2.9 Health aids

Health aids prescribed by a professional for the debtor or a dependant are exempted.²⁸⁸

6.6.3.2.10 Government benefits

The debtor's right to receive social security benefits, veteran's benefits, local public assistance, unemployment benefits or compensation, or disability or illness benefits are exempted.²⁸⁹

²⁸⁵S 522(d)(6).

²⁸⁶S 522(d)(7).

²⁸⁷S 522(d)(8); Waxman para 622.

²⁸⁸S 522(d)(9).

²⁸⁹S 522(d)(10)(A)-(C).

6.6.3.2.11 Maintenance

To the extent that it is reasonably necessary for the support of the debtor and any dependant, the debtor's right to receive alimony, support or maintenance, is exempted.²⁹⁰

6.6.3.2.12 Pension plans

Rights to receive payments under an eligible pension plan, or a similar contract based on length of service, age, illness, disability or death is exempt to the extent that it is reasonably necessary for the support of the debtor and any dependants.²⁹¹

6.6.3.2.13 Crime victim award

An award under a law for a crime victim's reparation is exempted.²⁹²

6.6.3.2.14 Wrongful death award

The debtor's right to receive payment arising from the wrongful death of an individual upon whom the debtor was dependent, is exempted to the extent that such payment is reasonable necessary to support the debtor and any of his dependants.²⁹³

6.6.3.2.15 Life insurance – dependant

The right to receive payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependant at the time when that individual died, is exempt to the extent that it is reasonably necessary for the support of the debtor or any of his dependants.²⁹⁴

6.6.3.2.16 Personal injury

A payment to the maximum of US\$15 000 arising from personal bodily injury of the debtor or an individual of whom the debtor is a dependant, is exempted. This

²⁹⁰S 522(d)(10)(D).

²⁹¹S 522(d)(10)(E).

²⁹²S 522(d)(11)(A).

²⁹³S 522(d)(11)(B).

²⁹⁴S 522(d)(11)(C).

payment does not include compensation for pain and suffering, or compensation for actual pecuniary loss.²⁹⁵

6.6.3.2.17 Loss of future earnings

A payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependant, is exempted to the extent that it is reasonably necessary for the support of the debtor and any of his dependants.²⁹⁶

6.6.3.2.18 Retirement accounts

Notwithstanding whether state or federal exemptions are taken, retirement funds in a tax-exempt fund or account under any of the relevant sections²⁹⁷ of Title 26 of the United States Code are exempt.²⁹⁸

Some of these exemptions are capped at a certain value. Exemption of Individual Retirement Accounts and Simplified Employee Plans²⁹⁹ is capped at US\$1 000 000.³⁰⁰ But rollovers into certain accounts under 26 United States Code,³⁰¹ and earnings on those rollovers are excluded from the cap.³⁰²

6.6.3.3 State exemptions and non-bankruptcy federal exemptions

In all states debtors may use both the state and the federal non-bankruptcy exemptions, while in some states debtors have a choice. They may elect to apply either their state exemptions and the federal non-bankruptcy exemptions, or they can use *only* the federal bankruptcy exemptions. Choosing the federal bankruptcy exemptions thus excludes a resident in these states from using either the state exemptions or the federal non-bankruptcy exemptions.³⁰³

²⁹⁵S 522(d)(11)(D); *In re Harris* 50 BR 157 (Bankr ED Wis 1985).

²⁹⁶S 522(d)(11)(E); *In re Harris* 50 BR 157 (Bankr ED Wis 1985).

²⁹⁷26 USC ss 401, 403, 408, 408A, 414, 457, or 501(a).

²⁹⁸11 USC s 522(b)(3)(C), (d)(12).

²⁹⁹26 USC ss 408 and 408A.

³⁰⁰11 USC s 522(n).

³⁰¹Those under ss 402(c), 402(e)(6), 403(a)(4), 403(a)(5) and 403(b)(8).

³⁰²11 USC s 522(n).

