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# Emergence of the Wage Earner's Plan Notes and

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# NOTES AND COMMENTS

## EMERGENCE OF THE WAGE EARNER'S PLAN

"The purpose of bankruptcy from the point of view of the man deeply in debt, is relief."<sup>1</sup> This statement is especially true in proceedings under Chapter XIII of the Bankruptcy Act.<sup>2</sup> One of the primary reasons for bankruptcy legislation is the relief of the poor but honest debtor who finds himself in financial difficulty. In ordinary bankruptcy,<sup>3</sup> the debtor surrenders his interest in all non-exempt property and is granted a discharge.<sup>4</sup> Generally he is allowed to retain his future acquisitions and earnings, with no legal obligation to use his newly gained wealth for the payment of his discharged debts.<sup>5</sup> On the other hand, when a wage earner files a petition under the provisions of Chapter XIII, he promises his future earnings to the payment of his existing debts. The wage earner's plan, as it is called, requires an extended period of belt-tightening. To the debtor who has the alternative of obtaining a discharge, through a straight bankruptcy, the decision to pledge his future must be difficult indeed.<sup>6</sup>

It has often been said that there is a stigma attached to an ordinary bankruptcy. The petitioner is called a "bankrupt." This term connotes to some the idea of a deadbeat, one who will not pay what he owes. The Act provides another method, the wage earner's plan, whereby the debtor may resolve his financial dilemma. Under such a plan he is called a "debtor" rather than a "bankrupt," and this is regarded by some as an attractive feature of Chapter XIII.

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<sup>1</sup> COWANS, *BANKRUPTCY LAW AND PRACTICE* 1 (1963).

<sup>2</sup> 11 U.S.C.A. §§ 1001-1086. It is beyond the scope of this comment to examine all the provisions and intricacies of Chapter XIII. A good introduction to the subject is found in COWANS, *op. cit. supra* note 1, at 83-95. For an exhaustive treatment see 10 COLLIER, *BANKRUPTCY* 531 *et seq.* (14th ed. 1963); 9 REMINGTON, *BANKRUPTCY* § 3747 *et seq.* (6th ed. 1955). Also, for the procedure involved see Gates, *My Practice in Chapter 13 Proceedings*, 17 *REF. J.* 95 (1943).

<sup>3</sup> Chapters I through VII of the Bankruptcy Act, 11 U.S.C.A. §§ 1-112.

<sup>4</sup> Of course there are conditions and exceptions to the granting of discharges. A discussion of these is beyond the scope of this comment.

<sup>5</sup> Section 70a, 11 U.S.C.A. § 110, provides generally that the trustee is vested with the bankrupt's title in any non-exempt property that the bankrupt could have transferred or which was subject to levy. But Congress did provide that future interests and inheritances which became vested within six months of the bankrupt's adjudication are drawn into the bankruptcy estate.

<sup>6</sup> For a practical discussion of what type of persons is a good prospect for Chapter XIII, see COWANS, *op. cit. supra* note 1, at 85.

But as has been pointed out: "No stigma need attach to an honest bankruptcy, and it is doubtful how much less stigma applies to a proceeding in the bankruptcy court where the petitioner is labeled a debtor and not a bankrupt."<sup>7</sup>

The wage earner's plan, as it now exists, was introduced into the Act by the Chandler Amendment in 1938. For fifteen years the provisions introduced by the amendment lay dormant, used mainly in Alabama and Kansas. Decisions from the courts were sparse.<sup>8</sup> Only 8,670 petitions were filed in 1953.<sup>9</sup> In 1960 there were 13,599.<sup>10</sup> In 1961 the figure reached 19,723,<sup>11</sup> and in 1962, it rose to 22,880.<sup>12</sup>

With this expanded use of Chapter XIII cases have begun to appear more frequently in the reports. This article will discuss some recent cases and weigh them in light of statutory and policy considerations.

