Volume 43 | Issue 1 Article 7

Winter 1-1-1986

Reaffirmation Under The Consumer Bankruptcy Amendments Of 1984: A Loser For All Concerned

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REAFFIRMATION UNDER THE CONSUMER BANKRUPTCY AMENDMENTS OF 1984: A LOSER FOR ALL CONCERNED

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A primary motive for individuals seeking bankruptcy relief is to obtain a discharge for all debts. The discharge affords an honest debtor an economic fresh start. Since 1898 Congress has consistently affirmed the fresh start policy as a primary bankruptcy goal in consumer cases.[1] Moreover, the courts have been adept at construing the bankruptcy laws to carry out this Congressional purpose.[2]

A debtor who reaffirms a pre-petition debt nullifies his discharge to that extent.[3] The bankruptcy discharge prevents enforcement of pre-petition claims.[4] When the debtor reaffirms a pre-petition debt, he re-establishes its validity. In sum, the effectiveness of the discharge declines as the number of reaffirmations increases.

Obtaining reaffirmations is the centerpiece of professional creditors' strategy in dealing with consumer bankrupts.[5] When a bankrupt client

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1. The bankruptcy discharge is the cornerstone of the fresh start policy. *See* 11 U.S.C. § 32 (1976) (repealed 1978) (discharge provision of the 1898 Bankruptcy Act); 11 U.S.C. § 727 (as amended 1984) (current Chapter 7 discharge provision). Section 524 includes the current provisions establishing the effect of a discharge in bankruptcy. 11 U.S.C. § 524 (as amended 1984).

2. *See, e.g.,* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934). Lines v. Frederick, 400 U.S. 18, 19 (1970); Perez v. Campbell, 402 U.S. 637, 648 (1971).

3. 11 U.S.C. § 524(a)(2) (1985).

4. *Id.* at § 727(b). In a reaffirmation agreement, the debtor effectively waives his or her discharge as to the claim reaffirmed. The "waiver" operates only to the extent that the debtor agrees to repay the debt. For example, a debtor may reaffirm a debt by agreeing to repay less than the full amount of the outstanding obligation. The creditor thereafter may seek to recover the full amount of the reaffirmed claim but may not attempt to recover any portion of the original debt that the debtor did not reaffirm.

5. Much of the controversy surrounding the proposals of the professional creditors to amend the Code concerned their efforts to deny Chapter 7 relief to consumer debtors. *See infra* note 6. The creditors argued that only debtors who could pay all or a large percentage of their debts would be denied Chapter 7; such debtors should convert their Chapter 7's to Chapter 13's. *See* Ayers, *Reforming the Reform Act: Should the Bankruptcy Reform Act of 1978 be Amended to Limit the Availability of Discharges to Consumers,* 17 NEW ENGLAND L. REV. 719, 726-27 (1981); Ginsberg, *The Proposed Bankruptcy Improvements Act: The Creditors Strike Back,* 3 N. ILL. L. REV. 1, 1-21 (1982). Mr. Henry J. Sommer, an attorney at Community

reaffirms, his discharge has a minimal effect on this creditor. The original contract is restored, permitting the creditor to receive most of the benefits of its bargain.

That creditors benefit from reaffirmations is apparent; why debtors so often sign them is not. Based on a standard cost/benefit analysis, many bankrupts enter economically irrational reaffirmations. Professional creditors[6] generally concede that improvident reaffirmations often curtail a debtor's fresh start.[7]

Modern bankruptcy law[8] has dealt with reaffirmations of consumer debts in three different ways. The Bankruptcy Act made no reference to reaffirmation agreements directly and left the issue entirely up to state law.[9] The Bankruptcy Reform Act of 1978 ("Code"), injected the bankruptcy judge into the process and required the judge's approval as a condition to the

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Legal Services in Philadelphia, argued that the creditors would use this new provision to force reaffirmations, not to encourage conversions to Chapter 13, because reaffirmation was their primary goal:

> [T]he vast majority of cases will go down a different course. This bill [forbidding Chapter 7 relief to some debtors] will be used by creditors to force unfair reaffirmations just as they used the household goods security interests and the false financial statement provisions under the previous Bankruptcy Act. . . .[T]he settlement reached won't be to have the debtor convert to Chapter 13. The creditor's lawyer will say, 'You reaffirm my debt and I will drop this proceeding.' That is what the creditor wants. His debt gets reaffirmed and all others get discharged.

Hearings on the Revision of the Bankruptcy Reform Act Before the Senate Judiciary Comm., 98th Cong. 1st Sess. 281 (1983) [hereinafter cited as Senate Hearings].

In one study undertaken in the late 1960's the data indicated that seventy percent of finance companies sought reaffirmations in bankruptcy cases. When all creditors were considered, thirty-five percent "systematically" sought reaffirmations. H. Jacob, Debtors in Court 109 (1969). That study also found that more than one-half of the debtors included in the study had reaffirmed one or more of their discharged obligations. *Id.* The Brookings Institute study found that over one-third of the debtors in that study had reaffirmed debts. D. Stanley & M. Girth, Bankruptcy: Problems, Process, Reform 60 (1971) [hereinafter cited as Brookings Institute].

6. "Professional creditors" refers to creditors who are members of the consumer finance industry. The consumer finance industry includes retailers, oil companies, consumer bankers, finance companies and credit unions. The industry is represented by various associations, formal and informal. Among the associations are the National Retail Merchants Association, the National Consumer Finance Association, the Bankruptcy Discussion Group, and the National Association of Credit Management. The Personal Finance Law Quarterly Report is probably the most prominent organ of the organizations. The Consumer Bankruptcy Amendments of 1984 received its impetus from the consumer finance industry.

7. Senate Hearings, *supra* note 5, at 281 (Testimony of Robert B. Evans, General Counsel, National Consumer Finance Ass'n, and Donald V. Beall, representing the Nat'l Credit Union Ass'n); Proposed Amendments to the Bankruptcy Reform Act suggested at the consumer Bankruptcy Seminar—Public Policy Choices, sponsored by the National Retail Merchant's Association and the National Consumer Finance Association in Washington, D.C. (Feb. 1981).

8. We define "modern" bankruptcy law as the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1978); the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978); and the Consumer Bankruptcy Amendments of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

9. *See generally* 1A Collier on Bankruptcy 17.33 (14th ed. 1971).

enforceability of the agreement reached by the debtor and creditor.[10] The Consumer Bankruptcy Amendments of 1984 ("CBA") have substituted the debtor's attorney for the bankruptcy judge to "approve" reaffirmation agreements between debtors and creditors.[11] A brief review of the enforceability of reaffirmation agreements under each of these bankruptcy law systems will illuminate the fundamental policies Congress adopted with respect to reaffirmations in each of the three bankruptcy systems.

The enforceability of reaffirmation agreements was purely a matter of state law under the Bankruptcy Act of 1898. The Bankruptcy Act provided that the debtor could obtain a discharge of his debts, but did not contain a provision limiting the effect of the discharge as against subsequent promises to repay the original prebankruptcy obligations. Under the common law of contracts, an express post-bankruptcy promise to repay a discharged debt was enforceable without the need for any new or additional consideration beyond that supporting the original obligation.[12] The courts held that the debtor's "moral obligation" to repay the original indebtedness was sufficient consideration to support the new promise.[13] Some states by statute required that the post-bankruptcy promise be made in writing.[14] Generally, however, no writing was necessary, and any express promise to repay was enforceable.[15] The Supreme Court upheld the primacy of state law on this issue, holding that the enforcement of the post-bankruptcy agreements did not conflict with the discharge policy contained in the Bankruptcy Act.[16]

A number of commentators recognized the adverse effect of a reaffirmation agreement on the debtor's discharge in bankruptcy.[17] The Brookings Institute study of the bankruptcy system offered empirical support for the proposition that debtors too often reaffirmed discharged obligations thereby returning to a precarious financial position notwithstanding the entry of an order of discharge in the case.[18] The authors of that study proposed that Congress amend the Bankruptcy Act to provide that reaffirmation agreements be unenforceable in order to enhance the effectiveness of bankruptcy discharges.[19] The Bankruptcy Commission which studied the bankruptcy system

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10. Bankruptcy Reform Act §§ 524(c)(4) & (d). *See, e.g.*, Matter of Bryant, 43 B.R. 189 (Bankr. E.D. Mich. 1984).

11. Consumer Bankruptcy Amendments § 524(c)(3).

12. RESTATEMENT (Second) OF CONTRACTS § 83 (1981).

13. *See, e.g.*, Super Chief Credit Union v. McCoy, 3 Kan. App. 2d 25, 595 P.2d 346, 347-48 (1978).

14. *See, e.g.*, Jelliffe v. Thaw, 67 F.2d 880, 881 (2d Cir. 1933).

15. *See* Boshkoff, *The Bankrupt's Moral Obligation to Pay His Discharged Debts: A Conflict Between Contract Theory and Bankruptcy Policy*, 47 IND. L. J. 36, 62-63 (1971).