³⁰³Sitarz D *Quick reference law series – laws of the United States – Bankruptcy exemptions* (2000) at 5 (hereafter Sitarz)

So, if the state where the debtor is domiciled has opted out of the federal bankruptcy exemptions, the only exemptions at the debtor's disposal are those available under the relevant state law and under federal non-bankruptcy law.³⁰⁴

It is not possible to consider all such exemptions here. Certain exemptions in certain states will, however, be mentioned briefly.

(1) State law exemptions

State law exemptions are those in effect from the date of bankruptcy in the state where the debtor has been domiciled for the 730 days immediately preceding the date of the filing of the petition. But if the debtor has not been domiciled in a single state for this 730-day period, the place in which he was domiciled for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place applies.³⁰⁵

The state bankruptcy exemptions that have been legislated for the various different states in the United States are too numerous and too varied to include in this thesis. However, a general trend in respect of exempt assets can be identified in respect of all the states that have provided for exempt property. Generally, certain categories of exemptions are provided for in these states. These categories will be considered next, with examples of these categories of exempt assets in three different states, namely Alaska,³⁰⁶ Florida³⁰⁷ and Texas.³⁰⁸

(a) Benefits

Various governmental benefits that are excluded from bankruptcy form part of this category. These may include unemployment benefits, worker's compensation and welfare benefits.³⁰⁹

³⁰⁴S 522(b)(2).

³⁰⁵S 522(b)(3)(A).

³⁰⁶Alaskan residents are excluded from using federal bankruptcy exemptions, but may use the federal non-bankruptcy exemptions and their state exemptions. In even numbered years the state may revise the amounts relating to exemptions; see Sitarz at 11.

³⁰⁷Residents of Florida may not use federal bankruptcy exemptions, but can apply federal non-bankruptcy exemptions and the state exemptions; see Sitarz at 30.

³⁰⁸In Texas *either* federal bankruptcy exemptions may be used, or the state exemptions may be applied. If the state exemptions are chosen, then the federal non-bankruptcy exemptions may also be used; see Sitarz 107.

³⁰⁹Sitarz at 5.

In Alaska some of these benefits include aid to the aged, blind and disabled, and to families with dependent children, in unlimited amount.³¹⁰ Federally exempt benefits³¹¹ and unemployment compensation,³¹² both in unlimited amounts, and several more aid related benefits are also exempt.

In Florida these benefits also generally relate to aid and compensation. Some of these benefits include an unlimited amount in public assistance,³¹³ unemployment compensation³¹⁴ and worker's compensation.³¹⁵

Texas state benefits that are exempt include an unlimited amount in medical assistance,³¹⁶ unemployment compensation³¹⁷ and worker's compensation.³¹⁸

(b) Insurance

This category includes any insurance-related property, including private annuity and disability-related proceeds, cash value on insurance policies, and various other insurance-based assets.

Exempt insurance benefits in Alaska include unlimited amounts in:

- disability benefits;³¹⁹
- fraternal society benefits;³²⁰
- medical, surgical or hospital benefits;³²¹
- insurance proceeds or recoveries for personal injury or wrongful death, up to the wage exemption amount;³²²
- life insurance or annuity contract loan to a maximum of US\$10 000;³²³ and

³¹⁰Alaska Statutes 47.25.210, 47.25.550 as in Sitarz at 11.

³¹¹Alaska Statutes 9.38.015 (a)(6) as in Sitarz at 11.

³¹²Alaska Statutes 9.38.015(b), 23.20.405 as in Starz at 11.

³¹³Florida Statutes Annotated 222.201 as in Sitarz at 30.

³¹⁴Florida Statutes Annotated 222.201 and 443.051(2), (3) as in Sitarz at 30.

³¹⁵Florida Statutes Annotated 440.22.

³¹⁶Texas Revised Civil Statutes Annotated, Human Resources 32.036as in Sitarz at 107.

³¹⁷Texas Revised Civil Statutes Annotated, Human Resources 5221b-13 as in Sitarz at 107.

³¹⁸Texas Revised Civil Statutes Annotated, Human Resources 8308-4.07as in Sitarz at 107.

