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Vern Countryman

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Chapter XIII Wage Earners' Plans: Past, Present and Future*

VERN COUNTRYMAN**

Chapter XIII of the Bankruptcy Act, as some teachers of Creditors' Rights and Bankruptcy know, is designed to make available to wage earners,¹ on a voluntary petition only, a procedure by which they can effect a plan of composition, or of extension, or both, through payments out of future earnings. The plan may cover unsecured debts and debts secured by personalty. If the plan is accepted by a majority in number and amount of unsecured creditors and by each secured creditor dealt with by the plan, and is confirmed by the court as meeting certain statutory standards—principally that it “is for the best interests of the creditors and is feasible”²—it becomes binding on all creditors. If the debtor performs in compliance with the plan,³ or if after three years he has not performed but the court finds that his failure to do so is “due to circumstances for which he could not be justly held accountable,”⁴ he is granted a discharge.

The attractiveness of the plan from the creditors' viewpoint is that they receive much more than the average eight percent dividend which they receive in the 12 percent of straight bankruptcy cases in which they receive any dividend at all.⁵ The attractiveness from the debtor's viewpoint is that he avoids the stigma

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** Professor of Law, Harvard University Law School. B.A., University of Washington, 1939; LL.B., University of Washington, 1942. Chairman, Committee on Chapter XIII and Consumer Bankruptcy, National Bankruptcy Conference.

1. A “wage earner” is defined as “an individual whose principal income is derived from wages, salary or commissions.” Bankruptcy Act § 606(8), 11 U.S.C. § 1006(8) (1964).

2. *Id.* § 656(a)(2), 11 U.S.C. § 1056(a)(2) (1964).

3. *Id.* § 660, 11 U.S.C. § 1060 (1964).

4. *Id.* § 661, 11 U.S.C. § 1061 (1964).

5. In a typical recent year, 75 percent of straight bankruptcy cases have been “no asset” cases in which nothing is left after the debtor's exemptions are set apart and another 13 percent have been “nominal asset” cases in which what is left after exemptions is consumed by administration expenses. The official statistics on these points do not separate business from personal bankruptcies. If they did, the picture would doubtless be even worse for personal bankruptcies.

of bankruptcy, retains any assets he may have, gets a plan which binds dissenting creditors, and is protected from creditors' levies while the proceedings are pending.

Chapter XIII, which was introduced by the Chandler Act, is now thirty years old. Ten years after its enactment, one-fourth of all employees who filed under the Bankruptcy Act filed under Chapter XIII. Twenty years after enactment, only one-fifth of them did so. In fiscal 1968 the proportion was again one-fifth. The consequence is that in a period during which total Bankruptcy Act filings increased elevenfold (from 18,000 in 1948 to almost 198,000 in 1968) and the proportion of total employee filings has increased from 66 percent to 82 percent, Chapter XIII filings have not increased proportionately, but only tenfold—from some 3,000 in 1948 to 31,000 in 1968.⁶

Even this description paints the picture too brightly. Over half of all Chapter XIII filings occur in only three states—Alabama, Tennessee and California. And almost 90 percent of all such filings occur in 13 states. In the rest of the country a Chapter XIII case is either an extreme rarity or unheard of. Moreover, in the relatively few states where Chapter XIII is used, more than half of the cases are dismissed without confirmation of a plan. Probably an additional one-sixth are dismissed after confirmation because of the debtor's default under the plan. In this latter group of dismissals for default creditors typically receive more than they would get in a straight bankruptcy proceeding, but the debtor usually does not get the discharge which he would almost certainly have gotten if he had filed in straight bankruptcy.⁷

So much for the past and the present, save to note that the nonuse of Chapter XIII in most of the country is apparently due to the hostility or indifference of bankruptcy referees and practitioners. To the extent that such attitudes are based on feelings that Chapter XIII is so horribly drafted as to be almost unworkable and that it contains substantive defects which largely negate any hope of lasting relief and rehabilitation for the debtor, they are very well-founded.

For the past five years the National Bankruptcy Conference has been working on an omnibus bill to revise Chapter XIII. Earlier versions have been introduced in Congress,⁸ but some of those provisions have been changed by the Conference and new ones have been added. My remarks about the future of Chapter XIII will, therefore, be directed to the Conference bill, which has

6. All statistics are from *Tables of Bankruptcy Statistics* published annually by the Administrative Office of the United States Courts for fiscal years 1948 through 1967 or from preliminary statistics published in the Annual Report of the Director of the Administrative Office for fiscal 1968.

7. Typically, in recent years, only one percent of straight bankrupts were denied discharges. Another two percent waived or did not apply for discharge, but many of these were corporate debtors.

8. H.R. 2520, 90th Cong., 1st Sess. (1967); H.R. 20, 89th Cong., 1st Sess. (1965); H.R. 12064, 88th Cong., 2d Sess. (1964).

been introduced in the Ninety-first Congress.^{8a} That bill is designed to do three things: (1) to remedy some of the worst draftsmanship now embodied in Chapter XIII, (2) to eliminate some obstacles which discourage the debtor and his counsel from even attempting to work out a wage earner's plan, and (3) to improve the debtor's chances not only of carrying out a plan but also of obtaining lasting relief and rehabilitation. I will deal with the more important proposals in each area.