16. Zavelo v. Reeves, 227 U.S. 625 (1913); *but cf.* Boshkoff, *supra* note 15, at 50-52 (suggesting that *Zavelo* presented a case in which more than moral obligation supported the bankrupt's reaffirmation agreement).

17. *See* Boshkoff, *supra* note 15, at 36-39.

18. Brookings Institute, *supra* note 5, at 59-62.

19. *Id.* at 210.

for Congress also adopted this position.[20]

When Congress acted to update the bankruptcy system, however, it did not enact a provision prohibiting the enforcement of reaffirmation agreements. Rather, Congress took a middle road by permitting the enforceability of reaffirmation agreements concerning consumer debts only if the bankruptcy judge found that the agreement did not impose an undue hardship on the debtor or the debtor's dependents and that the agreement was in the debtor's best interest.[21] Thus, Congress added a second step to the reaffirmation process. Under the Bankruptcy Act the debtor and creditor negotiated the reaffirmation agreement and no additional actions were required for that agreement to become operative. Under the Code, however, the debtor/creditor negotiation represented only the first part of the reaffirmation process. Once the parties concluded their negotiation of the reaffirmation agreement, they had to present the agreement to the court for approval by the bankruptcy judge as noted above.[22]

By permitting the continued enforceability of reaffirmation agreements in specific circumstances under the Code, Congress clearly rejected the proposals to prohibit these agreements in all instances. Nonetheless, the inclusion of bankruptcy court approval of these agreements as a condition of enforceability evidences a congressional intention to provide greater protection for debtors than existed under the Bankruptcy Act.[23]

If the reported decisions are any indication, the Code prevented many debtors from entering into improvident reaffirmation agreements.[24] The most frequently stated rationale for the bankruptcy courts' refusal to approve proposed reaffirmation agreements was that the agreements were not in the best interest of the debtor.[25] The courts generally adopted a rule that the best interest test required a primarily economic consideration of the debtor's

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20. COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, FINAL REPORT, H.R. Doc. No. 137, PART I, 93d Cong. 1st Sess. 177 (1973).

21. Bankruptcy Reform Act § 524(c)(4).

22. *Id.*

23. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. 162-64 (1977).

24. *See* notes 25-31 *infra*. No statistics are available to identify the total number of reaffirmation agreements. Moreover, it is unlikely that a bankruptcy court approving a reaffirmation agreement would issue a written opinion. Nonetheless, the reported decisions clearly demonstrate that the courts denied a significant number of proposed reaffirmation agreements. Moreover, one surmises that these opinions would operate to prevent parties from filing similar agreements subsequent to the publication of such an opinion.

25. *See, e.g., In re* Berkich, 7 B.R. 483, 484 (Bankr. E.D. Pa. 1980), *In re* Blount, 4 B.R. 92, 97-98 (Bankr. M.D. Tenn. 1980); *In re* Avis, 3 B.R. 205, 206-07 (Bankr. S.D. Oh. 1980). One commentator concisely stated the results of the bankruptcy court decisions:

> Since it is difficult to conceive of a reaffirmation which is in the best interest of the debtor, except, perhaps, where further credit actually would not be available to the debtor in the absence of reaffirmation, it seems quite likely that a court would approve only those reaffirmation agreements which are in settlement of nondischargeability actions or which provide for redemption.

Ahart, *Obtaining Reaffirmations of Individual Debts under the Bankruptcy Code*, 97 BANKING L.J. 153, 156 (1980).

proposed reaffirmation agreement.[26] Thus, even if the proposed reaffirmation did not unduly burden the debtor financially, the court still could deny approval of the agreement if the proposal did not make "economic sense."[27] This would hold true even if the debtor could articulate significant non-economic reasons for the reaffirmation. Consequently, courts denied approval of reaffirmations of debts secured by collateral worth less than the outstanding obligation,[28] debts guaranteed by relatives or co-workers of the debtor,[29] debts owed to creditors from whom the debtor anticipated a need for future credit,[30] and even debts which if unpaid could lead to criminal action being taken against the debtor.[31]

The consumer credit industry attacked the Code soon after it went into effect.[32] Through its spokespersons, the professional creditors identified provisions it perceived as inappropriate and made recommendations to address the problems.[33] A focal point of their attack was the Code's treatment of reaffirmations. They argued that the Code's test for approval was too stringent, that reaffirmations which were in both the debtors' and creditors' interests did not occur, and that it was a waste of everyone's time, the debtor's creditors' and bankruptcy judge's, to compel the debtor to appear at the discharge hearing.[34] The debtor's attorney along with the debtor's family and friends, the industry asserted, could provide sufficient guidance to assist the debtor in determining whether to reaffirm particular obligations. The industry offered the following system to replace the Code's method of dealing with reaffirmations. The judge would be removed from the reaffirmation process; no longer would the judge pass on the validity of reaffirmations at the discharge hearing. In fact, the discharge hearing would be

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26. *See, e.g., In re* McGrann, 6 B.R. 612, 613 (Bankr. E.D. Pa. 1980); *In re* Blount, 4 B.R. 92, 97-98 (Bankr. M.D. Tenn. 1980).

27. *See supra* notes 25-26.

28. *E.g., Blount,* 4 B.R. at 97-98.

29. *E.g., Avis,* 3 B.R. at 207.

30. *Cf. In re* Hosler, 12 B.R. 395, 396 (Bankr. S.D. Oh. 1981). *Hosler* was a Chapter 13 case in which the court would not permit the debtor to classify an unsecured creditor separately to pay that creditor more than other unsecured creditors. *See id.* The effect of the classification would be substantially the same as if the debtor reaffirmed the obligation. *See also In re* Hill, 4 B.R. 694, 697 (Bankr. D. Kan. 1980).

31. *Cf. In re* Gay, 3 B.R. 336, 338 (Bankr. D. Colo. 1980) (Chapter 13 case in which court would not permit debtor to classify separately and pay more to creditors holding checks drawn by debtor on insufficient funds even though those creditors could initiate criminal actions against debtor).

32. *See generally* Ginsberg, *supra* note 5; Sullivan, Warren & Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data,* 1983 WIS. L. REV. 1091, 1094-95 & n.20; Ulrich, *Comments on the Consumer Finance Industry's Proposals to Improve the Position of Secured Creditors in Consumer Bankruptcy Cases,* 39 WASH. & LEE L. REV. 381 (1982). *See also* Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984,* 27 WM. & MARY L. REV. 91 (1985) (review of consumer bankruptcy changes adopted by Congress in response to consumer credit industry pressure).

33. *See generally* Senate Hearings, *supra* note 5, at 39 (statement of Jonathan M. Landers).

34. *Id.* at 90-91.

abolished.[35] Presumably, the debtor's attorney would resume the role of debtor's advisor on reaffirmations. In addition, the period for rescinding a reaffirmation agreement would be extended from 30 to 60 days after the discharge was granted.[36] Thus the extended rescission period assertedly provided ample time for the debtor to reflect on his decision and to act reasonably to rescind the obligation if it proved improvident.[37]

By the time Congress responded to consumer credit industry requests for the shifting of the balance away from a perceived pro-debtor posture of the Code, several other fundamental problems with the bankruptcy process took precedence over the consumer issues as legislative concerns. Specifically, Congress had to address the constitutional/jurisdictional difficulties raised by the *Marathon Pipe Line* case.[38] Congress also had to resolve the conflict between the bankruptcy laws and the labor laws highlighted by the Supreme court's decision in *N.L.R.B. v. Bildisco.*[39] Consequently, it is safe to assume that Congress did not focus as closely as it otherwise might have done on the myriad of consumer bankruptcy issues that form the bulk of the CBA.[40]

Congress apparently saw some merit in the consumer credit industry position that bankruptcy judges should be removed from the reaffirmation process. Nonetheless, the form that the amendment to the reaffirmation provision took reflects a continued concern in Congress that debtors need relatively formal protection from improvidently reaffirming debts. As a result, the CBA amended section 524 of the Code to provide that reaffirmation agreements are enforceable against a debtor who is represented by an attorney during the course of negotiating the agreement only if the debtor's attorney executes and files a declaration or affidavit stating that the agreement "represents a fully informed and voluntary agreement by the debtor; and. . .does not impose an undue hardship on the debtor or a dependent of the debtor."[41] Therefore, when a debtor is represented by

35. *Id.*

36. *Id.*

37. *Id. See also* Ginsberg, *supra* note 5, at 40-44 (offering summary of industry proposals).

38. Northern Pipeline Constr. Co. v. Marathon Pipe Line Co. 458 U.S. 50 (1982). *See* Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 HARV. J. ON LEGIS. 1 (1985).

39. 104 S. Ct. 11 (1984). *See* Gregory, *Legal Developments Since* NLRB v. Bildisco: *Partial Resolution of Problems Surrounding Labor Contract Rejection in Bankruptcy*, 62 DEN. L. J. 615 (1985).