³¹⁹Alaska Statutes 9.38.015(b), 9.38.030(e)(1),(5) as in Sitarz at 11.

³²⁰Alaska Statutes 21.84.240 as in Sitarz.at 11.

³²¹Alaska Statutes 9.38.015(b), 9.38.015(a)(3) as in Sitarz at 11.

³²²Alaska Statutes 9.38.015(b), 9.38.030(e)(3), 9.38.050(a) as in Sitarz at 11.

³²³Alaska Statutes 9.38.017, 9.38.025 as in Sitarz at 11.

- life insurance proceeds if the beneficiary is the insured's spouse or dependent, limited to the wage exemption amount³²⁴

In Florida insurance exemptions include the following, all in unlimited amounts:

- annuity contract proceeds;³²⁵
- death benefits if not payable to the deceased's estate;³²⁶
- disability or illness benefits;³²⁷
- fraternal society benefits;³²⁸ and
- life insurance cash surrender value³²⁹

In Texas insurance exemptions include the following unlimited amounts in:

- fraternal society benefits;³³⁰
- life insurance if the beneficiary is the debtor or a dependent of the debtor;³³¹
- retired public school employees group insurance,³³²
- Texas employee uniform group insurance,³³³
- Texas state college or university employee benefits;³³⁴ and
- limited life, health, accident or annuity benefits, cash value, or proceeds³³⁵ – this exemption is capped at a certain maximum amount, with a larger exempt sum being allowed if the debtor is a head of a family.³³⁶

(c) Pensions

This is retirement-related property. Various pensions and retirement plans are included in this exemption.

³²⁴Alaska Statutes 9.38.030(e)(4) as in Sitarz at 11.

³²⁵Florida Statutes Annotated 222.14 as in Sitarz at 30.

³²⁶Florida Statutes Annotated 222.13 as in Sitarz at 30.

³²⁷Florida Statutes Annotated 222.18 as in Sitarz at 30

³²⁸Florida Statutes Annotated 632.619 as in Sitarz at 30

³²⁹Florida Statutes Annotated 222.14 as in Sitarz at 30

³³⁰Texas Revised Civil Statutes Annotated, Insurance 10.28 as in Sitarz at 107.

³³¹Texas Revised Civil Statutes Annotated, Insurance 42.002(a)(12) as in Sitarz at 107.

³³²Texas Revised Civil Statutes Annotated, Insurance 3.50-4(11)(a) as in Sitarz at 107.

³³³Texas Revised Civil Statutes Annotated, Insurance 3.50-2(10)(a) as in Sitarz at 107.

³³⁴Texas Revised Civil Statutes Annotated, Insurance 3.50-3(9)(a) as in Sitarz at 107.

³³⁵Texas Revised Civil Statutes Annotated, Insurance 21.22 as in Sitarz at 107.

³³⁶Texas Revised Civil Statutes Annotated, Property 42.001, 42.002 as in Sitarz at 108.

In Alaska, Florida and Texas pension exemptions relate mainly to civil service, armed forces or police-type pensions, some of which may be limited, while others enjoy unlimited exemption.³³⁷ For example, in Alaska exemption on some pensions apply only to unpaid benefits on that pension, while retirement benefits deposited more than a specified number of days before the bankruptcy date enjoy unlimited exemption.³³⁸

In Florida and Texas most pension exemptions are in an unlimited amount.³³⁹

(d) Miscellaneous

Items included here relate to property of business partnerships and exempt amounts that may in one way or another be applied to any property, be it personal property or real estate. Alaska, Florida and Texas all exempt alimony up to an amount needed for support or up to a wage exemption amount. They also all exempt property of a business partnership in an unlimited amount. Alaska also exempts liquor licences and fisheries permits in an unlimited amount.³⁴⁰

(e) Personal property

This is all personal property specifically exempt from bankruptcy that debtors probably keep after bankruptcy.