Correcting Deplorable Draftsmanship

Valuing Collateral. Section 602⁹ provides that provisions of the Act applicable in straight bankruptcy proceedings shall apply also in Chapter XIII where not inconsistent with its provisions, except that Section 70f¹⁰ shall not apply. Insofar as Section 70f provides for the sale of a bankrupt's assets, the exclusion is understandable, but Section 70f also directs, and thereby authorizes, the appointment of appraisers in straight bankruptcy proceedings.¹¹ From the exclusion of Section 70f some referees have concluded that they have no authority to appoint appraisers in Chapter XIII, and from there have proceeded to the further conclusion that they either can not or will not value the collateral on secured claims as they would do under Section 57h in a straight bankruptcy proceeding.¹² Hence they treat every secured creditor as 100 percent secured. The Conference bill would amend Section 606(1)¹³ to direct that the value of all security—

8a. H.R. 6792, 91st Cong., 1st Sess. (1969).

9. 11 U.S.C. § 1002 (1964).

10. *Id.* § 110 (f) (1964).

11. *Ibid.*:

The court shall appoint a competent and disinterested appraiser and upon cause shown may appoint additional appraisers, who shall appraise all the items of real and personal property belonging to the bankrupt estate and who shall prepare and file with the court their report thereof. Real and personal property shall, when practicable, be sold subject to the approval of the court. It shall not be sold otherwise than subject to the approval of the court for less than 75 per centum of its appraised value.

12. Bankruptcy Act § 57h, 11 U.S.C. § 93(h) (1964):

The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court.

Since the Chapter XIII plan may include claims secured by personalty and since, whether it does or not, the court may under Section 614 enjoin during the Chapter XIII proceeding any act or the commencement or continuation of any proceeding to enforce any lien upon the property of the debtor, the provision in Section 57h for establishing values by liquidating the collateral, and the provision limiting dividends to the unsecured deficiency may be inconsistent with and therefore inapplicable under Chapter XIII.

13. 11 U.S.C. § 1006(1) (1964).

whether the security is personalty or realty¹⁴ and whether the secured claim is proved or not—shall be determined pursuant to Section 57h and that so much of the claim as exceeds the value so determined shall be treated as an unsecured claim.

Proof of Claims. Chapter XIII authorizes a wage earner's plan to deal with unsecured claims and claims secured by personalty whether or not they are provable in straight bankruptcy.¹⁵ It provides for receipt of proofs and allowance or disallowance of claims at the first creditors' meeting.¹⁶ It directs that if the plan is accepted at the first creditors' meeting by all creditors affected thereby, whether or not their claims have been proved, the court shall rule on confirmation.¹⁷ If all affected creditors have not then accepted, a separate ruling on confirmation is to be made when the plan has been accepted by a majority in number and amount of unsecured creditors whose claims have been proved and allowed before conclusion of the first creditors' meeting and by each secured creditor whose claim is dealt with by the plan.¹⁸ If the plan is confirmed it is binding on all creditors whether or not their claims have been scheduled, filed or allowed.¹⁹ The Chapter XIII discharge, if granted, covers all dischargeable debts provided for in the plan but covers nondischargeable debts only if held by creditors who have accepted the plan,²⁰ and debts may be nondischargeable either because nonprovable or because specifically excepted from discharge.²¹

But nowhere does Chapter XIII say explicitly that only those creditors who have proved their claims may participate in the plan, nor does it fix a time within which claims must be proved. It might be thought that this is all taken care of by Section 602 through the incorporation of Section 57n as a straight bankruptcy provision not inconsistent with Chapter XIII.²² But some referees view Section 57n as inapplicable and direct payments under the plan on all claims

14. Valuation of real estate security is necessary to determine (1) whether the debtor has an equity so that foreclosure should be stayed during the Chapter XIII proceeding (see p. 287 *infra*), or (2) whether the secured creditor has an unsecured deficiency which should be treated as an unsecured claim. Partially secured creditors are so treated in Chapter XI plans although such plans may not deal with secured claims. *United States v. National Furniture Co.*, 348 F.2d 390 (8th Cir. 1965); *Wm. H. Wise & Co. v. Rand McNally & Co.*, 195 F. Supp. 621 (S.D.N.Y. 1961).

15. Bankruptcy Act § 606(1), 11 U.S.C. § 1006(1) (1964).

16. *Id.* § 633(1), 11 U.S.C. § 1033(1) (1964).

17. *Id.* § 651, 11 U.S.C. § 1051 (1964).

18. *Id.* § 652, 11 U.S.C. § 1052 (1964).

19. *Id.* § 657, 11 U.S.C. § 1057 (1964).

20. *Id.* §§ 660-61, 11 U.S.C. §§ 1060-61 (1964).

21. *Id.* § 17a, 11 U.S.C. § 35(a) (1964).

22. "Except as otherwise provided in this Act, all claims provable under this Act . . . shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed . . ." *Id.* § 57n, 11 U.S.C. § 93(n) (1964).

scheduled by the debtor, whether or not they are proved.²³ Indeed, some referees go further and allow creditors whose claims arise after the Chapter XIII petition is filed to participate in the plan. The Conference bill would amend Section 657 to exclude from participation in the plan, but not from the effect of a discharge, all claims which are not filed within six months of the first creditors' meeting or within such further time, not exceeding an additional six months, as the court may allow. The bill would also amend Section 606(1) to exclude from participation or discharge all claims arising after the filing of the petition.