#### CONTENTS OF A PLAN

What can be included in a wage earner's plan is governed by the general language found in section 646.<sup>13</sup> Three mandatory provisions and four permissive ones are found in that section. The plan must treat all unsecured debts generally, that is, alike and without discrimination. The debtor must also provide in his plan for submission of his future wages to the jurisdiction of the court. He must also insert a provision stating that the court has the power to modify the plan from time to time. In addition, the plan may deal with secured debts, provide for priority between secured and unsecured debts, provide for rejection of executory contracts by the trustee, and include other provisions harmonious with Chapter XIII.<sup>14</sup>

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<sup>7</sup> MACLACHLAN, *BANKRUPTCY* 374 (1956). Professor MacLachlan's reference to "debtor" was in the context of a discussion of Chapter XIII. The term "bankrupt" refers to one who has been adjudicated in an ordinary bankruptcy proceeding. 11 U.S.C.A. § 1(4). In Chapter XIII, section 606 reads in part: ". . . (3) 'debtor' shall mean a wage earner who filed a petition under this chapter. . . ." 11 U.S.C.A. § 1006(3).

<sup>8</sup> *Ibid.* In fact the author said: "The affairs of such wage earners have not produced any considerable body of case law." Professor MacLachlan doubted whether Chapter XIII had much utility at all.

<sup>9</sup> 1953 DIRECTOR ADMIN. OFF. U.S. COURTS ANN. REP. 196-198.

<sup>10</sup> 1961 DIRECTOR ADMIN. OFF. U.S. COURTS ANN. REP. 213.

<sup>11</sup> *Ibid.*

<sup>12</sup> 1962 DIRECTOR ADMIN. OFF. U.S. COURTS ANN. REP. 67. The impetus to the increases noted occurred in 1959 when the \$5,000.00 limit on earnings was removed, so that all who receive their principal income from wages are now eligible to file Chapter XIII petitions.

<sup>13</sup> 11 U.S.C.A. § 646.

<sup>14</sup> See generally NADLER, *THE LAW OF DEBTOR RELIEF* 531-40 (1954).

## NECESSITY OF FILING PROOF OF CLAIM

Writers have divided on whether creditors need file proof of claims in order to participate in a distribution under the plan.<sup>15</sup> Under the old section 12 of the Bankruptcy Act, which governed compositions, creditors whose claims were scheduled by the bankrupt but were never proved could nevertheless join in the distribution.

*In re Heger*<sup>16</sup> held that only creditors who filed proofs of claim were entitled to dividends. The court decided that section 57n<sup>17</sup> applied in Chapter XIII proceedings. That section denies participation to creditors who do not file claims within six months of the first meeting of creditors. *In re Maye*<sup>18</sup> also applied section 57n to a wage earner's proceeding in deciding a different question. The court said that neither the debtor nor the referee could require as a condition precedent to a creditor's participation that he file within a period shorter than the six months allowed by 57n.

## THE COURT'S POWER OVER SECURED CREDITORS

Creditors whose claims are secured by estates in real property or chattels real cannot be included in a wage earner's plan.<sup>19</sup> Several cases have discussed whether they can nevertheless be restrained by the court from enforcing their security. *In re Garrett*<sup>20</sup> upheld an order restraining a mortgagee from foreclosing where the mortgagor had an equity in the realty. The court said that under

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<sup>15</sup> See the authorities cited in *In re Heger*, 180 F. Supp. 147, 148 (D. Minn. 1959).

<sup>16</sup> 180 F. Supp. 147 (D. Minn. 1959).

<sup>17</sup> 11 U.S.C.A. § 93(n).

<sup>18</sup> 180 F. Supp. 43 (E.D. Va. 1958).

<sup>19</sup> *In re Garrett*, 203 F. Supp. 459 (D. Ala. 1962). Section 606, 11 U.S.C.A. § 1006, excludes from the phrase "claims" claims secured by estates in real property. Further, a creditor is defined as a holder of a claim. From these two definitions the court concluded that it was the intent of Congress to exclude from Chapter XIII plans a creditor fully secured in realty. *Id.* at 460.

Section 646, 11 U.S.C.A. § 1046, reads: "A plan under this chapter . . . (2) may deal with secured debts severally. . . ." Thus section 646 by its terms seems to exclude creditors secured by estates in real property. But the definitions laid down in section 606 are to be applicable "unless inconsistent with the context" of the remainder of the chapter. The court did not consider whether the context of section 646 was inconsistent with the definitions of "claims," "creditors," or "debts" given by section 606. Nor does Collier discuss any possible conflict. 10 COLLIER, *op. cit. supra* note 2, at 654.