In all three states, Alaska, Florida and Texas, these exemptions relate to items such as books, clothing, implements, tools of the trade, health aids, heirlooms and jewellery. Each state specifically exempts a motor vehicle. Mostly, the exemption on these items is capped at a specific maximum amount.³⁴¹

(f) Real estate

Generally, these exemptions, also called “homestead exemptions”, allow a fixed maximum value of a personal residence. As with most categories of exemptions,

³³⁷See Sitarz at 12, 31 and 108.

³³⁸See, eg, Alaska Statutes 9.38.015(b), 9.38.017 as in Sitarz at 11.

³³⁹See Sitarz at 31 and 108.

³⁴⁰See Sitarz at 12, 31 and 108.

³⁴¹See Sitarz at 12, 31 and 108.

this exemption differs from state to state, but note the changes regarding homestead exemptions that were introduced by BAPCPA.³⁴²

In Alaska real property that is used as a residence is exempted to the amount of US\$54 000.³⁴³

Real estate in Florida enjoys unlimited exemption if the property is used as a residence and does not exceed 160 contiguous acres. The exemption must be filed in the Circuit Court.³⁴⁴

In Texas real property carries exemption of unlimited value up to one acre in a town, village or city, and 200 acres elsewhere (100 for a single person). The exemption must be filed with the county.³⁴⁵

(g) Wages

This exemption refers to general wage exemptions and specific wage exemptions for specific professions. This item also differs from state to state, but generally 75 percent of wages are exempt from creditors.

In Alaska the wage exemption is capped at a maximum amount which varies, depending on whether or not the debtor is the sole wage earner, and whether the wage is paid weekly, monthly or over other periods.³⁴⁶ In Florida there is an exemption of 100 percent of wages for heads of family, up to US\$500 per week either unpaid or paid and deposited into a bank account for up to six months.³⁴⁷ In Texas wages earned, but unpaid, are exempted in an unlimited amount, while unpaid commission up to 75 percent is exempt, but capped at a specific amount, which differs depending on whether the debtor is the head of a family, in which case the cap is a higher amount.³⁴⁸

³⁴²See para 6.4.5 above

³⁴³Alaska Statutes 9.38.010 as in Sitarz at 12.

³⁴⁴See Sitarz at 31.

³⁴⁵See Sitarz at 108.

³⁴⁶See Sitarz at 12.

³⁴⁷Florida Statutes Annotated 222. 11 as in Sitarz at 31.

³⁴⁸Texas Revised Civil Statutes Annotated, Property 42.001(b)(1), 42.001 (d) and 42.002 as in Sitarz at 108.

(h) Spouses

It has already been mentioned that joint bankruptcy filings by spouses allow each spouse to claim separately for exemptions. However, there are some exceptions and some uncertainty in this regard, and the position in each state must be considered to obtain clarity in this respect.³⁴⁹

(2) Non-bankruptcy federal law

Exemptions may be provided by federal law other than the Bankruptcy Code, and may be claimed under the provisions of section 522(b)(3)(A) of the Bankruptcy Code. These exemptions may be used only if a debtor has chosen to use the relevant state law exemptions. If the debtor has chosen to use the federal bankruptcy exemptions, the federal non-bankruptcy exemptions are not available to him.³⁵⁰

These federal non-bankruptcy exemptions relate mostly to various benefits that are provided for under different United States Codes. The exemption in respect of such benefits, insurance, pensions, personal property or wages may be exempted in an unlimited amount, or it may be capped at a specified value. Examples of these exemptions are social security payments,³⁵¹ civil service retirement benefits,³⁵² government employee death and disability benefits,³⁵³ railroad workers unemployment insurance,³⁵⁴ and a certain percentage of earned, but unpaid, wages,³⁵⁵ to mention only a few.

6.6.3.4 Exemptions in joint cases

Each debtor in a joint case is entitled to any available exemptions.³⁵⁶ If joint debtors elect the federal exemptions, they may “stack” their exemptions, meaning that *each* debtor may claim the maximum homestead exemption, the maximum

³⁴⁹See par. 6.5.4 above.

³⁵⁰Sitarz at 127.

³⁵¹See 42 USC s 407.

³⁵²See 5 USC s 8346(a).

³⁵³See 5 USC s 8130.