Usury. Section 656(b) provides that "[b]efore confirming any . . . plan the court shall require proof from each creditor filing a claim that such claim is free from usury . . ." ²⁴ The objective is clear, but the procedure is ridiculous. Any creditor desiring to hinder confirmation could, if this provision is read literally, file a claim and then fail to produce proof that it was free from usury unless and until required to do so in contempt proceedings brought before the district judge. In at least one district the matter is handled as if the statute said, "No creditor may participate in distributions under the plan" unless he establishes that his claim is free from usury.²⁵ The Conference bill would amend Section 656(b) to make it say precisely that.

Removing Obstacles to Use of Chapter XIII

Unwarranted Penalties for Failure—or Even for Success. Since 1903 the Bankruptcy Act has forbade successive straight bankruptcy discharges more frequently than six years.²⁶ When the Chandler Act added Chapters XI (Arrangements), XII (Real Property Arrangements), and XIII (Wage Earners' Plans), Section 14c(5) was amended to forbid a straight bankruptcy discharge to one who has within the preceding six years been granted a discharge in any proceed-

23. *In re Heger*, 180 F. Supp. 147 (D. Minn. 1959), holds Section 57n applicable in Chapter XIII so that claims not proved within the six-month period therein specified cannot participate in distributions under the plan, and *In re Maye*, 180 F. Supp. 43 (E.D. Va. 1958) holds it applicable so as to invalidate a referee's order fixing an earlier date for proof as a condition to participation. *See also* Fausett v. Murner, 402 F.2d 961 (5th Cir. 1968); *In re Willett*, 265 F. Supp. 999 (S.D. Calif. 1967); *In re Gates*, 256 F. Supp. 1 (E.D. Wis. 1966). But the court in *In re Heger*, *supra* at 150, noted that information furnished by the Administrative Office revealed that "a majority" of the referees require proof and allowance of claims as a condition to participation under the plan.

24. 11 U.S.C. § 1056(b) (1964).

25. *In re Perry*, 272 F. Supp. 73 (D. Maine 1967). *See also In re Bogan*, 281 F. Supp. 242 (W.D. Tenn. 1968). *Cf. In re Richards*, 272 F. Supp. 480 (D. Maine 1967).

26. Bankruptcy Act § 14c(5), 11 U.S.C. § 32(c)(5) (1964). More precisely, under Section 14c(5) as it now reads, a discharge may not be granted in a proceeding initiated on a petition filed within six years of the initiation of a prior proceeding in which a discharge was granted.

ing under the Bankruptcy Act, or had an arrangement by way of composition or a wage earner's plan by way of composition confirmed.²⁷ This is an unfortunate provision, clearly based on the fact that the draftsman's left hand had forgotten what the right hand had done.²⁸ The House Committee report explains, "[i]nasmuch as the confirmation of the composition operates as a discharge, there is no reason why it should not be so treated."²⁹ But, while confirmation of an arrangement by way of composition under Chapter XI or XII operates as a discharge,³⁰ confirmation of a wage earner plan by way of composition does not. The wage earner debtor qualifies for a discharge only by fully performing under the plan³¹ or by persuading the court, three years after confirmation, that his failure to do so is "due to circumstances for which he could not be justly held accountable."³² Yet Section 14c(5), having first made any discharge actually granted in the Chapter XIII proceeding a bar to a bankruptcy discharge for six years, goes on to give the same effect to the confirmation of a composition plan³³ in a Chapter XIII proceeding in which no discharge was granted.³⁴

Thus the debtor contemplating a composition plan under Chapter XIII must face the risk that if, after committing his earnings for an appreciable period of time, he fails to perform and for that reason fails to obtain his Chapter XIII discharge³⁵ he will also have forfeited his right to a straight bankruptcy dis-

27. The additional reference in present Section 14c(5) to confirmation of a prior composition, other than by way of an arrangement or a wage earner plan, is, as the Supreme Court has noted, a "drafting oversight," the draftsmen having forgotten that former Section 12 (and former Section 74) "under which such a composition might have been confirmed, [were] repealed in the same enactment." *Perry v. Commerce Loan Co.*, 383 U.S. 392, 401 n.7 (1966). The Conference bill would make the appropriate deletion.

28. For the second time, see note 27 *supra*.

29. H.R. REP. NO. 1409, 75th Cong., 1st Sess. 29 (1937). Prior to the Chandler Act, compositions were possible under former Sections 12 and 74, and former Section 14c provided that confirmation of a composition should operate as a discharge. All of these provisions were eliminated by the Chandler Act.

30. Bankruptcy Act §§ 371, 476, 11 U.S.C. §§ 771, 876 (1964).

31. *Id.* § 660, 11 U.S.C. § 1060 (1964).

32. *Id.* § 661, 11 U.S.C. § 1061 (1964).

33. Prior confirmation of a wage earner plan by way of *extension*, though within the six-year period, will not, of course, bar a straight bankruptcy discharge. *Barnes v. Maley*, 360 F.2d 922 (7th Cir. 1966). See also *In re Holmes*, 309 F.2d 748 (10th Cir. 1962); *In re Autry*, 204 F. Supp. 820 (D. Kan. 1962). H.R. REP. NO. 1409, 75th Cong., 1st Sess. 29 (1937), explains that this more favorable treatment for confirmed extension plans was thought justified because "it is contemplated that debts shall be paid in full."