40. The consumer credit industry commenced its efforts to obtain legislative relief from the Bankruptcy Reform Act even before the Act became effective. For example, several states legislatively "opted out" of the federal bankruptcy exemption scheme prior to the effective date of the Bankruptcy Reform Act. More extensive efforts commenced shortly thereafter. *See* Sullivan, Warren & Westbrook, *supra* note 32, at 1094-95 & n.20. The Senate began hearings on the credit industry proposals in early 1981. *See* Senate Hearings, *supra* note 5. Despite several years of lobbying, Congress did not enact the bankruptcy amendments until two years after the Supreme Court's decision in *Marathon Pipe Line*, and less than five months after the Court's decision in *N.L.R.B. v. Bildisco*. Thus, the primary impetus for the adoption of the 1984 bankruptcy amendments arguably was the *Bildisco* decision.

41. Consumer Bankruptcy Amendments, 11 U.S.C. §§ 524(c)(3) (A) & (B).

counsel, the court no longer passes judgment on the propriety of the reaffirmation agreement. In the absence of counsel for the debtor, the Code test for reaffirmations was retained.[42] The court, like the debtor's attorney, must find that the agreement does not impose undue hardship on a debtor or a dependent of the debtor.[43] There is no stated requirement that the court determine that the debtor is fully informed and voluntarily contracting with the creditor. On the other hand, the court specifically must find that the agreement is in the best interest of the debtor.[44] In any event, the court still must conduct a hearing during which it must inform the debtor that he or she need not reaffirm any debts, and that if any debts are reaffirmed, the court must describe to the debtor the legal effect and consequences of the enforceability of reaffirmation agreements.[45]

THE ATTORNEY'S ROLE IN COUNSELLING A DEBTOR ABOUT REAFFIRMATIONS

Regulation of the enforceability of reaffirmation agreements under the Bankruptcy Act of 1898, the Code, and the CBA generally suggests three significantly different ways for debtors' attorneys to counsel their clients. Likewise, adoption of the Bankruptcy Commission and commentators' suggestion that all reaffirmation agreements be prohibited would lead to other advice being given to consumer debtors by their attorneys. A hypothetical dialogue between a debtor and the debtor's attorney under each of the three enacted bankruptcy systems will illuminate some of the problems inherent in the treatment of reaffirmation agreements. We will also offer a hypothetical counselling session under a system that would prohibit all reaffirmation agreements. These dialogues identify the significantly different ways of evaluating the issues raised under each system as well as illustrate the tension that often exists between the attorney and the attorney's client in this area. Once we have set out these interviews, we will address the shortcomings of each system for regulating the reaffirmation process and offer support for our conclusion that Congress should prohibit reaffirmation agreements.

A. *The Bankruptcy Act*

As noted above, the debtor and creditor determined whether to reaffirm debts otherwise discharged in bankruptcy under the Bankruptcy Act. While no limits on the time during which the debtor had to execute a reaffirmation agreement existed, we believe that debtors often agreed to reaffirm debts during the pendency of the bankruptcy case. Therefore, we are assuming that they considered the reaffirmation agreement with their attorneys. The following is a simulated counselling session which we believe might have occurred under the Bankruptcy Act.

42. *Id.* at § 524(c)(6). *Cf.* Bankruptcy Reform Act § 524(c)(4).
43. *Id.* at § 524(c)(6)(A)(i).
44. *Id.* at § 524(c)(6)(A)(ii).
45. *Id.* at § 524(d).

Lawyer:

Come in, Bankrupt. What can I do for you now?

Bankrupt:

I need some advice. At the end of my meeting with creditors yesterday, Ames, the guy who sold my car to me, said that I could either sign a new contract to pay for my car or he would take it back. Can he do that?

Lawyer:

Yes, he can repossess your car. He has a valid lien on it.

Bankrupt:

Then I guess I had better sign his contract. I must have a car. I need it to go to work, get the groceries, pick up the kids and so on.

Lawyer:

That's true. You do need transportation. Nevertheless, this may not be your best option. What do you pay per month on this car?

Bankrupt:

$250 per month.

Lawyer:

You can't afford it. A month ago I filed a bankruptcy for you. You were greatly over extended financially. You had large medical debts, one for the birth of your third child and one for emergency care of another. You and your wife had bought too many new things for the family. That you were laid off for a month unexpectedly aggravated your situation. The layoff made your financial situation intolerable more quickly than otherwise, but you were so deeply in debt, you never could have gotten out on your own. A financial crisis was inevitable.

Bankruptcy should reduce and simplify your problems. In a month or so you will get a discharge. This means that you will not have to worry about any of those old debts unless you want to. We decided to pay your doctors. You need their good will in the future. You ought not pay any other creditors unless an equally good reason for doing so can be found. I cannot find a good reason for paying Ames. In fact, it would put you back where you were when you came to see me.

One final point. Recall that I worked out a budget for you. You and your wife agreed that $1,000 had to go each month for household necessities. You only make $1,200 a month. Where do you get the extra $250?

Bankrupt:

I explained some of this to Ames. He said that he would give me a better deal, one in which I could pay over a longer time. Under the present contract, I agreed to pay $250 per month for 3 years. I already paid for a year. Ames said I could pay say $180 or $185 for three and a half years.

Lawyer:

Wait a minute. Under your budget you have only $200 extra for anything else the family needs. You might want to buy some new item, have some recreation, cover emergencies, or, God forbid, save something for a rainy day. If you pay $180 a month for this car, you have only $20 left over. This would not give you much breathing space.

Bankrupt:

Yes, but I do need a car. Maybe you could work out a better deal for me?

Lawyer:

I doubt that I could. And, you would have to pay for my time which probably would cost more than any savings I could get. Why not get a less expensive automobile?

Bankrupt:

I like this one. I've worked on it so that it looks real nice. People in my neighborhood recognize me in it. I like that. This makes me feel good. If I buy something else, it wouldn't be the same. The car is a part of me.

Lawyer:

How much is your car worth? What could you sell it for?

Bankrupt:

$3,000 to $4,000.

Lawyer:

So, you are willing to pay $6,000 for a $3,500 car. Even figuring in the maximum interest rate, this is a bad deal. You are throwing your money away. In effect you are giving it to Ames.

Bankrupt:

Hey, you asked me what someone else might pay for the car. It's worth more to me than to anybody else. There is a lot of me in that car. I'm willing to sacrifice to keep it. In tough times you have to hang onto things which bring back good times.

Moreover, Ames treated me right. He didn't take the car back even when I went bankrupt.

Lawyer:

Ames could not have repossessed due to the automatic stay.

Bankrupt:

Whatever. He's a good guy. He will never sell to me again if I welch on him this time. I'd lose prestige in his eyes. And mine. I'd pay to keep that.

Lawyer:

O.K. I can't stop you, Bankrupt. I'm simply telling you that your decision to reaffirm is unwise. But, it is your decision.

Bankrupt:

I'll be able to afford it. I should be getting a raise in six months, and I can always pick up a second job if I need to.

Lawyer:

It's also possible that you could lose your job, or you or someone in your family could become sick or injured which would put an even greater strain on your budget. All in all, I think you're asking for trouble, but ultimately it's up to you.

Bankrupt:

My decision is to reaffirm.

We think that such an interview would be representative of many counselling sessions between bankrupts and their lawyers so long as reaffirmations remained unregulated. Bankrupts would often reaffirm despite the best advice of counsel. Most bankrupts do not think like a University of Chicago economist. One doubts that they are rational profit maximizers in their individual affairs. They use their own cost/benefit analysis. For this reason they will not act in their "best interest" as the Code defined the term.[46] They need protection. All modern consumer legislation is based on this assumption.

Equally significant, Lawyer cannot compel Bankrupt to act rationally, i.e., as a profit maximizer. Lawyer may explain the legal consequences of the discharge, its intended result, and why a particular reaffirmation will work counter to his interest, but the ultimate decision belongs to Bankrupt. This lack of authority is the essence of the traditional attorney-client relationship: the lawyer advises but the client decides.[47]

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46. *See* Jackson, *The Fresh Start Policy in Bankruptcy*, 98 HARV. L. REV. 1393 (1985) (extensive discussion of psychological factors influencing consumer debtors' behavior).

47. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC-7-8 (1979).

In sum, even if debtors are fully advised, there is no reason to believe that sound legal counselling significantly reduces the number of reaffirmations.[48] One guesses, moreover, that on most occasions the debtor probably does not discuss a reaffirmation matter with his attorney unless compelled to do so. If Congress wants debtors to act rationally concerning reaffirmations, the statute must say so.