The Fourth Circuit dismissed all the above reasoning as a technicality when it said in a footnote to *Hallenbeck v. Penn Mutual Life Ins. Co.*, 323 F.2d 566, 569 (1963): "This would seem to be a purely technical point, it making no substantial difference whether the payments are made to the creditor by the trustee under the plan or directly to the creditor by the debtor. . . ."

<sup>20</sup> 203 F. Supp. 459 (D. Ala. 1962).

section 611<sup>21</sup> the bankruptcy court had the jurisdiction to deal with all of the debtor's property.

However, the district judge in *In re Hallenbeck*<sup>22</sup> saw things differently. In fact he was doubly sure because he had to decide the same case twice. Mr. and Mrs. Hallenbeck had an equity of \$500 in a lot held by the entireties. The defendant insurance company held a note secured by a deed of trust on the lot. The husband, three months delinquent in his payments, filed a wage earner's petition which was confirmed. In the plan he proposed to have the trustee apply all proceeds to the payment of the secured debt, until the arrearage was cleared. However, the defendant exercised its option under an acceleration clause, declared the remaining balance of the note due, and proposed to foreclose when the debtor did not satisfy the entire sum. The referee enjoined the insurance company from foreclosing.

The district court held that since the lot was held by the entireties, the bankruptcy court had no power to deal with it. By way of dictum the court also based its holding on a view opposite the one taken by *Garrett*. Subsequent to this decision Mrs. Hallenbeck also filed, and her petition was properly joined with her husband's. Now the court had to decide precisely the same issue which faced the court in *Garrett*. It based its holding on section 606,<sup>23</sup> which explicitly excludes from the definition of a claim one which is secured by an estate in real property. Since Congress excluded this class of creditors from Chapter XIII, the court reasoned, it must have intended to put the class outside the reach of the bankruptcy court altogether. The *Garrett* court had taken a different approach. Section 611 gives the court exclusive jurisdiction over the debtor's property during the period of the plan, without any limitation. Section 614<sup>24</sup> confers the power to enjoin or stay until final decree any proceeding to enforce a lien upon the debtor's property. The court referred to cases under Chapter XI where secured creditors have been enjoined, even though *no secured creditor* may be dealt with under that chapter.<sup>25</sup> The court wished to prevent the dissipation of the debtor's equity in the property because under section 666<sup>26</sup>

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<sup>21</sup> 11 U.S.C.A. § 1011.

<sup>22</sup> 209 F. Supp. 263 (W.D. Va. 1962); *reheard subsequently* 211 F. Supp. 604 (W.D. Va. 1962).

<sup>23</sup> 11 U.S.C.A. § 1006. ". . . (1) 'claims' shall include all claims of whatever character . . . but shall not include claims secured by estates in real property or chattels real. . . ."

<sup>24</sup> 11 U.S.C.A. § 1014.

<sup>25</sup> For a detailed discussion of the injunctive power under Chapter XI, see 8 COLLIER, *op. cit. supra* note 2, at 253-82.

<sup>26</sup> 11 U.S.C.A. § 1066.

Chapter XII proceedings may be dismissed and the debtor adjudicated a bankrupt.

The *Garrett* view was to prevail. In *Hallenbeck v. Penn Mutual*<sup>27</sup> the Fourth Circuit reversed the district court. In approving the reasoning of the *Garrett* decision, the appellate court stressed the proper distinction between the creditor's inability to be included in the plan and the court's injunctive power.<sup>28</sup> The court stated that the "general purpose of Chapter XIII is to afford a means of relief and rehabilitation . . . by providing a method for effecting a composition with creditors, or extension of time to pay debts, or both."<sup>29</sup> In the discretionary exercise of its injunctive power, the bankruptcy court acts as a court of equity and has the requisite powers to effectuate the primary purpose of Chapter XIII—the rehabilitation of the wage earner.

These cases concerning claims secured by real property interests can be compared to cases where the creditors had their security in personal property. These latter cases are not easily harmonized. Chapter XIII plans may include provisions for creditors secured by chattels.<sup>30</sup> Each secured creditor must be dealt with on separate terms. The plan can include some secured creditors and exclude others altogether, but no secured creditor can be included unless he consents. Before the court can confirm the plan, section 652<sup>31</sup> requires that those secured creditors who are "dealt with" must approve.