34. Actually, confirmation of a composition plan followed by a later discharge in the Chapter XIII proceeding would, under Section 14c(5) as it now reads, provide two grounds for denying a later discharge, but the six-year bar period as to both would run from the date of the filing of the Chapter XIII petition. See note 26 *supra*.

35. Lurking here is another anomaly in Chapter XIII. Even though the debtor's failure is clearly "due to circumstances for which he cannot be justly held accountable" within the meaning of Section 661 (*e.g.*, illness, unemployment), he cannot seek a discharge under that section until three years after confirmation. But if "a debtor

charge until the expiration of six years after initiation of the Chapter XIII proceeding. There is no reason why a debtor who has tried a wage earner composition and failed should be in a worse position than one who never tried at all. The present state of the law probably discourages many well-advised debtors from making the attempt, and builds a trap for those not well advised. Accordingly, the Conference bill would amend Section 14c(5) so that only a prior Chapter XIII discharge, if any, and not the mere confirmation of a composition plan, would bar a later bankruptcy discharge.

But even this amendment to Section 14c(5) does not seem to go far enough. There is also the problem of the wage earner debtor who under an extension plan has fully performed. When that occurs, Section 660 directs that the court "shall" grant a discharge of all debts provided for by the plan. The value of this discharge is not apparent, since it only covers debts which under an extension plan have been fully paid.³⁶ The disadvantage of the discharge is apparent. It bars a discharge in straight bankruptcy until the expiration of six years after the Chapter XIII petition was filed.³⁷

Again, there is no reason why the debtor who has fully paid debts existing at the time of his Chapter XIII petition should be put in a worse position with respect to his post-petition debts than that occupied by other debtors with respect to all debts. The well-advised debtor might conclude that he had better waive his Chapter XIII discharge or do something to forfeit it, such as defaulting on the last payment under the plan, or that he had better stay out of Chapter XIII proceedings entirely. And again, the law may prove a trap for the all too frequent debtor who is not well advised. Hence, the Conference bill would further amend Section 14c(5) to exclude entirely from its operation a discharge

defaults in any of the terms of the plan . . . the court shall . . . (2) . . . enter an order dismissing the proceeding under this chapter or, with the consent of the debtor, adjudging him a bankrupt . . ." Bankruptcy Act § 666, 11 U.S.C. §1066 (1964). In the latter event, the confirmation might also be held to bar his discharge in straight bankruptcy. See *id.* § 669(3), 11 U.S.C. § 1069(3) (1964). Some, but not all, referees are willing to use a provision in the plan authorizing modifications pursuant to Section 646(5) to stall the necessity for dismissal until the debtor can qualify for a Section 661 discharge. The Conference bill would reduce the waiting period under Section 661 from three years to one year.

36. Post-petition interest on unsecured claims will not have been paid, and apparently will be discharged (*cf.* *Bruning v. United States*, 376 U.S. 358 (1964)), but this seems to be the full measure of the discharge granted to a debtor who fully performs under an extension plan.

37. *In re Thompson*, 51 F. Supp. 12 (W.D. Va. 1943) avoids this result by deciding that "discharge" in Section 14c(5) means "discharge *in bankruptcy*." The fact that the italicized words appeared in the corresponding provision prior to the 1938 amendment but were deleted by that amendment was taken to mean that they were regarded as "surplusage." The fact that the amendment substituted a discharge "in a proceeding under this Act" was ignored. *Cf. In re Bingham*, 190 F. Supp. 219 (D. Kan. 1960), *appeal dismissed*, 297 F.2d 341 (10th Cir. 1961).

“ordered pursuant to Section 660 upon compliance by the debtor with the provisions of a wage earner’s plan by way of extension.”

Unwarranted Bars to Use of Chapter XIII. Thus far I have been discussing the operation of Section 14c(5) where it says the court in a straight bankruptcy proceeding must deny a bankruptcy discharge because of something which occurred in an earlier Chapter XIII proceeding within the six year bar period. But Section 14c(5) may also operate to require a Chapter XIII court in certain circumstances to refuse confirmation of a wage earner plan or the Chapter XIII discharge because of a prior bankruptcy discharge within the six year bar period.

Section 656(a)(3) forbids confirmation of a plan if “the debtor has . . . been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of [a] bankrupt. . . .”³⁸ Clearly the reference is to some of the provisions of Section 14c providing grounds for denial of a discharge—falsification of records, fraudulent conveyances, refusal to obey a lawful order, etc. But is all of Section 14c incorporated or, more to the point, is Section 14c(5) incorporated? An easy, though perhaps not an overly persuasive, answer would be a strict reading of Section 656(a)(3) under which a debtor who had previously obtained a straight bankruptcy discharge³⁹ would not be “guilty” of an act which would bar a discharge—and certainly he would not have failed to perform a duty.⁴⁰

The Supreme Court had one aspect of the problem before it in *Perry v. Commerce Loan Company*,⁴¹ where a wage earner who had previously obtained a straight bankruptcy discharge sought confirmation of an *extension* plan within the six year bar period. The Court, while noting the availability of the easy solution which reads Section 14c(5) out of Chapter XIII for all purposes, declined to follow that course. Instead, it concluded that the “purpose” of Section 14c(5)—“to prevent the creation of a class of habitual bankrupts . . . who might repeatedly escape their obligations as frequently as they chose by going through repeated bankruptcy”—could have no application to a debtor who, on his

38. 11 U.S.C. § 1056(a)(3) (1964).