B. *The Bankruptcy Code*

In the Code, Congress rejected the Bankruptcy Commission's suggestion that reaffirmation agreements be unenforceable. Influenced to some extent by the pleas of professional creditors that reaffirmations on some occasions promoted consumer and societal welfare, Congress enacted sections 524(c) and (d) to regulate this area.[49] Congress arguably agreed with the Commission but did not want to appose a powerful lobbying group.

Code sections 524(c) and (d) placed life and death power over reaffirmations in the bankruptcy judge, who acted as a patriarch for his extended family. Those provisions created time limits during which reaffirmation agreements had to be signed.[50] Sections 524(c) and (d) also required the judge to determine whether each reaffirmation was in the "best interest" of the debtor. For the courts, "best interest" equaled economic rationality.[51] Most reaffirmations failed when measured against this standard.[52] The judges generally responded in much the same manner as Lawyer in our first dialogue. Unlike Lawyer, however, the judge could compel Bankrupt to act rationally.

In this legal environment Lawyer's interest in the matter was likely to become attenuated. Let's pick up the conversation between Lawyer and Bankrupt under the Code after Bankrupt discloses the matter he wants to discuss.

Lawyer:

> Well, Bankrupt, there's not much I can really do for you about this. Before you can enter this agreement, we must convince the bankruptcy judge that this is a wise decision on your part. I doubt that the judge will think that it is.

Bankrupt:

> Do you mean to tell me that I cannot make this deal even if I want to? I'm over 21. I'm no minor. I know what I'm doing.

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48. *See supra* text accompanying notes 41-45.

49. Bankruptcy Reform Act §§ 524(c) & (d).

50. *Id.* §§ 524(c)(1) & (2) (reaffirmation agreement had to be made before granting of discharge and could be rescinded any time up to 30 days after it became enforceable); *id.* § 524(c)(4)(ii) (agreement must be in debtor's best interests).

51. *See supra* text accompanying note 27.

52. *See supra* text accompanying notes 21-31.

Lawyer:

That is precisely what I am telling you. The judge can overturn the deal with Ames. Of course, if you make voluntary payments to Ames, this would be all right. In this situation, you could stop paying Ames any time you wished. For example, if Ames let you keep the car and you wrecked it, you would owe nothing to Ames based on any contract because the law says that no contract exists unless the bankruptcy judge says it does. For this reason Ames probably won't let you keep the car unless the judge goes along.

Bankrupt:

Can't you get the judge to see this my way?

Lawyer:

I'll try. I have to be there anyway. Nonetheless, I doubt there's much I can say. Ordinarily the judge compares the value of the car to the total amount of payments you will make to determine if this is a good deal. Very seldom does he ever think this is a good deal. He thinks you can do better. But he'll explain all this to you.

With a bankruptcy judge the debtor's appointed guardian, attorneys no longer worried very much about reaffirmations. The attorney could do very little to influence the court.[53] One surmises that most advice about reaffirmations during the Code period came to debtors through the creditors and ultimately the court. In this particular instance the debtor's and creditor's desires coincided. Debtor's attorney abdicated responsibility without guilt.

C. *The Consumer Bankruptcy Amendments*

The consumer credit industry lobbied strenuously for a revision of a number of consumer bankruptcy provisions.[54] While their arguments undoubtedly played a role in spurring Congress to act, the congressional resolution to the problem of assertedly over-protective reaffirmation provisions did not mirror the industry's suggestion.

Under the CBA, the judge would seem to have no direct role in the approval of reaffirmation agreements in which the debtor has an attorney. Instead, the debtor's attorney becomes his chief guardian against improvid-

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53. To state that the reaffirmation decision rested with the court is not to suggest, however, that counsel for the debtor could not present the proposed reaffirmation to the court in a manner more likely to receive approval by the judge. Indeed it is the attorney's duty to do so. Model Code of Professional Responsibility Canon 7 (1979). For an example of the role the debtor's attorney may play in presenting a reaffirmation proposal to the court, *see In re* Delano, 7 B.R. 72, 73 (Bankr. D. Me. 1980) (court withheld approval or denial of reaffirmation agreement and directed debtor's counsel either "to initiate redemption proceedings. . .or to make a sufficient written showing that redemption is unavailable or inappropriate in the circumstances").

54. *See* Sullivan, Warren & Westbrook, *supra* note 32, at 1094-95 & n.20.

ence.[55] To assure that the attorney gives careful consideration to this problem, the attorney must execute the affidavit now required by Section 524(c)(3).[56] Section 524(c)(3) provides that the debtor's attorney must file a declaration or affidavit with the court stating that the reaffirmation agreement

"(A) represents a fully informed and voluntary agreement by the debtor; and

(B) does not impose an undue hardship on the debtor or a dependent of the debtor."

Such an affidavit completely changes the usual rules of an attorney/client relationship for it compels the attorney to consider her own interests in advising her client what to do about the reaffirmation.[57] Because this change seems so radical and the statute seems remarkably complicated, we shall set out what we think the new provisions mean before working through an attorney/client conference under CBA section 524(c)[58]. We conclude that the lawyer risks personal liability to various parties if the reaffirmation fails.

Section 524(c)(3) imposes two new obligations on the attorney. First, the attorney must affirm that the new commitment "represents a fully informed and voluntary agreement by the debtor."[59] Congress wished to insure that the debtor understood the full legal consequences of the new arrangement by placing upon the debtor's attorney the obligation to explain the reaffirmation completely. Such a duty seems appropriate. Yet, the CBA does more than that. It requires that the attorney swear that the debtor both understands and voluntarily entered the reaffirmation agreement, i.e., the attorney states as a fact that the debtor both comprehends and signs it freely.[60] If this reading is correct, no attorney can *safely* comply. An affidavit stating what the debtor has been told about the law regarding reaffirmations, the history of this one, and the debtor's responses could be drafted. No prudent lawyer, however, would declare positively in an affidavit that her subjective reading of a client's state of mind on such a complex matter as a reaffirmation represented the actual state of mind of the client. Nonetheless, section 524(c)(3)(A) seems to impose this obligation. If a court subsequently found that the debtor did not understand,[61]

55. Consumer Bankruptcy Amendments § 524(c)(3).

56. *Id.*

57. *See infra* text accompanying notes 68-70.

58. *See* J. WHITE, BANKRUPTCY AND CREDITORS RIGHTS 411 (1985). According to Professor White, section 524(c) of the Consumer Bankruptcy Amendments "is so filled with restrictions and pitfalls that a cynic might suggest it was put there in the hope and belief that it would prove unworkable and thus have the same consequence as though reaffirmations had been prohibited altogether." *Id.*

59. Consumer Bankruptcy Amendments § 524(c)(3)(A).

60. *Id.* at § 524(c)(3). *See* BANKR. RULE 9012.

61. Any judicial considerations of the reaffirmation agreement would occur of necessity some time after the parties reached agreement. The earliest judicial review of the agreement likely could occur at the debtor's discharge hearing. The court must inform the debtor that reaffirmation agreements are not required and of the legal effects and consequences of the agreement. *Id.* at § 524(d). One bankruptcy judge has stated to one of the authors that he

some sanction could be imposed.[62]

The second part of the affidavit raises even more slippery matters. The attorney must state that the reaffirmation "does not impose an undue hardship on the debtor."[63] In applying this phrase to a reaffirmation under the Code, the judge would have had to consider whether the debtor could have paid the reaffirmed debt out of anticipated income without causing himself or his family financial difficulties.[64] Arguably, the test under the CBA is broader. In determining the fate of the reaffirmation, the lawyer

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questions debtors about their reaffirmation agreements at the discharge hearing after he has received the filed proposed agreement and debtor's attorney's affidavit. In one instance, the judge informed the debtor that he would not enter an order of discharge and would consider dismissing the case under section 707(b) of the Bankruptcy Code as an abuse of Chapter 7 if the debtor insisted upon going forward with reaffirmations of two large secured claims that exceeded the values of two luxury automobiles the debtor sought to retain. While this use of the section 707(b) dismissal power is different from the apparent purpose of the statute, it arguably is consistent with the language and directive of the section. *See* Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM. & MARY L. REV. 91, 98-100 (1985).

It also is possible that the bankruptcy courts, and perhaps other courts, might consider the propriety of these agreements much later. For example, it is possible that the debtor, or the debtor's dependents, may raise the issue of the attorney's exercise of bad judgment or negligence as a defense to a subsequent action on the reaffirmed debt. The debtor might also raise the issue to support a third party claim against the attorney. *See* FED. R. CIV. P. 14(a). The debtor could assert either a breach of contract or a malpractice claim against the attorney. In either event, the court would be considering the attorney's actions as of the time of the reaffirmation. Nevertheless, the court would be undertaking this review at a time when the reaffirmation appears to have been improvident. In that sense, prudence would dictate that attorneys who execute affidavits approving reaffirmation agreements have a substantial "record" on which to base their approval decision which would thereafter be available to defend the propriety of that decision in subsequent litigation. Of course, creating this "record" would generate costs and attorney fees that the debtor generally would be responsible to pay. These costs of investigating and determining the propriety of the reaffirmation agreement now borne by the debtor formerly were paid or incurred by the creditor and the court. Shifting these costs to the debtor should reduce the number of reaffirmation agreements.