The more difficult question confronting the courts is: When is a creditor "dealt with"? The plan in *In re Clevenger*<sup>32</sup> provided in part: ". . . secured debts held by creditors who accept the plan shall have priority over the unsecured debts and shall be dealt with separately. . . ."<sup>33</sup> The secured creditors rejected the plan. The trustee offered to assume the contract and its payment schedule. The creditors were held not to have been dealt with and the trustee was allowed to assume the contract. When the secured creditors tried to reclaim their security, they were denied relief. The court

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<sup>27</sup> 323 F.2d 566 (4th Cir. 1963).

<sup>28</sup> *Id.* at 569 where it was said: "Although Penn Mutual is not a 'creditor,' cannot file a 'claim' against debtors, and therefore may not be required to participate in the wage earner's plan, it does not follow as a matter of law, that the Referee erred in enjoining foreclosure. *Jurisdiction to issue such an injunction is grounded independently and is not subject to the same restrictions as is the scope of the wage earner plan under Chapter XIII.*" (Emphasis added.)

<sup>29</sup> *Id.* at 570.

<sup>30</sup> See text accompanying note 14 *supra*.

<sup>31</sup> 11 U.S.C.A. § 1052.

<sup>32</sup> 282 F.2d 756 (7th Cir. 1960).

<sup>33</sup> *Id.* at 756.

held its injunctive power extended to cover the situation. But in *In re O'Dell*<sup>34</sup> a chattel mortgagee rejected a provision in the debtor's plan whereby the trustee was to pay a reduced amount on the contract. The district court held that a plan which does not provide for payment according to the terms of the contract deals with secured claims. Unlike the *Clevenger* trustee, the *O'Dell* trustee did not assume the contract. The real tenor of the court's opinion is based upon the reasoning implicit in the following quotation:

The bankruptcy court has exclusive jurisdiction of the debtor and his property, wherever located, and of his earnings and wages during the period of the consummation of the plan (§ 611) . . . Associates (the creditor) cannot pursue the remedies available to it in the state courts. It is subject to the provisions of § 614, authorizing the stay until final decree of any suit to enforce its lien. Under these circumstances, it is unrealistic to say that its claim is not "dealt with by the plan."<sup>35</sup>

Thus, even if the secured creditor is not mentioned by the plan, he is still "dealt with" because he is brought under the injunctive power of the bankruptcy court.

In a similar fact situation the same judge held that the creditor was entitled either to his contract payments and assumption by the trustee or the return of his security.<sup>36</sup> In this case the secured creditor did not resist confirmation of the plan. Rather the creditor wanted return of his security, which was denied by the referee but allowed by the district judge. In an earlier case, a reclamation petition was denied an acquiescing creditor where the debtor had a substantial equity in the chattel and the plan provided for full payment.<sup>37</sup>

At this point it will be profitable to contrast the realty cases with the personalty cases. *In re Clevenger*<sup>38</sup> and *Hallenbeck v. Penn Mutual*<sup>39</sup> are clearly in concert. Both cases involved an exercise of the bankruptcy court's injunctive power in instances where the creditors could not be included in the plan. The basic reasoning behind these cases can be traced to decisions under Chapter XI. *In re O'Dell*<sup>40</sup> adds a concept repeated in *In re Copes*:<sup>41</sup> a secured

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<sup>34</sup> 198 F. Supp. 389 (D. Kansas 1962).

<sup>35</sup> *Id.* at 391.

<sup>36</sup> *In re Copes*, 206 F. Supp. 329 (D. Kansas 1962).

<sup>37</sup> *In re Duncan*, 33 F. Supp. 997 (E.D. Va. 1940); the *Duncan* case is cited and explained in *In re Copes*, 206 F. Supp. 329 (D. Kansas 1962) and in *Hallenbeck v. Penn Mutual Life Ins. Co.*, 323 F.2d 566 (4th Cir. 1963).

<sup>38</sup> 282 F.2d 756 (7th Cir. 1960).

<sup>39</sup> 323 F.2d 566 (4th Cir. 1963).

<sup>40</sup> 198 F. Supp. 389 (D. Kansas 1962).

<sup>41</sup> 206 F. Supp. 329 (D. Kansas 1962).

creditor is dealt with by a plan when he receives less than the full contractual payment. Such a creditor cannot be forced into the plan unless he accepts, nor may he be enjoined from foreclosing if he chooses not to accept.