39. Actually, the cross-referring is more complex. If Section 14c(5) is incorporated by Section 656(a)(3), a Chapter XIII court is also directed to refuse confirmation if the debtor, in a prior Chapter XIII proceeding within the six-year period, had a composition plan confirmed or received a Chapter XIII discharge. To the extent that the Conference bill would amend Section 14c(5) to eliminate such matters as a bar to later bankruptcy discharge it would also eliminate them as a bar to confirmation of a second wage-earners’ plan.

40. This solution was adopted in *In re Mayorga*, 355 F.2d 89 (9th Cir. 1966), interpreting Section 656(a)(3) not to bar confirmation of a wage earner extension plan because of a prior bankruptcy discharge, and in *In re Goldberg*, 53 F.2d 454 (6th Cir. 1931), interpreting identical language in former Section 12 not to bar confirmation of a composition plan because of a prior bankruptcy discharge.

41. 383 U.S. 392 (1966).

second trip, proposed not to escape his debts, but to pay them in full.⁴² Dictum in the opinion calls for a contrary result, however, where a *composition* plan is involved:

A composition under Chapter XIII, unlike an extension, is closely akin to straight bankruptcy . . . proceedings . . . for under such a plan the debtor is discharged from his debts and claims of the creditors are only partially paid It is both logical and consistent with the underlying purposes of § 14(c) (5) that confirmation of wage-earner compositions be barred by prior bankruptcy⁴³

The decision in *Perry* is commendable, but the dictum is deplorable. The latter, if accepted, means that a debtor with a prior bankruptcy discharge who cannot carry a wage earner extension plan but conceivably could carry a composition plan has no alternative but to let matters deteriorate while he waits the running of the six year bar period—by the end of which time he may not be able to carry a composition plan either, but may have to file another bankruptcy petition. Such a rule seems to serve neither the interests of the debtor nor of his creditors. Accordingly, the Conference bill would amend Section 656(a) (3) to provide that nothing in Section 14c(5) shall bar confirmation of a wage earner plan whether it be for composition or extension.

Further dictum in *Perry* says that, while the prior bankruptcy discharge will not bar confirmation of an extension plan, and will not bar a Section 660 discharge if the debtor fully performs (such discharge being "little more than a mere formality"), it will bar a Section 661 discharge if the debtor defaults on his extension plan, even if the default is due to circumstances for which he could not justly be held accountable. This was said to follow because "[a] request for relief under Section 661 would, in effect, constitute an attempt to transpose an extension plan into a composition" ⁴⁴ As we do not believe that a prior discharge should bar confirmation of a composition plan, we do not find this reasoning persuasive. No debtor undertaking an extension plan can be sure that factors beyond his control will not prevent successful performance. Yet his counsel must advise him, because of his prior discharge, that the risk of later default is a denial of Chapter XIII discharge no matter how excusable the default and no matter how much has been paid to his creditors at the time of default. Such a rule can only result in further pressure on the well advised debtor to let

42. *Id.* at 399. This conclusion had previously been reached by other courts: *In re Mayorga*, 355 F.2d 89 (9th Cir. 1966); *Edins v. Helzberg's Diamond Shops, Inc.*, 315 F.2d 223 (10th Cir. 1963); *In re Sharp*, 205 F. Supp. 786 (W.D. Mo. 1962); *In re Mahaley*, 187 F. Supp. 229 (S.D. Cal. 1960). *But see In re Schlageter*, 319 F.2d 821 (3d Cir. 1963); *In re Fontan*, 227 F. Supp. 973 (S.D. Miss. 1964); *In re Nicholson*, 224 F. Supp. 773 (D. Ore. 1963).

43. *Perry v. Commerce Loan Co.*, 383 U.S. 392, 403 (1966).

44. *Id.* at 404.

matters deteriorate until the six year bar period has expired. The Conference bill would amend Section 661 to provide that nothing in Section 14c(5) shall bar a discharge for excusable default.⁴⁵

Finally, if the prior bankruptcy discharge within the six year bar period is no longer to be a bar to confirmation of a composition plan, there remains the problem of how to treat the debtor with such a prior discharge if he successfully performs under such a plan. One possibility is to disallow him the Chapter XIII discharge to which other debtors without prior bankruptcy discharges are automatically entitled under Section 660. But such a rule, like the rule barring confirmation of composition plans, would only discourage or delay resort to Chapter XIII, with at best no benefit and at worst considerable detriment to both debtor and creditor.

The alternative is to give him his Chapter XIII discharge for full performance, which would cover the unpaid balances of debts provided for by the plan, but would not affect new debts incurred during the Chapter XIII proceeding. Without more, the Chapter XIII discharge would then stand as a bar to another discharge in straight bankruptcy for the six year bar period. For the debtor who has achieved rehabilitation under the composition plan and is able to handle debts incurred while performing the plan and thereafter, this may be no problem. For the debtor who has been hard put to make ends meet while paying out under the plan, it is a problem and he may be better off without the Chapter XIII discharge.

Since no debtor contemplating a Chapter XIII composition plan can know in advance what his circumstances will be at the time of completion of performance, the effect again is to deter or delay resort to Chapter XIII so long as Section 660 provides that a discharge "shall" be granted upon completion of payments under the plan. The Conference bill's solution is to provide that the debtor who fully performs under a composition plan may file a written waiver of the discharge to which he would otherwise be entitled.⁴⁶

More Effective Relief

There are at least two apparent reasons why so many Chapter XIII debtors do not get plans confirmed, or do not complete their plans, or do not find them-

45. Since, under the Conference bill, the prior discharge would not bar confirmation of either an extension or a composition plan, the bill's amendment of Section 661 would apply to excusable defaults under either type of plan.