³⁵⁴See 45 USC 352(e).

³⁵⁵See 15 USC 1673.

³⁵⁶S 522(m).

vehicle exemption and so forth.³⁵⁷ But it must be remembered that the Code prohibits stacking federal and state exemptions. Thus *both* debtors must choose either the federal exemptions or the state exemptions.³⁵⁸

In respect of state exemptions, the courts are split in deciding whether section 522(m), which allows joint debtors separate exemptions, applies to states that have opted out of the federal exemption system. On the one side the opinion is that section 522(m) applies only to the federal exemptions. It does not bind opt-out states. This means that such states may provide one set of exemptions that must be shared by both debtors in the joint case.³⁵⁹ The other line of thought is that section 522(m) entitles each debtor in a joint case “to take some exemptions, whether the amount is determined by state or federal law”.³⁶⁰ This means that an opt-out state must still allow each debtor in a joint case to claim separate exemptions.³⁶¹

6.6.3.5 Objections to exemptions

Interested parties can file objections to claimed exemptions. The person objecting carries the burden to prove that the exemption may not be claimed.³⁶² These objections to exemptions by interested parties must be filed not later than 30 days after the conclusion of the meeting of creditors held under section 341.³⁶³ If no such objection is filed, the property claimed as exempt by the debtor is exempt from the bankruptcy estate.³⁶⁴ The debtor may therefore acquire an excessive exemption if the trustee and creditors are not vigilant. This issue came before the Supreme Court in *Taylor v Freedland & Kronz*,³⁶⁵ which held that the failure by the creditor or trustee to file the objection within the 30-day period (or the period extended by the court) barred the right to object, and the exemption stood, irrespective of the debtor’s right to the exemption being questionable.

³⁵⁷S 522(m) and see *In re Gallo* 49 BR 28 (Bankr ND Tex 1985).

³⁵⁸S 522(b); See Waxman para 640 and further.

³⁵⁹*In re Granger* 754 F 2d 1490 (9th Cir 1985).

³⁶⁰*Cheeseman v Nachman* 656 F 2d 60 (4th Cir 1981).

³⁶¹See Waxman para 642.

³⁶²Rule 4003(c).

³⁶³Rule 4003(b); see Yerbich at 30.

³⁶⁴S 522(l).

³⁶⁵503 US 638 (1992).

6.6.3.6 Effect of exemptions

Property exempted by the debtor is not liable during or after the case for any debt that arose or is deemed to have arisen before the date of bankruptcy.³⁶⁶

But there are exceptions to this rule, so some types of debts may be satisfied from the exempt property of the debtor. These debts of an individual debtor generally relate to certain non-dischargeable taxes, non-dischargeable alimony, maintenance or spousal or child support, debt secured by certain liens, debts owed by institution-affiliated party of an insured financial institution for fraud and related (criminal or illegal) acts, and certain student loans.³⁶⁷

These debts therefore survive a discharge granted to an individual who received a discharge under chapter 7, 11 or 12, or (a hardship discharge under) chapter 13.³⁶⁸ All the debtor's exempt assets may be consumed by these non-dischargeable debts if such debts are large enough.³⁶⁹

6.7 Conclusion

The historical survey of bankruptcy law in the United states shows that it had its origins in the older English practices of debt slavery and imprisonment.³⁷⁰ From that earliest time property of the debtor was at the disposal of creditors for the satisfaction of their debts, while imprisonment was a later remedy. The bankruptcy procedure was initially creditor-driven, available only against traders. Concessions to the debtor regarding property excluded from a bankrupt estate began to develop in the early eighteenth century, but further relief to debtors developed slowly. American colonies adopted the English system with few states giving a debtor release from imprisonment or discharge from his debts.³⁷¹

³⁶⁶S 522(c).

³⁶⁷See eg ss 522(c)(1), 523(a)(1), 523(a)(5), 522(c)(2)(A) and (B), 522(c)(3), 523(a)(4) and 523(a)(6).