When will the courts allow the debtor an injunction against the secured creditor who has not been or cannot be included in the plan? The *Penn Mutual* case laid down a workable test consisting of three elements:<sup>42</sup>

1. The injunction is necessary to carry out the plan or preserve the estate;
2. The injunction will not impair the creditor's lien;
3. The debtor has made provision for the payment of the full contractual periodic amounts.

These elements are in addition to the general equitable requirements of good faith and an ability on the part of the debtor to carry out the plan. Such injunctions, like any others, are in the sound discretion of the referee.<sup>43</sup>

Although the cases agree on the above mentioned principle, at one point the appellate court in *Penn Mutual* did not follow the *Copes* and *O'Dell* cases to their logical conclusions. It was stated in *Copes*: "I hold that a secured creditor who rejects a plan is entitled either to his contract benefits or the return of his security." Certainly an acceleration clause is a "contract benefit."<sup>44</sup> Then why did the *Penn Mutual* court, which cited *Copes* approvingly, not allow the creditor to declare the whole sum due and to repossess his security? The reasons must be several. First, the court was impressed with the rehabilitative purpose of Chapter XIII. To allow the creditor to defeat a plan by invocation of an acceleration clause would frustrate the objectives of the law. Second, the court cited the *Garrett* case where the debtor was also in default. However, no mention is made in that case of an acceleration clause. Third, close comparisons to Chapter XI were drawn. Finally, the court never squarely faced the issue. Consequently, there is still room for dispute whether the court may deny the creditor his power of acceleration.

The question of who is a secured creditor under section 652<sup>45</sup> was before the court in *Interstate Finance Corporation v.*

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<sup>42</sup> *Hallenbeck v. Penn Mutual Life Ins. Co.*, 323 F.2d 566 (4th Cir. 1963).

<sup>43</sup> *Id.* at 572.

<sup>44</sup> *In re Copes*, 206 F. Supp. 329, 330 (D. Kansas 1962).

<sup>45</sup> 11 U.S.C.A. § 1052.

*Scroggham*.<sup>46</sup> The debtor had listed the plaintiff as an unsecured creditor. At the creditor's meeting Interstate's attorney stated that the debt was in fact secured by a duly filed chattel mortgage on the debtor's automobile. The referee ruled that since Interstate had not filed a proof of security, it was not to be considered a secured creditor and did not have the veto power set forth in section 652. The referee further ruled that the requisite majority of the unsecured creditors had approved the plan. The district court refused to set aside the confirmation. The Sixth Circuit reversed, holding that the creditor ". . . was not required to file a proof of claim in order to protect its security."<sup>47</sup>

#### THE SIX YEAR LIMITATION

The Bankruptcy Act makes provision for both extension and composition plans.<sup>48</sup> When either plan is successfully and fully performed, a discharge is granted.<sup>49</sup> But even the debtor who fails to perform completely may obtain a discharge where the court in its discretion finds the debtor's failure was due to circumstances for which he could not justifiably be held accountable.<sup>50</sup>

Section 656a(3)<sup>51</sup> allows a plan to be confirmed if the wage earner has not committed any act or omission which would bar his discharge. Under section 14c(5)<sup>52</sup> a discharge will be denied where the debtor has been granted a discharge in bankruptcy or a confirmation of a wage earner's composition plan within six years of the debtor's filing.

This combination of sections 656a(3) and 14c(5) gives rise to a number of problems for debtors who have had bankruptcy

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<sup>46</sup> 265 F.2d 889 (6th Cir. 1959).

<sup>47</sup> *Id.* at 892. A vigorous dissent was registered by Judge Miller. "It is the settled rule in the administration of a bankruptcy that a secured creditor, who has the security in his possession, may rely upon his security and is not required to file proof of his secured claim, but if the security is within the jurisdiction of the bankruptcy court he must file a secured claim if he wishes to retain his secured status." *Id.* at 893. The provisions of ordinary bankruptcy are applicable in Chapter XIII unless inconsistent with the Chapter's provisions. Judge Miller argues that Chapter XIII contains nothing which would make the rules requiring proof of claim inconsistent. But the majority opinion construes section 652, 11 U.S.C.A. § 1052, to show Congress intended that only the claims of unsecured creditors need be filed and proved in order to qualify to vote. Secured creditors are placed under no such condition.