46. The bill also provides that neither the waiver nor the failure to grant the discharge shall bar the discharge of debts provided for by the plan in any subsequent proceeding. Cf. *In re Dunn*, 251 F. Supp. 637, 641 (M.D. Ga. 1966), holding that dismissal of a Chapter XIII proceeding because of the debtor's default will bar confirmation of a second plan covering the same debts since the debtor is "barred by res judicata from again listing them in a plan."

selves better off after having completed them. One is the preferred treatment given to secured creditors. The other is the failure to screen out unconscionable claims which, in fairness to the debtor and other creditors, should not be allowed to participate under the plan.

Secured Claims. I have already described one amendment which would eliminate the practice in many districts under which a creditor with collateral, no matter how little it may be worth, is treated as 100 percent secured. Under that amendment, the Chapter XIII court would value the collateral and the unsecured deficiency would be treated like other unsecured claims. This proposal, of course, does not take care of the creditor who has enforced his security by foreclosure sale outside of the Chapter XIII proceeding and who presents a deficiency claim in that proceeding. In the future, most such foreclosures will take place under the Uniform Commercial Code.⁴⁷ This will usually mean non-judicial repossessions and non-judicial sales⁴⁸ with judicial intervention authorized by state law⁴⁹ only to determine whether the debtor has received notice of the sale and whether the sale was conducted in a "commercially reasonable manner." And the "fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner."⁵⁰

Because these provisions do not give the debtor much more protection against sacrificial and collusive foreclosure sales than did pre-Code law, the Conference bill would add a new Section 647(1) directing the Chapter XIII court, whenever a deficiency claim is proved and if requested by the debtor, to determine the fair value of the collateral at the date of foreclosure sale and, if it finds that value to exceed the sale price, to adjust the amount of the deficiency claim accordingly.⁵¹

At this point, of course, I am referring to the once-secured creditor who has realized on his security outside the Chapter XIII proceeding and is participating in that proceeding only as an unsecured creditor for his deficiency

47. For a more distant future, Section 6.103 of the proposed Uniform Consumer Credit Code may forbid deficiency claims by the seller who has repossessed, but the prohibition applies only to consumer sales where the cash price of the goods was \$1,000 or less, thus excepting the ubiquitous automobile dealer and, by virtue of Section 2.107, the finance company which takes his paper. Moreover, since the prohibition does not apply to lenders, some sellers will doubtless respond to the invitation to cast the sale in the form of a purchase money loan.

48. UNIFORM COMMERCIAL CODE §§ 9-503—05.

49. *Id.* § 9-507.

50. *Id.* § 9-507(2).

51. If the issue of fair value of the collateral has been previously contested before and finally determined by a court of record (*i.e.*, not by default judgment and not by a justice of the peace) the Conference bill makes that determination conclusive in the Chapter XIII proceeding.

claim. Let me return to the secured creditor who has not foreclosed, whose secured claim has been reduced to the value of the collateral as determined by the Chapter XIII court, and who, to the extent of that value, will participate in the Chapter XIII proceeding as a secured creditor. If his secured claim is dealt with by the plan it cannot be confirmed without his consent.⁵² At the time Chapter XIII was drafted some thirty years ago this individual veto given to each secured creditor was thought to be required by the 1935 decision in *Louisville Joint Stock Land Bank v. Radford*.⁵³ That case found the due process clause violated by the first Frazier-Lemke Act's provision of a five-year moratorium on farm mortgage foreclosures although the farmer debtor was required to pay the mortgagee a reasonable rent during the moratorium period. Apparently the 1937 decision in *Wright v. Vinton Branch Bank*,⁵⁴ sustaining provisions of the second Frazier-Lemke Act which limited the moratorium period to three years and gave the bankruptcy court jurisdiction to reduce it further, was either not considered or not thought to justify a change.⁵⁵ In any event, the result is to enable each secured creditor to veto any plan which would in any way modify the terms of his contract.⁵⁶ There is no limitation of good faith or reasonableness on the exercise of the veto.

The alternatives, as matters now stand, are to modify the plan either to require strict compliance with the terms of dissenters' contracts or to exclude the claims

52. Bankruptcy Act § 652, 11 U.S.C. § 1052 (1964).

53. 295 U.S. 555 (1935).

54. 300 U.S. 440 (1937).

55. H.R. REP. No. 1409, 75th Cong., 2d Sess. 54 (1937). The report was filed four months after *Wright* was decided, but states that "[t]he provision for so dealing with secured creditors is made necessary by the decision of *Louisville Joint Stock Land Bank v. Radford*." The later Senate Report merely refers to the House Report for an explanation of Chapter XIII. S. REP. No. 1916, 75th Cong., 3d Sess. 18 (1938).