62. *See* BANKR. RULE 9011. Bankruptcy Rule 9011, which is an adaptation of Federal Rule of Civil Procedure 11, authorizes an appropriate sanction for this kind of violation. *Id.*; *see* FED. R. CIV. P. 11. Presumably the attorney also would be liable to the debtor for the loss caused by the attorney's failure to explain fully the terms and consequences of the agreement.

63. Consumer Bankruptcy Amendments § 524(c)(3)(B).

64. *See* 6 COLLIER BANKRUPTCY PRACTICE GUIDE, ¶ 77.05 (1984). Collier distinguishes the undue hardship from the best interest test as follows:

> The concept of undue hardship is related to the amount of the obligation to be reaffirmed in terms of the debtor's ability to pay that obligation. The concept of best interests would involve an analysis of the best benefits and burdens which will accrue to the debtor under the reaffirmation.

Id. Interestingly, Collier offers no example illustrating the meaning of undue hardship although several examples concerning the best interest test are presented. The court in *In re* Bryant, 43 B.R. 189, 192 (Bankr. E.D. Mich. 1984) noted that it frequently is difficult to separate the concepts of undue hardship and best interests. Thus, it is not surprising that there are no decisions that are based solely on a finding that a reaffirmation agreement would pose an undue hardship on the debtor.

should not only consider whether the debtor is able to pay but also whether the reaffirmation is one the debtor ought to make. To illustrate the standard, take the case of Bankrupt's proposed reaffirmation with Ames in our interview, a typical example of an agreement with a secured creditor. The attorney would not only have to assess Bankrupt's ability to pay over the period of the agreement, but whether this is a good bargain. "Undue hardship" seems to be a relative concept. For example, that Bankrupt could purchase these goods elsewhere on better terms or redeem them under section 722 seems to indicate that this reaffirmation imposes an undue hardship.[65]

We think that another basis exists for attorneys to interpret "undue hardship" in the same manner as bankruptcy judges read "best interests" under the Code. In the absence of an attorney negotiating the agreement, the court must find that the debtor's "best interests" are served by the reaffirmation.[66] It seems unlikely that Congress would want to reduce the standard for protection against improvident reaffirmation agreements for debtors simply because they are represented by counsel. Nevertheless, this would be the result if section 524(c)(3)(B) were read literally. Furthermore, no good reason exits to apply different standards of review of the debtor's and creditor's proposal based on the presence or absence of an attorney for the debtor. A recent bankruptcy decision supports the view suggested here.[67]

The problems of statutory construction combined with the difficulty of ascertaining factually whether the reaffirmation will place an undue hardship on the debtor should make debtor's attorneys reluctant to approve the agreements. Section 524(c)(3)(B) requires that the attorney swear that the new agreement "will impose no undue hardship on the debtor or dependent

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65. *See, e.g., In re* Delano, 7 B.R. 72, 73 (Bankr. D. Me. 1980). If redemption or replacement of the goods at a lower price renders a proposed reaffirmation inappropriate, it does so, to a large extent, because the debtor is reaffirming an unsecured debt. *See* 11 U.S.C. § 506 (1982) (claims are unsecured to extent to which debt exceeds value of collateral). A fortiori, claims that are totally unsecured would not appear to be appropriate to reaffirm.

66. Consumer Bankruptcy Amendments § 524(c)(6)(A)(ii).

67. *See In re* Carey, 51 B.R. 294 (Bankr. D.C. 1985). In *Carey*, counsel asked the court to ratify a reaffirmation agreement. The debtor previously had reaffirmed an obligation to repay a loan secured by her automobile. The loan was not in default prior to the filing of the bankruptcy petition. The debtor's second attorney sought the court's ratification of that agreement. After noting that court approval was no longer necessary or appropriate when the debtor was represented by counsel, the court indicated that it was not in the debtor's "best interest" to reaffirm the debt since the creditor could not repossess the automobile until the debtor defaulted after bankruptcy. *Id.* at 295. The court did not consider whether the agreement created "an undue hardship" for the debtor or her dependents. Rather, the court adopted the Code view that since a better alternative was available for the debtor, reaffirmation could not be permitted. The court focused primarily on whether the creditor could repossess the automobile in the absence of a post-bankruptcy payment default, and therefore may not have fully considered its general statements about reaffirmations. Nonetheless, the substantial reliance on the "best interests" standard rather than the "undue hardship" standard suggests that debtors' attorneys attempting to determine whether to approve reaffirmation agreements for their clients should consider the debtor's "best interests" as well as whether the agreement would be an undue hardship.

of the debtor."[68] Is it possible for the attorney to warrant the truth of such a prediction? No one can be sure what will happen even a short time into the future. Debtor could lose his job, acquire unexpected liabilities, or just decide not to pay. Yet, the CBA seems to demand the attorney's express warranty that the new agreement will not impose undue hardship in the debtor's new economic life. Is the attorney guilty of malpractice and therefore personally responsible in damages if the bankruptcy judge subsequently determines that the reaffirmation was a mistake? Such a determination could occur whenever the debtor is having difficulty paying at the time of the judge's review. The debtor's financial difficulty could serve as a basis for the conclusion that the attorney's warranty in the affidavit was erroneous in fact. While the sanctions for a violation are not specified, Congress must have contemplated some kind of attorney liability. For this reason no prudent attorney would ever sign the affidavit even if the attorney thought that the reaffirmation was in the client's best interest.

The prior discussion accents a related flaw in section 524(c)(3)(B). The affidavit virtually compels the attorney to put the attorney's interests above those of the attorney's client. Consequently the affidavit creates an inherent conflict of interest between the attorney and her client. This cannot strengthen an attorney-client relationship which has long been the subject of much concern.[69]

Finally, section 524(c)(3) works against the Congressional goal it enacted to obtain. Prudence dictates that debtors' attorneys, to protect their own interests, should apply the Code "best interest" test to determine the propriety of reaffirmation agreements. The likelihood of the attorney approving the agreement would seem to be less than if the debtor were presenting the agreement to the judge for approval.[70] This is so even though Congress intended that more reaffirmations be approved under the CBA than under the Code.

The implications of new section 524(c)(3) become painfully apparent in the next dialogue between Lawyer and Bankrupt. The original dialogue evinced the standard give and take in which the client holds the ultimate decision-making power. Under the CBA, the client discovers that Congress has transferred this power to the debtor's attorney with regard to reaffirmations. Thus, the lawyer no longer tells the debtor "it's your decision."
Lawyer:

> I have tried to explain to you, Bankrupt, why the reaffirmation contract on your car would be a mistake. I hoped that you could see it my way. Since you cannot, I am going to have to veto the transaction. You cannot reaffirm without my approval, and I refuse to give my approval. This agreement is not in your best interest.

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68. Consumer Bankruptcy Amendments § 524(c)(3)(B).

69. *See infra* text accompanying notes 91-100.

70. The debtor's attorney is liable to the debtor for any malpractice. The bankruptcy judge, however, is immune from liability that the debtor may attempt to assert.

Bankrupt:

Wait a minute. You're my lawyer. You're not my mother. I think this is a good deal.

Lawyer:

The law makes me your mother, at least for this purpose. Since I think you could make a better deal, or, better stated, you could make a purchase which is more in keeping with your present circumstances, the law demands that I veto this particular deal. If I approved this reaffirmation and it didn't work out, I could be liable personally to you, or your family, or maybe to even Ames. If I approve this deal, it is as if I co-signed a note for you.

Bankrupt:

I'm not asking you to guarantee my debt.

Lawyer:

I know that, but the law makes me your guarantor. I have to sign an affidavit if I approve this arrangement, and this affidavit imposes such liability upon me.

Bankrupt:

What you're really saying is that you won't approve this agreement because it is not in your best interest. You are really protecting yourself.

Lawyer:

Yes.[71]

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71. An attorney might draft a sterilized affidavit which says that the attorney has fully explained all of the legal implications of the reaffirmation to the debtor and that in the attorney's opinion the reaffirmation would not impose an undue hardship. While such an affidavit may fulfill the legislative purpose to ensure that the attorney has carefully reviewed the reaffirmation, while precluding liability for malpractice, it does not comply with section 524(c)(3)(B). Were it submitted with the new agreement, the judge would have no option but to reject the reaffirmation.

Second, and more directly, the attorney could get a release from liability regarding any reaffirmation. The form of the affidavit virtually compels this self defense measure. The attorney's explanation will educate the debtor not only as to the law concerning reaffirmations but also as to the attorney's guarantee for the successful conclusion of the new agreement. The new education invites Debtor to lie, for any error redounds to his benefit. To prevent the possibility of disingenuous statements by Debtor, the attorney may dictate instructions to himself from the client stating that the client understands the new commitment, that he wants to sign it, and that he releases the attorney from all liability related to this transaction.