<sup>48</sup> "[P]lan' shall mean a plan for a composition or extension. . . ." 11 U.S.C.A. § 1006(7). Judicial recognition of the distinction is found in *In re Thompson*, 51 F. Supp. 12 (W.D. Va. 1943).

<sup>49</sup> 11 U.S.C.A. § 1060.

<sup>50</sup> 11 U.S.C.A. § 1061.

<sup>51</sup> 11 U.S.C.A. § 1056a(3).

<sup>52</sup> 11 U.S.C.A. § 32c(5).

proceedings and who have need of them within the following six years.

*In re Thompson*<sup>53</sup> held that a prior extension plan under Chapter XIII, where the debts were fully paid, was not a bar to a subsequent bankruptcy within the six year period. The court so held even though it realized that under section 660<sup>54</sup> the debtor had been granted a discharge upon full payment of his debts in the previous extension. The case is sound on both statutory and policy grounds. Section 14c(5) explicitly mentions that a prior Chapter XIII composition plan will bar a subsequent discharge. But no mention is made of an extension. Section 14c(5) is designed to eliminate the habitual bankrupt. A debtor who fully settles his debts should not be classed with the habitual bankrupt. That Congress intended to allow a bankruptcy after a successfully completed extension is implied by its clear mention of composition in 14c(5) without any corresponding expression on extensions.

Next *In re Mahaley*<sup>55</sup> decided that a previous discharge in voluntary bankruptcy would not bar a later confirmation of an extension plan under Chapter XIII. The issue decided in this case is extremely important. Many who have received discharges are in financial difficulty within six years. Whether or not they can protect their possessions and pay off their debts through an extension of time is vital.

The question posed in *Mahaley* has been bantered about by the courts. *In re Sharp*<sup>56</sup> squarely agrees with the view of *Mahaley*. Also where the wage earner had a previous extension, he was allowed another within six years.<sup>57</sup> But there is authority against *Mahaley*

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<sup>53</sup> 51 F. Supp. 12 (W.D. Va. 1943).

<sup>54</sup> 11 U.S.C.A. § 1060.

<sup>55</sup> 187 F. Supp. 229 (S.D. Calif. 1960). The same result was reached in *In re Autry*, 204 F. Supp. 820 (D. Kansas, 1962).

<sup>56</sup> 205 F. Supp. 786 (W.D. Mo. 1962).

<sup>57</sup> *In re Holmes*, 309 F.2d 748 (10th Cir. 1962). Mention must be made of a case decided by the District Court of Kansas where both *Holmes* and *Sharp* were decided. *In re Bingham*, 190 F. Supp. 219 (D. Kansas 1960), held that a previous Chapter XIII proceeding barred confirmation of an extension plan. The case did not disclose whether the prior plan was by way of extension or composition. Different courts have interpreted the case differently. *In re Autry*, 204 F. Supp. 820 (D. Kansas, 1962), thought the prior plan was a composition; *In re Holmes*, 309 F.2d 748 (10th Cir. 1962), considered it an extension; and the court in *In re Sharp*, 205 F. Supp. 786 (W.D. Mo. 1962), failed to consider the question. *Bingham* is doubtful authority, since it was discussed disapprovingly by its own circuit court in *Holmes*.

The problem of a wage earner with prior bankruptcy history is discussed in the following notes and comments: *Confirmation of Extension Plan Within Six Years*, 4 B.C. IND. AND COM. L. REV. 745 (1962); *Effect of Discharge on Subsequent Chapter XIII Proceedings*, 47 IOWA L. REV. 155 (1961); *Wage Earners' Plans-Chapter XIII*, 45 MARQ. L. REV. 582, 595 (1961); *Wage Earner Plans and the Six-Year Rule*, 15 STAN. L. REV. 518 (1963).

and *Sharp*, on the question whether a previous discharge through a straight bankruptcy or composition plan will bar a subsequent extension. *In re Schlageter*,<sup>58</sup> a Third Circuit case, rejected the views of the two district courts in *Mahaley* and *Sharp* and held that the previous discharge was a bar even to an extension.