56. *Interstate Fin. Corp. v. Scroggum*, 265 F.2d 889 (6th Cir. 1959); *In re Rutledge*, 277 F. Supp. 933 (E.D. Ark. 1967) (secured claim "dealt with" by plan which provides for full monthly payments required by contract but only requires delinquent payments to be brought current "within a reasonable length of time"); *In re Pappas*, 216 F. Supp. 819 (S.D. Ohio 1962); *In re O'Dell*, 198 F. Supp. 389 (D. Kan. 1961). One court has held that a secured creditor is not "materially and adversely affected" within the meaning of Section 607 (which the court equated to being "dealt with" within the meaning of Section 652) even though (1) plan payments of \$8.75 per week would in some months be less than the contract payments of \$36.75 per month, since over a twelve month period the plan payments would amount to more than the contract payments, and (2) no provision was made for bringing current two delinquent monthly payments, so that the effect of the plan was to extend the contract term by two months. (But the creditor had made no attempt to accelerate maturity because of the delinquencies, thus indicating that he had "the usual attitude of creditors similarly situated" of being "more interested in obtaining the money due . . . than in repossessing the property.") And an alternate ground for decision was that the creditor could not object to confirmation after accepting distributions under the plan for almost a year.) *In re Wilder*, 225 F. Supp. 67 (M.D. Ga. 1963). And *Cheetham v. Universal C.I.T. Credit Corp.*, 390 F.2d 234 (1st Cir. 1968), sanctions the device of providing in the plan that any secured creditor adversely affected by the plan shall not be dealt with by it unless he consents—a device rejected in *In re Pappas*, *supra*.

of every dissenting secured creditor. The first alternative may not be feasible, and the second may mean (1) that the necessity for dealing with the secured creditor outside the plan jeopardizes the ability of the debtor to perform under the plan, and (2) that even if he succeeds in performing under the plan, it will give him no relief as to the excluded secured claims. The Conference bill deals with each aspect of this problem.

First, as to treatment during the Chapter XIII proceeding of secured creditors not dealt with by the plan, Section 611 now gives the Chapter XIII court exclusive jurisdiction over all property of the debtor. Moreover, Section 614 authorizes the court, upon notice and "for cause shown," to stay until final decree "any act or the commencement or continuation of any proceeding to enforce any lien upon the property of a debtor."⁵⁷ One appropriate cause for stay would appear to be that the collateral, *e.g.*, an automobile, is essential to the ability of the debtor to carry out the plan.⁵⁸ Another appropriate cause would appear to be to enable the debtor to cure defaults and thus avoid loss of his equity in the collateral.⁵⁹ But here the cases are not satisfactory. While it is recognized that the Chapter XIII court may restrain the secured creditor from resorting to foreclosure without obtaining the court's consent, and that such consent may, on some terms, be withheld,⁶⁰ some courts take the view that foreclosure will be stayed only on condition that the debtor immediately cure all defaults and thereafter keep up payments strictly according to contract terms.⁶¹

57. 11 U.S.C. § 1014 (1964). This power to stay extends to claims secured by realty, even though such claims cannot be dealt with by the plan. *Hallenbeck v. Penn Mut. Life Ins. Co.*, 323 F.2d 566 (4th Cir. 1963); *In re Pizzolato*, 281 F. Supp. 109 (W.D. Ark. 1967); *In re Willett*, 265 F. Supp. 999 (S.D. Cal. 1967); *In re Garrett*, 203 F. Supp. 459 (N.D. Ala. 1962). *Cf. In re Oglialoro*, 370 F.2d 557 (4th Cir. 1966).

58. *In re Rutledge*, 277 F. Supp. 933 (E.D. Ark. 1967) (automobile). Both the automobile . . . *In re Pizzolato*, 268 F. Supp. 353 (W.D. Ark. 1967), and the home in *In re Pizzolato*, 281 F. Supp. 109 (W.D. Ark. 1967) were found to be essential to performance by a breadwinning wife with an invalid husband and two children. The clearest case for a stay, of course, is the one where an otherwise unsecured creditor has garnished the debtor's wages. *In re Willett*, 265 F. Supp. 999 (S.D. Calif. 1967).

59. *Hallenbeck v. Penn Mut. Life Ins. Co.*, 323 F.2d 566 (4th Cir. 1963) (home); *In re Clevenger*, 282 F.2d 756 (7th Cir. 1960) (automobile and television set); *In re Pizzolato*, 281 F. Supp. 109 (W.D. Ark. 1967) (home); *In re Pizzolato*, 268 F. Supp. 353 (W.D. Ark. 1967) (automobile); *In re Willett*, 265 F. Supp. 999 (S.D. Cal. 1967) (home); *In re Garrett*, 203 F. Supp. 459 (N.D. Ala. 1962) (home); *In re Duncan*, 33 F. Supp. 997 (E.D. Va. 1940) (refrigerator). *In re Garrett, supra*, finds an obligation in the Chapter XIII court to preserve the debtor's equity in realty for the benefit of his estate against the possibility that the Chapter XIII proceeding may end in bankruptcy.

60. *First Nat'l Bank v. Cope*, 385 F.2d 404 (1st Cir. 1967).

61. *In re Clevenger*, 282 F.2d 756 (7th Cir. 1960); *In re Copes*, 206 F. Supp. 329, 330 (D. Kan. 1962); ("a secured creditor who rejects a plan is entitled either to his contract benefits or the return of his security"); *contra, In re Garrett*, 203 F. Supp. 459 (N.D. Ala. 1962); *In re Pizzolato*, 281 F. Supp. 109 (W.D. Ark. 1967) (Debtor had missed enough \$53 monthly payments on her home to be \$300 in arrears. Foreclosure stayed on condition that \$53 per month be paid. Mortgagee, by delaying foreclosure until after Chapter XIII petition, had "impliedly consented" to the arrearages, which

Such rigorous conditions seem to defeat the purpose for which the stay is granted. Accordingly, the Conference bill would amend Section 614 to authorize stays upon the condition that the debtor, after confirmation of his plan, cure defaults "in such manner and at such time as the court may fix" and meet contract payments as they become due thereafter, without acceleration.