³⁶⁸Many of the exceptions to a discharge under s 523(a) are not applicable to a standard discharge under chapter 13. Generally, all debts included in the debtor's chapter 13 plan of repayment are discharged, except alimony, maintenance and spousal or child support, student loans, liability for certain kinds of illegal acts and certain kinds of long-term indebtedness – see s 1328(a) and Waxman para 678.

³⁶⁹See Waxman para 647.

³⁷⁰See para 6.2.1 above.

³⁷¹See para 6.2.1 above.

American “insolvency” law, which was designed for the relief of debtors, developed in the early nineteenth century when states enacted constitutional provisions prohibiting imprisonment for debt, but the creation of a unified debtor creditor statute, combining discharge and bankruptcy elements took long to achieve.³⁷² The Act of 1800, although creditor-orientated, brought together “insolvency” and “bankruptcy”, and made specific provision for limited exempt property.³⁷³

The first direct attempt to protect debtors was found in the Bankruptcy Act of 1841 which introduced voluntary proceedings for both merchants and non-merchants, and extending provisions regarding exempt property. This Act’s provision of voluntary bankruptcy for all achieved a fundamental policy change in American bankruptcy law and although it was soon repealed at the insistence of creditors, the policy change endured.³⁷⁴ This policy change was further witnessed in the Bankruptcy Act of 1867, which was a compromise between debtor and creditor interests. Exemptions were extended to include certain federal non-bankruptcy law exemptions and state exemptions.³⁷⁵

The Bankruptcy Act of 1898, which remained in force until the promulgation of the Bankruptcy Code in 1978, provided for a broad definition of property of the bankruptcy estate and extensive reform in favour of debtors regarding exempt property.³⁷⁶ The courts also construed this legislation to favour certain exemptions for debtors, all with the intention of removing unnecessary obstacles in the way of the debtor’s fresh start.³⁷⁷ The 1898 Act was extensively amended by the Chandler Act of 1938. But the most important effect of the 1898 Act regarding debtor-friendly policy considerations was its denying creditors the control of the debtor’s access to a discharge.

³⁷²See para 6.2.2 above.

³⁷³See para 6.2.3 above.

³⁷⁴Tabb “The historical evolution of the bankruptcy discharge” (1991) *Am Bankr LJ* at 350 and further.

³⁷⁵See para 1.2.3 above

³⁷⁶Countryman V “Bankruptcy and the individual debtor – and a modest proposal to return to the seventeenth century” (1983) *Catholic University Law Revue* 809 at 817.

³⁷⁷Dickerson “From jeans to genes: The evolving nature of property of the estate”(1999) *Bankr Dev J* at 292-293.

The Bankruptcy Code of 1978 was the first thorough revision of bankruptcy law since the 1898 Act, generally continuing the policy of a debtor-friendly approach to bankruptcy. It substantially expanded, among other things, the rights of the consumer debtor, making chapter 13 thereof a more desirable option for debtors, and expanding the number and variety of assets exempt from the creditors' reach. Because the incorporation of state exemption laws into the federal bankruptcy case had always been criticised,³⁷⁸ it was eventually amended by including federal exemptions in the new Code. But it also provided for the "opt-out" model, giving the debtor the option to elect either the federal exemptions or the relevant state exemptions, but also permitting the respective states to exclude this choice of exemptions by legislation that provides exclusively for state exemptions, meaning that federal exemptions are then unavailable to that state's residents.³⁷⁹ The result is section 522(b)(2) of the Code allowing the debtor to choose between federal or state exemptions, unless state law does not authorise this (the opt-out clause). This arrangement remained intact in the 2005 amendments to the Code, despite criticism and calls for uniformity of state exemptions in bankruptcy.³⁸⁰

After the enactment of the code there was a sharp increase in the number of business and bankruptcy filings, particularly chapter 7 filings. Whether the increase in filing has resulted from the generosity of the Code, to the change in society's notions about the morality of avoiding one's debt or to the wider availability of lawyers is uncertain and much disputed.³⁸¹

Be that as it may, several amendments to the Code inevitably followed, perhaps the most substantial being the Bankruptcy Abuse Prevention Consumer Protection Act of 2005. However, none of these amendments drastically changed the existing

³⁷⁸See, eg, Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 405 note 28 and Vukowich WT "The bankruptcy commission's proposals regarding bankrupt's exemption rights" (1975) *Cal L Rev* 1439 at 1441-1446.