Yet, this may not end the attorney's problem. First, the court may not permit the attorney to avoid her paternalistic role so easily. Second, even if the release takes care of the client's unhappiness, it may be of no avail when the matter is brought to the court's attention. Arguably, the section 524(c)(3) certifications are made to the court, not the client, and an erroneous oath in this setting could be regarded as a most serious matter. Finally, Disciplinary Rule 6-102 of the Model Code of Professional Responsibility and Rule 1.8 (h) of the new Model Rules of Professional Conduct provide that attorneys generally may not attempt to limit their liability to clients for malpractice. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 6-102 (1979); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8(h) (1983).

Bankrupt:

Maybe I should get another lawyer, one who is more concerned about me than about herself.

Lawyer:

You can do that, but your new lawyer will tell you the same thing. I would prefer not to veto your deal. Having to act in this way is bound to make you suspicious of me. It injects considerations which are detrimental to our relationship. You certainly have a right to wonder whether I'm acting in your interest in other matters as well. Unfortunately, there's not much I can do about it. The law doesn't give me, or any other lawyer, an option.

If I thought it would help you to fire me for this purpose, I'd tell you to do so.[72] In fact, that probably would be the best way out for both of us. There are two problems with doing that: first, I doubt the bankruptcy judge will let me out in this way; and second, even if she did, it wouldn't help you in the long run because the judge would certainly veto the reaffirmation herself. The law will protect you against yourself.[73]

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72. Section 524(c)(6) provides that the judge applies the Code test for reaffirmations in instances involving "an individual who was not represented by an attorney during the course of negotiating [a reaffirmation] agreement." If the bankruptcy judge permits attorneys to withdraw, no attorney alerted to the possibility of personal liability would continue to represent the debtor in any matter concerning reaffirmations. The case now comes within the purview of Section 526(c)(6), and the judge would pass on the validity of reaffirmation under the Code test.

Such a course action cannot possibly have been contemplated by Congress. The Consumer Bankruptcy Amendments were intended to preclude this judicial veto. If the attorney is permitted to withdraw, the amendments bring about no changes. Moreover, debtors would lose the benefits of their attorneys' skills in negotiating reaffirmations. For the reasons suggested, not to mention ethical considerations, judges will not permit Debtor's attorney this easy exit. Several bankruptcy judges have told us that the attorney will not be permitted by the court to withdraw on this aspect of the case. The local rules of some bankruptcy courts require that the attorney who filed the petition continue to represent the debtor in all matters arising throughout the proceedings until the case is closed or the court relieves the attornry. *See, e.g.*, Local Rule 9010.2, quoted in *In re Wright*, 48 B.R. 172, 174 (Bkrtcy. E.D. N.C. 1985).

73.In *In re Reidenbach*, 59 B.R. 248 (Bkrtcy. N.D. Ohio 1986), debtor moved the bankruptcy court to review her reaffirmation agreement pursuant to § 524(c)(6) on the ground that her attorney, who had filed her petition and was still employed, had not been physically present at the negotiation for the new agreement. The court refused to review the reaffirmation, holding that for the purposes of § 524(c)(6) this debtor was in fact represented by her attorney even if the attorney was not physically present at the negotiations. Nonetheless, the court recognized that § 524 might cause future difficulties. First, this section seemed to offer the indolent attorney to a way of avoiding responsibilities. Equally important, the wary but conscientious attorney who thought that the reaffirmation was not in the client's best interest could be forced to choose between giving in to an adamant client or sending him away. The court responded by telling the bar that it will require the attorney to comply with § 524(c)(3). In the case of the wary but conscientious attorney, however, the court would permit a statement explaining why the attorney

Bankrupt:

Is there anything I can do?

Lawyer:

You might try this approach. The law permits you to make voluntary payments to Ames on the car, and Ames can keep these. Thus if you tell Ames that if he will let you keep the car you will pay him and do so, that's fine. On the other hand, any formal arrangement with Ames is void. Ames knows that he cannot enforce any agreement he makes with you without my approval. Thus, while I doubt Ames would let you enter into any of these voluntary arrangements, he might. There's no harm in asking.

Bankrupt:

Would you call him for me to see what you can work out?. . . .

Our focus in the dialogues between Bankrupt and Lawyer has pointed out the weaknesses in each of the systems employed by Congress to deal with reaffirmations. Under the Bankruptcy Act, debtors reaffirmed too often despite the best advice of counsel.[74] The client-Bankrupt's tendency to ignore his attorney's counsel was to be anticipated.[75] The client always made the ultimate decision. This lead to improvident reaffirmations. With the Code, creditors asserted that too few reaffirmations occurred.[76] Equally significant in our view, however, the Code reduced the importance of the advice of counsel to the debtor, for this statute rendered the bankruptcy judge the "gatekeeper" for reaffirmations. Knowing that the judge was the hurdle for his client (and the client's creditors), many attorneys may have felt little duty to guide the client in this area.[77]

CBA section 523(c)(3) creates new flaws without offering any compensating benefits. Congress thought too few reaffirmations occurred under the Code.[78] As we suggested above, there is reason to expect that fewer will occur under the CBA. On this matter, therefore, the CBA offers no "improvement." In addition, Congress may have also thought its amendments would reduce costs to the parties and the system.[79] We doubt this would be the result, particularly for the debtor. The function of the section 524(c)(3)(B) affidavit must have been to compel the attorney to protect the debtor against

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was unable to approve the reaffirmation as acquired by § 523(c)(3). Under these circumstances, which the court thought would be unusual, the judge will review the reaffirmation under § 524(c)(6).

74. *See supra* text accompanying notes 17-20.

75. *See supra* text accompanying notes 46-47.

76. *See, e.g.,* Senate Hearings, *supra* note 5, at 167 (statement of Fred M. Haden, Gen. Counsel of the Nat'l Ass'n of Fed. Credit Unions); *id.* at 179 (statement of Eldon Hoekstra, Secretary of the Credit Union Nat'l Ass'n).

77. *See* Midlothian State Bank v. Roth, 43 B.R. 484, 487 (N.D. Ill. 1984) (noting significance of warnings given to debtors at discharge hearings).

78. S. REP. No. 446, 97th Cong., 2nd Sess. 22-23 (1982).

79. *Id.*

his own improvidence.[80] Proper exercise of the protective function requires that the attorney conduct a legal[81] and factual[82] investigation of the debtor's and creditor's relationship as well as determining the debtor's ability to repay the affirmed obligation. In addition, the attorney must examine the debtor's ability to repay the reaffirmed debt. To make this determination, the attorney presumably may not rely solely on the assertions of the debtor that he or she can make the payments.[83] This type of investigation can be costly and time consuming. Assuming that some routine reaffirmations will obtain attorney approval, prudence would dictate that the attorney for the debtor have created a "record" to support his or her decision. The greater the amount of debt being reaffirmed, or the lower the amount of the debtor's "disposable income,"[84] the greater the pressure on the debtor's attorney to create a complete "record" to support the reaffirmation approval decision. It is doubtful that many debtors can afford to pay increased fees for bankruptcy representation. Thus, the CBA does not offer the benefits Congress desired.

In several important respects CBA solution is a step backward when one compares its resolution of the reaffirmation problem with the Act and the Code. We have already noted the inherent conflict of interest that arises under section 524(c)(3)(B). Here we focus upon the fact that the CBA compels the attorney to usurp the client's decision making power altogether. In our view this undermines the attorney-client relationship. Attorneys,

80. *See* Senate Hearings, *supra* note 5, at 90. Section 8 of the Consumer Bankruptcy Improvements Act of 1981 provided that reaffirmations would be enforceable without the approval of either the court or the debtor's attorney. *Id.* Congress decided instead to place the attorney in the decision making role in recognition of the continuing need to protect debtors in reaffirmation matters. *Id.*

81. The debtor's attorney must conduct a legal investigation to determine the validity of the creditor's claim and security interest. The debt may be subject to attack because it is usurious in violation of some consumer legislation, etc., while the security interest may be unperfected and subject to the trustee's power to avoid the lien. In these instances, the debtor's attorney would be determining the legal validity of the claim or interest even though the legal determination requires factual investigation.

82. The debtor's attorney must conduct a factual investigation of the creditor's claim to determine if the debtor has any equity in property that secures the claim being reaffirmed. The attorney also must attempt to determine whether the debtor's future disposable income will enable the debtor to repay the reaffirmed obligation.