Obviously, the best way to achieve lasting relief is to bring more secured claims under the plan. To that end, the Conference bill borrows from the "cram down" provisions of Chapter X⁶² and Section 77e,⁶³ the latter of which has already survived constitutional challenge.⁶⁴ The Conference bill would add a new Section 652(b) (1) authorizing the court to confirm a plan dealing with a dissenting secured creditor if the court finds that the plan "adequately provides for the preservation by such creditor . . . of the value of its claim . . . against the property and future earnings of the debtor."⁶⁵ And, to avoid pre-occupation with form rather than substance, the bill would also amend Section 646(2)⁶⁶ to make clear that the plan "may alter or modify the rights" of secured creditors, and new Section 652b(2) would tell the court that it could apply the "cram down" provision on appropriate findings even though the terms of a secured creditor's contract are modified by the plan.

Unconscionable Claims. For the future, in all states but Louisiana, Chapter XIII courts may test contracts for the sale of goods by the unconscionability test of Section 2-302 of the Uniform Commercial Code. This, of course, is not a concept new with the Code⁶⁷ nor is it one which by pre-Code law is confined to contracts for the sale of goods. It has been applied also to service contracts⁶⁸ and to loans of money.⁶⁹

will be paid, though delayed); *In re Rutledge*, 277 F. Supp. 933 (E.D. Ark. 1967) (Contract payments on automobile to be made and delinquent payments to be brought current within thirty days); *In re Pizzolato*, 268 F. Supp. 353 (W.D. Ark. 1967) (Three delinquent monthly payments of \$70 on automobile brought current; final balloon payment of \$435 to be met by a "substantial" payment followed by monthly payments of \$70 until balance paid with interest); *In re Duncan*, 33 F. Supp. 997 (E.D. Va. 1940) (Contract payments on refrigerator to be maintained until balance paid, but no provision for bringing current delinquency on seven monthly payments of \$6.90 about which creditor had not complained until after petition filed).

62. Bankruptcy Act § 216(7), 11 U.S.C. § 616(7) (1964).

63. 11 U.S.C. § 205(e) (1964).

64. *R.F.C. v. Denver & R.G.W.R.R.*, 328 U.S. 495 (1946).

65. The Conference bill also provides that if thereafter "the rights of a secured creditor are substantially impaired by reason of a default in any of the terms of a plan which deal with the secured debt . . . the rights of the secured creditor in his collateral shall not . . . be affected by the plan or by any discharge granted in the proceeding pursuant to section 661."

66. 11 U.S.C. § 1046(2) (1964).

67. 1 A. CORBIN, CONTRACTS § 128 (1963).

68. *Mandel v. Liebman*, 303 N.Y. 88, 100 N.E.2d 149 (1951).

69. *In re Elkins-Dell Mfg. Co.*, 253 F. Supp. 864 (E.D. Pa. 1966). Section 5.108 of the Uniform Consumer Credit Code also prescribes an unconscionability test for consumer credit sales, consumer leases and consumer loans.

Because the broader pre-Code doctrine is not yet established in many jurisdictions, because the Code provision is confined to sales of goods and because, in any event, there is no reason to confine the Chapter XIII court to state law concepts, the Conference bill would add its own provision on unconscionability. Proposed new Section 647(2) would authorize the court, on notice and hearing, to "determine that a claim, secured or unsecured, is unconscionable or contains unconscionable terms," and to "disallow such claim and order it excluded from the plan, or allow the claim without the unconscionable terms, or so limit the claim as to avoid any unconscionable result."⁷⁰ It is contemplated that, as applied in a Chapter XIII proceeding, this provision may reach to unconscionability as against other creditors as well as against the debtor, and that the proper way to "avoid any unconscionable result" may be to subordinate the over-reaching creditor's claim to those of other creditors. It is proposed also, therefore, that Section 652a(1) be amended to authorize voting by classes of unsecured creditors and that the "cram-down" provision of new Section 652b(1) apply to unsecured as well as to secured creditors.

Finally, since the treatment of unconscionable claims contemplates also that some claims may be excluded from the plan entirely, there are corresponding amendments to Sections 614, 660 and 661 to make clear that the creditor whose claim is excluded as unconscionable may be enjoined from seeking to enforce it elsewhere and that his claim will be covered by the Chapter XIII discharge.

Conclusion

These are the principal provisions of the Conference's omnibus bill. I do not present them with the thought that I am giving a preview of what the law will be tomorrow. Given the other issues which clamor for congressional attention today, it is extremely difficult to capture enough of that attention to carry any amendment to the Bankruptcy Act. We do not predict definitive action in the Ninety-first Congress—although we can hope. There will, in any event, be time enough for deliberate consideration of all suggestions for improvement in the omnibus bill. And, since the Conference makes no claims to perfect wisdom or perfect draftmanship, we would welcome such suggestions from the profession.

70. As with prior determinations of the value of collateral (see note 51 *supra*), a prior determination of conscionability by a court of record before which the issue was contested would be conclusive in the Chapter XIII proceeding.