³⁷⁹Bartell LB "The peripatetic debtor: Choice of law and choice of exemptions"(2006) *Emory Bankruptcy Developments Journal* at 406.

³⁸⁰Brown WH "Political and ethical considerations of exemption limitations: The 'opt-out' as child of the first and parent of the second" (1997) *Am Bankr LJ* at 149; Engledow WM "Cleaning up the pigsty: Approaching a consensus on exemption laws (2000) *Am Bankr LJ* at 276-78; Ponoroff L "Exemption limitations: A tale of two solutions" (1997) *Am Bankr LJ* at 221.

³⁸¹White at 56.

provisions, basically since the 1898 Act, regarding estate property and excluded or exempt property. Although access to bankruptcy has been made more labourious, once the debtor does gain access to the system, he gains access to certain property to assist him in finding a fresh start and this is a fundamental policy in American bankruptcy law that has remained constant.³⁸² The provisions relating to the property in the bankruptcy estate and to exemptions have progressed or developed in the debtor's favour over the centuries, and in recent years have not been interfered with, despite pressure from creditor groups. This appears to confirm that the debtor-centred approach in American bankruptcy policy is firmly entrenched, thereby also confirming the traditional underlying policy of equal treatment of creditors and the rehabilitation of the debtor. But as has been indicated above, more recent ideas, or perhaps one should say ideals, of a social or economic nature regarding American bankruptcy policy have developed, usually taking the side of either the debtor or the creditor. But American bankruptcy policy, it would appear, remains entrenched in the ideal of treating the creditors equally and giving the debtor a chance at a fresh start. This fundamental policy is overlapped by the policies of treating bankruptcy as a remedial mechanism with modest aims, protection of debtor and creditor interests, and the preservation of the bankruptcy estate. These policies, where or when necessary are, in turn, trumped, overlapped or co-mingled with policy considerations from other sectors of society. Thus American bankruptcy policy, as with most policy issues, is dynamic and does not sit in a vacuum. This is a lesson to be learnt by the important role-players in the formulation policy in the South African insolvency law arena. While South African insolvency policy is by no means static, it has been particularly creditor-motivated, with little interest in the well-being of the honest, but unfortunate, debtor. Movement in the direction of some form of respite for the debtor is at snail's pace and, at times, perhaps in reverse gear.³⁸³

Although there has been a definite policy shift towards a more creditor-friendly system in American bankruptcy law, the provisions regarding the bankruptcy estate and exempt property may be considered liberal compared with that of South

³⁸²See para 6.2.3 above.

³⁸³Consider, eg, the treatment of spouses in South Africa, whether married in community of property or out of community of property, as well as their position in former insurance legislation – see chs 9 and 10 below.

Africa. That system also has more clarity or certainty in respect of the content of the bankruptcy estate, and the extent of excluded and exempt property. Its provisions, for example, maintain a consistency in the categories of property included in the estate, as well as the categories and the maximum sums of assets included or excluded from the estate. In respect of estate assets, South African law may do well to follow this example, thereby reducing uncalled-for litigation in respect of estate assets. Poorly drafted and inconsistent legislation leads to litigation that may otherwise be avoided.³⁸⁴

While it will probably always be difficult, if not impossible, to formulate a perfect definition of “estate property”, or “insolvent estate”, one should attempt to provide for a broad, all-inclusive definition, as has been done in the United States Bankruptcy Code. If this has been achieved, excluded and exempt property may be defined in detailed and consistent legislation. The Code, however, seems inelegant in its language and riddled with excessive use of cross-referencing. But in respect of the assets of the bankruptcy estate, it has achieved considerable clarity and consistency. For example, the provisions in respect of community property may serve as an example for South African law reform on this topic.³⁸⁵