83. *See* Consumer Bankruptcy Amendments § 524(c)(3)(B). Section 524(c)(3)(B) also requires that the attorney consider the interests of the debtor's dependents. This direct reference to dependents would seem to place these parties in the class of persons Congress intended the attorney to protect. To act responsibly, the attorney must consider the impact of the reaffirmation on dependents as well as the debtor. Since the debtor's dependents are mentioned specifically in the statute, they would seem to have standing to assert a claim against the debtor's attorney for malpractice in connection with a reaffirmation agreement. *Cf.* Ventura County Humane Soc. for Prevention of Cruelty to Children & Animals, Inc. v. Holloway, 115 Cal. Rptr. 464, 40 Cal. App. 3d 897 (1974) (intended beneficiaries have cause of action against testator's attorney).

84. *See* 11 U.S.C. § 1325(b) (1985). Under this section of the Bankruptcy Code, disposable income is that which exceeds the amount reasonably necessary for the support of the debtor and his dependents.

whether their clients are debtors in bankruptcy, testators making wills, decisionmakers in a business setting or the victims of tortious acts, are representatives and agents of their clients.[85] It is imperative that this role not be overridden. Other than reaffirmation agreements in bankruptcy, a lawyer does not have the power to prevent a client from entering into an otherwise legally enforceable agreement. The lawyer may believe that the deal arrived at by the client is not a good one; nonetheless, the lawyer may not deny the client the opportunity to make the bad deal. Yet, this is exactly what the CBA amendment to section 524(c) of the Bankruptcy Code requires of the debtor's attorney.

D. *Prohibition of All Formal Reaffirmation Agreements*

The Bankruptcy Commission and others have argued that a prohibition of reaffirmation agreements would further the fresh start policy of the bankruptcy laws.[86] In response, professional creditors suggested that debtors may have a number of good reasons for reaffirming a particular obligation.[87] Regardless of the pros and cons of reaffirmation, debtors who want to repay obligations discharged through bankruptcy may do so.[88] This informal method of repayment combined with a prohibition on the enforceability of reaffirmations could lead to the following dialogue.

Lawyer:

> Your creditors will not be allowed to attempt to get you to repay the debts discharged in this case. There is no way they can require you, as a matter of your own personal liability, to repay those obligations.

Bankrupt:

> But some of those people really were decent to me during those tough times, and I'd like to repay them.

Lawyer:

> That's fine. You can repay these debts voluntarily, but the creditors cannot take legal action against you if you decide not to pay or become unable to pay.

Bankrupt:

> Does this mean I get to keep my car and don't have to pay for it?

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85. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 & comments (1983).

86. *See supra* text accompanying notes 17-20.

87. Senate Hearings, *supra* note 5, at 90.

88. 11 U.S.C. § 524(f) (1985). The 1984 Amendments added a subsection to section 524 which provides that "nothing contained in subsection (c) or (d) of this section prevents a debtor from voluntarily repaying any debt." *See id.*

Lawyer:

No. The creditor has a lien on or interest in the car. The bankruptcy discharge does not affect that lien. The creditor can't force you to pay the debt, but can repossess the car to recover as much as possible on the debt.

Bankrupt:

I don't want to lose the car. Is there anything I can do to hang onto it?

Lawyer:

Well, you can pay the creditor the value of the car and keep it.

Bankrupt:

I don't have that kind of money. I just want to keep making my regular payments.

Lawyer:

You could do that, but the creditor probably does not have to let keep onto the car. As I said, he has no ability to force you to pay the debt, so he may feel a need to protect himself as much as possible by repossessing the car. On the other hand, I think that if you maintain full insurance and continue to pay him more each month than the car is depreciating in value, the creditor conceivably is better off letting you keep the car on the basis of your payments. Of course, that's up to him.

Bankrupt:

Well, I'd be willing to go along with something like that. Would you talk to him for me about it?

Lawyer:

I'll talk to his lawyer and get back with you once I receive his response.

The foregoing discussion points out that a prohibition of reaffirmations is not a panacea. Some, and perhaps many, debtors will lose their automobiles or other property subject to valid security interests if reaffirmation agreements are unenforceable. Those debtors would be forced to purchase another automobile. Given their immediate past financial history, they many encounter serious difficulty in obtaining credit for a major new purchase. Nevertheless, credit may be available directly to the debtor in some instances, and the debtor also might enlist the aid of a co-signer to assist in obtaining credit for the purchase.

In many other cases, the creditors may accept the informal reaffirmation that Lawyer described at the conclusion of the interview. In that event, the creditor arguably considers the prospect for recovery of a greater portion of the outstanding indebtedness while retaining a lien on the property sufficient to allow the debtor to continue to use the collateral. If the debtor's payments equal or exceed the depreciation of the automobile, it is economically sensible for the creditor to encourage a continuation of the repayments. Certainly, repossessing the automobile would not leave the debtor favorably disposed to continuing payments. Nevertheless, some creditors probably would not permit "informal" reaffirmations under any circumstances.[89] Their refusal is not a sufficient reason to condemn a prohibition against the enforceability of reaffirmations. A complete prohibition will stop other credit transactions that present no good reasons for debtors to reaffirm from operating to reduce the effect of a discharge in bankruptcy.[90] We believe that this positive effect and the likelihood that some creditors will consent to "informal" reaffirmations that are in the creditor's economic best interests outweigh the costs which some debtors must bear when they are unable to retain property through redemption or an "informal" reaffirmation.

Equally significant, this solution does not disrupt the attorney-client relationship. It creates no conflict of interest. The attorney's duty is to advise, and the client's right to decide is retained. No unnecessary costs are placed on the debtor. The debtor, therefore, obtains the kind of representation Congress desired.

THE LARGER PROBLEM OF BETTER REPRESENTATION FOR CONSUMER BANKRUPTS

Historically, the quality of debtor representation in consumer bankruptcy cases has been subject to serious question.[91] For example, under the Bankruptcy Act, debtors had to apply for the entry of a discharge.[92] While the

89. The authors have been told by representatives of some creditors that they will not permit "informal" reaffirmations because they believe it is too costly. Other creditors encouraged debtors to enter informal reaffirmations where formal agreement could not be approved. Consumer Bankruptcy Amendments section 524(f) was enacted to insure the validity of payment made pursuant to informal reaffirmations. *See supra* note 88. Neither of us has seen any formal data indicating what creditors actually do.

90. The situation of the credit union presents the best case against the Commission's position that formal reaffirmations should never be permitted in bankruptcy. Many credit union members who had been discharged in bankruptcy attempted to reaffirm this debt. Some debtors took this course because they thought the credit union was their best source of credit in the future. Others sought to reaffirm because this loss fell on other members. This argument seemed so appealing that the Senate at one point indicated a purpose to limit any reaffirmations to credit unions. *See* S. REP. No. 95-68, 98th Cong., 1st Sess. 11 (1983). The Senate subsequently altered its position.

The prohibition of all formal reaffirmations should not hurt this creditor if the debtor truly wants to repay. Consumer Bankruptcy Amendments section 524(f) permits voluntary payment. The Commission proposal, like the Code and the CBA, does prevent this creditor from locking the debtor into a formal arrangement which the debtor might subsequently find he cannot fulfill. Again, this seems a satisfactory balance given the strong policy in favor of a fresh start.

91. *See* Brookings Institute, *supra* note 5, at 197; J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY 89-90 (1956).

92. Bankruptcy Act of July 1, 1898, ch. 541, § 14a, 30 Stat. 544.66 (codified at 11 U.S.C. § 32a) (repealed 1979).

entry of a discharge would seem to be a fundamental concern for debtors and their attorneys, there was a widespread practice of debtors' attorneys failing to seek the entry of a discharge order.[93] The Bankruptcy Act was amended to provide for the automatic entry of discharge orders which overcame the problem of insufficient representation of consumer debtors in that context.[94] Subsequent study of the bankruptcy system, however, continued to identify the quality of debtor representation as a problem.

The Brookings Institution study noted that

> The reader should not conclude that all [bankrupts'] counsel who appeared were effective. Occasional instances of conscientious representation were in sharp contrast to the typical performance. Frequently, attorneys could identify their clients only by calling their names and waiting to see who answered. The fact that counsel was looking at a given file for the first time during an examination was usually painfully obvious to the referee and trustee, not to mention the debtor (and us). A common excuse for the low level of performance was that the appearance was the attorney's first as counsel for a bankrupt. Whatever the reason, the apathetic bungling often displayed by individual bankrupts' attorneys is one of the most appalling aspects of the present system.[95]

This observation of the quality of representation in a public forum suggests that the quality of representation in the more secluded context of reaffirmation agreements would suffer even more greatly.

Although the Code generated substantial scholarly commentary and extensive continuing legal education activities, it does not appear to have resolved the problem of the low quality of consumer debtor representation.[96] The congressional hearings considering the consumer bankruptcy amendments contained several references to the problem.[97] Moreover, informal or anecdotal information supports an inference that the additional burden placed on consumer debtors' attorneys in reaffirmation matters under new section 524(c)(3) has not forced those attorneys to expand their knowledge and increase their efforts in these matters.[98] Even if attorneys did increase

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93. *See* J. MacLachlan, Handbook of the Law of Bankruptcy 90 (1956). MacLachlan attributes the failure of attorneys to seek discharges to "the minimum fees paid in no-asset cases" which resulted in the cases being handled by "struggling attorneys who tried to eke out a living on a quantity production basis." *Id.*

94. Act of July 1, 1898, as amended by the Chandler Act of 1938, ch. 541, § 14a, 52 Stat. 840-940 (codified at 11 U.S.C. § 32a) (repealed 1979). The history of these changes is set forth in 1A Colliers on Bankruptcy, ¶ 14.03 (14th ed. 1978).