Most of the provisions in the Code that relate to excluded or exempt property are clear and certain, and are based on the long-established socio-economic policy of assisting the debtor in achieving a fresh start, but simultaneously respecting the creditors’ rights. The further policy of accepting bankruptcy to be remedial in nature must then be leaned on when questioning the efficacy of these socially orientated policies that encapsulate the exemption provisions. Here the homestead exemption comes to mind. Although the homestead provision is clear and certain in its drafting in both federal and state legislation, and is cradled by very old policy favouring the protection of the homestead, its efficacy in practice appears questionable. First, inconsistent state homestead legislation flaws the policy upon

³⁸⁴See, eg, all the South African litigation that has resulted from s 21 of the Insolvency Act 24 of 1936 discussed in ch 10, the litigation in respect of insurance policies in paragraph and that in respect of inherited property in chs 8 and 9 below, and in fact, the multitude of litigation relating to all the problem areas concerning assets of the insolvent estate in South Africa.

³⁸⁵See para 6.5.4 above and ch 10 below.

which the homestead idea is founded. Some debtors in America will benefit handsomely from this legislation, while others will benefit very little, depending on the legislation in a particular state. But this is a problem that comes with federalism. The real problem with the homestead legislation is that it may really hold little value for the debtor when the homestead is mortgaged. The secured creditor has preference over the homestead equity, to the exclusion of other creditors and the debtor. In South Africa, where probably the majority of homeowners are mortgagors, a homestead exemption may hold little value, unless a provision may be formulated whereby the homestead is excluded from the insolvent estate for a particular period during which the debtor can attempt to come to a payment arrangement with his creditor.

Apart from the homestead exemption, other federal and state exemptions, and non-bankruptcy law exemptions are perhaps broad and comprehensive enough to serve as a form of social security, albeit limited, and funded primarily by creditors. But in comparison with many other systems, it is generous. For South African purposes, it is interesting to note that American law recognises exemptions of motor vehicles, crime victim awards and firearms, to mention only some. Furthermore, a good degree of clarity has been achieved in respect of the exemption, and the maximum exempt amounts of, for example, insurance policies, pensions, personal injury, maintenance and future earnings.

But the intention with exempt and excluded property is not for the debtor to receive a windfall or to abuse the system, as has been the case particularly in respect of homestead exemptions in some states. An attempt to put an end to this problem in the BAPCPA, it would appear, really only affects short-term estate planning and an abuse of the system in the short term. But an effective homestead exemption for the honest, but unfortunate, debtor remains available. Creditors interests in respect of exemptions are also protected in that interested parties can file objections to claimed exemptions.

One aspect of American law that appears unsatisfactory is the uncertainty, or perhaps the inequality, created by state law, particularly in respect of exemptions.

This was, however, considered by the American courts and found to be constitutional.³⁸⁶ It would appear that both debtors and creditors either gain or lose one or more benefits regarding, among other things, exemptions, all depending on the state in which they are living. But this appears to be a problem that will always be inextricably linked to a federal system of government. In this respect the distinction between state law exemptions and federal exemptions seems to be an acceptable compromise in those circumstances.

Generally, however, it may be argued that American bankruptcy law policy in respect of estate property and exemptions is succeeding in its aim of striking a balance between debtor and creditor interests, and the interests of the various other stakeholders. This is so because these provisions relating to estate property have remained more or less constant, despite numerous amendments to the bankruptcy legislation over the past century or so.

Catherine Smith³⁸⁷ referred to the golden thread in South African insolvency law which is woven through insolvency proceedings, being advantage to creditors. One wonders whether one will not be forced to enquire whether or not that thread has, through time and modern changes, been tarnished, therefore calling for fresh ideas to be sewn together with a new, but stronger, thread which may hold together the ideas and principles embodied in the South African Constitution, particularly the possibility of a more debtor-friendly policy in helping the debtor on his road towards a fresh start. On this journey through insolvency law reform in South Africa and in reconsidering some of the policies upon which one hopes to venture into the future, it may be useful to consider some of the policies underpinning American bankruptcy law.

³⁸⁶See para 6.6.1 above.

³⁸⁷See para 6.1 above.