95. Brookings Institute, *supra* note 5, at 80.

96. *See* Senate Hearings, *supra* note 5, at 292 (statement of Richard L. Levine, Director and Counsel of the Executive Office for U.S. Trustees). Mr. Levine stated that "more than 90 percent of the lawyers who advertise heavily have either never seen a bankruptcy procedure before, or, if they are seeing it now for the first time are giving their clients, perhaps because of the magnitude of the work, great disservice."

97. *Id.* at 298-300 (statement of Richard L. Levine).

98. For example, judges have told us of instances of unsecured debts being reaffirmed without comment by the debtor's attorney; attorneys approving reaffirmations for luxury cars;

their efforts, would this help the debtor? The additional investigations needed in such cases properly would result in increased fees.[99] Yet, there does not appear to be much potential for increases in the amounts debtors can pay for legal services. Therefore, debtors' attorneys either must bear the costs or limit their investigations.

Although no empirical evidence exists to verify our conclusion,[100] we believe that debtors' attorneys as a group have not been willing to bear the costs of the additional investigations which the CBA reaffirmation provisions generate. This would suggest that debtors are not receiving the extent of protection that Congress believes is appropriate in reaffirmation matters. Thus, the solution to the reaffirmation problem set out in the CBA is defective and inferior to the previously existing systems and the remedy recommended by the Bankruptcy Commission.

CONCLUSION

At common law, agreements made after the initiation of bankruptcy proceedings to repay debts that would otherwise be discharged were enforceable. The courts found a sufficient "moral obligation" to operate as consideration for the promise to pay a discharged debt. Comprehensive study of the bankruptcy system indicated that allowing reaffirmation agreements diminished the debtor's discharge in bankruptcy and opportunity for a fresh economic start. This concern led to proposals that reaffirmation agreements be banned; however, Congress was unwilling to take that ultimate step. Instead, Congress continued to permit reaffirmation agreements otherwise enforceable under nonbankruptcy law; however, Congress placed greater restrictions on the enforceability of those agreements. The bankruptcy judge had to assist the debtor in making a determination that a reaffirmation agreement would be in the debtor's best interest. Clearly, Congress did not believe that the protection available to debtors under the Bankruptcy Act, that is, the counsel of the debtors' attorneys, was sufficient to provide adequate protection of the debtors' discharge.

Although Congress decided in 1978 that consumer debtors' attorneys

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and debtor's attorney negotiating a reaffirmation which the judge subsequently signs. *See generally* Lavien, *Malpractice in Bankruptcy: Observations from the Bench*, 90 COMM. L.J. 95 (1985). Judge Lavien notes that bankruptcy is the third largest area of malpractice according to an ABA study and that most of the errors are due to inadequate knowledge of the law. *Id.*

Cf. Hardison v. General Finance Corp., 738 F.2d 893 (7th Cir. 1984). In *Hardison*, a discharged debtor reaffirmed an old debt at the insistence of the creditor to get a new loan. Counsel subsequently challenged the transaction under the Truth-in-Lending Act, and the debtor lost. Code sections 524(c) and (d) requiring judicial approval were ignored. Yet, it seems that on these facts the reaffirmation itself was void, and the creditor's actions apparently violated the discharge injunction. *See* 11 U.S.C. § 524(a)(2) (Supp. 1985). Nevertheless, the debtor's attorney did not raise the issue.

99. *See supra* text accompanying notes 79-84 and *infra* note 103.

100. The Consumer Bankruptcy Committee of the American Bar Association Section of Corporation, Banking and Business Law has begun to consider the problem and likely will conduct some form of survey research.

were not acting sufficiently to protect the interests of their clients in regard to reaffirmation agreements, Congress in 1984 determined that debtors' attorneys now are able to provide ample protection for their clients' interests in these matters. Congress made this determination even in the face of testimony that would support further the claim that debtors did not receive adequate representation in these areas.[101]

In addition to the apparent change in position as to the sufficiency of consumer/debtor representation, Congress also undermined the attorney/client relationship in reaffirmation matters. If paternalism was the problem when bankruptcy judges had authority to approve or disapprove reaffirmation agreements, requiring the debtor's attorney to offer the same approval or disapproval is no less paternalistic.[102] Furthermore, if Congress removed judges from the reaffirmation process only because they rendered the process too costly, it is questionable that they have reduced the cost of the process in any significant manner. In fact, a persuasive argument exists that the same costs are involved but they are now borne by debtors rather than creditors in the reaffirmation process.[103] In addition, Congress clearly felt uneasy about throwing open the reaffirmation doors to whatever agreements debtors and creditors might reach. Nonetheless, placing the ultimate decisionmaking authority in the hands of the debtor's attorney may not increase the diligence of those attorneys.[104] Whether or not the attorney must "approve" the agreement, the attorney has a fundamental responsibility to provide complete representation to the debtor including advising the debtor on the propriety and ultimate enforceability of reaffirmation agreements.[105] Granting to the debtor's attorney the power to prevent the debtor and creditor from entering into enforceable reaffirmation agreements serves only to distort the attorney/client relationship unnecessarily. Debtors may voluntarily repay an obligation discharged in bankruptcy. In fact, to the extent that reaffirmation agreements are found to be an appropriate way for debtors to show their "good faith" to their creditors notwithstanding their seeking bankruptcy relief, it would seem that a debtor voluntarily repaying a previ-

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101. *See supra* notes 91, 93, 95-98.

102. Whether the judge or the debtor's attorney has the power to disapprove reaffirmations, the debtor is denied the ability or power to enter into an enforceable reaffirmation agreement.

103. The potential for personal liability of the debtor's attorney in reaffirmation matters suggests that more extensive investigation would be undertaken than if the bankruptcy judge were deciding the issue. *See supra* text accompanying notes 79-84. Even if the same costs are created, however, the costs are borne by the debtor, or the debtor's attorney if the higher fees generated are not paid. Previously, the bankruptcy system and the affected creditor shared a greater portion of the costs. Presumably, creditors still incur these costs because they need to determine whether a proposed reaffirmation agreement is feasible and prudent. The costs formerly borne by the system, however, are now shifted to the debtor. *See supra* note 61. This is especially ironic when one considers that reaffirmation agreements exist primarily for the benefit of the creditor.

104. *See supra* note 93.

105. MODEL RULES OF PROFESSIONAL CONDUCT Canon 7 (1979).

ously discharged debt should gain greater favor than one who no longer has an option to discontinue making payments.

All things considered, we believe that the prohibition of reaffirmation agreements is the most appropriate course.[106] Debtors' attorneys still must counsel their clients on the advisability of voluntarily repaying debts after the entry of a discharge order in bankruptcy. Attorneys will not, however, need to provide any advice to their clients regarding the enforceability of prebankruptcy claims except to say that the debtors have no personal obligation to repay any amount discharged to the bankruptcy case. To the extent that debtors want to repay some or all of their discharged debts, they should be permitted to do so. On the other hand, they should not be permitted to "bargain away" the value of their discharge when future unforeseeable (and sometimes foreseeable) consequences render the bargain a bad one.

106. Each of us admits to changing his mind on this matter in the course of writing this article. Morris originally favored the Code position. He thought that few reaffirmations, if any, should be permitted and that the judges had reached the correct result in interpreting the Code. The Code, however, seemed both too expensive and too time consuming for all parties to justify this compromise. More significantly, the Code tended to deprive the debtor of the advice of his attorney since the attorney was likely to lose interest in the matter. The Consumer Bankruptcy Amendments seemed worse because they placed most of the costs of the reaffirmation process on debtors and disrupted the relationship between the debtor and his attorney. By a process of elimination, Morris was driven to the position of the Bankruptcy Commission.

Ulrich, on the other hand, initially agreed with the position adopted by the Bankruptcy Act. Writing the dialogue between Bankrupt and Lawyer under that statute demonstrated to him its questionable benefits. In too many cases, lawyers' advice would be ignored. In many others, Bankrupt would reaffirm without any professional advice. Many bankrupts would lose the fresh start in this way. While paternalism ordinarily is a bad idea, in this situation it seems the lesser of two evils. The Code method seemed overly expensive and the Consumer Bankruptcy Amendments added new difficulties. Outright prohibition coupled with express permission to repay voluntarily was the best alternative available.

WASHINGTON AND LEE LAW REVIEW

Volume 43 | Winter 1986 | Number 1

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