*Mahaley* determined that the purposes of section 14c(5) were so inconsistent with subsequent Chapter XIII extension proceedings that 14c(5) was inapplicable. Section 14c(5) seeks to prevent the habitual bankrupt who will not pay his obligations. The primary purpose of a Chapter XIII extension plan is to free the debtor from attachments and garnishments so he can ultimately repay his debts in full. But the Third Circuit in deciding *Schlageter* construed the same sections of the Bankruptcy Act differently than did the *Mahaley* court. The court upheld the referee's and district judge's refusal to honor the debtor's petition for an extension plan. Prior discharge after bankruptcy within six years of filing was a bar to confirmation. The decision was grounded on the fear that the debtor, while not fully completing the plan, would still receive a discharge under section 661<sup>59</sup> because of his good faith attempt to complete. The judge in *Mahaley* answered this objection by saying that under these circumstances a discharge could not be granted. The key to the situation lies in the discretionary power of the court under section 661. This section does not make the discharge mandatory even though the debtor's failure to complete the plan was justified. The court may or may not grant the discharge as it sees fit.<sup>60</sup>

The *Mahaley* result is desirable because it allows a debtor confirmation of an extension plan even though he has had a discharge within six years. The fears voiced by the *Schlageter* court seem well founded, until one looks at the discretionary power vested in the court under section 661. The court should not exercise its discretionary power to grant the discharge when a previously discharged debtor fails to complete an extension. A decision on this basis would have been better than the prohibitory fiat laid down by *Schlageter*.

There may have been deeper reasons for the divergence in the above two decisions. The *Mahaley* case was heard in the District Court for the Southern District of California where 1,053 cases were commenced within the district during the 1962 fiscal year. During the same period in the Third Circuit, where *Schlageter* was

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<sup>58</sup> 319 F.2d 821 (3d Cir. 1963).

<sup>59</sup> 11 U.S.C.A. § 1061.

<sup>60</sup> 10 COLLIER, *op. cit. supra* note 2, at 697.

heard, only 187 were filed. The Tenth Circuit, where 1,859 petitions were filed in 1962, handed down the *Sharp* decision which approved *Mahaley*.<sup>61</sup> It is submitted that those courts which are more familiar with Chapter XIII proceedings will be more favorable to the debtors who file them. These courts, especially in the referee's chambers where the plans originate and are administered, are more cognizant of the need for relief which faces debtors. To referees who have handled a volume of Chapter XIII proceedings, it is reasonable to allow the debtor an opportunity to file an extension. If the plan is successful, the creditors will be satisfied. If unsuccessful, the creditors may still pursue their remedies, since under the *Mahaley* philosophy no discharge will be granted.

In summary the courts have held that a fully completed prior extension under Chapter XIII is not a bar to either straight bankruptcy or subsequent wage earner plans. But a discharge by way of composition or bankruptcy proceeding will prevent future compositions or bankruptcies within six years. There is a split on whether such discharges will bar confirmation of a Chapter XIII extension plan. *Mahaley* and *Sharp* say the plan is available; *Schlageter* says it is not. It is submitted that under such circumstances the debtor should be allowed an extension, but not granted a discharge if he fails to pay off his debt in full.

#### FROM DEBTOR TO BANKRUPT

The debtor files a Chapter XIII proceeding. A confirmation is granted. This debtor then changes his mind because he finds the financial burden too heavy; or his wife objects to their limited budget; or there is some other reason which may be more or less valid. Can a debtor, once his plan has been filed and approved, change his mind and be adjudicated a bankrupt? Section 657<sup>62</sup> makes such a plan binding on the creditors and on the debtor. Provision is made in section 666<sup>63</sup> for dismissal of a case where the debtor has defaulted, or the debtor under default may consent to an adjudication. However, no statutory allowance is made for a voluntary abandonment of a successful plan. The appellant trustee in *Rice v. Mimms*<sup>64</sup> claimed that if the debtor was not in default, he could not file an ordinary petition. The district court had honored the debtor's petition and adjudicated him a bankrupt. On appeal the Tenth Circuit affirmed.

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<sup>61</sup> All the figures in the text were abstracted from Table F2 found in the ANNUAL REPORT, *op. cit. supra* note 12, at 260-62.

<sup>62</sup> 11 U.S.C.A. § 1057.

<sup>63</sup> 11 U.S.C.A. § 1066.

<sup>64</sup> 291 F.2d 823 (10th Cir. 1961).

The trustee argued that under section 657, the debtor was bound by his plan. Further, section 668<sup>65</sup> clearly states:

Except as provided in section 666 of this Act and elsewhere in this chapter, a debtor shall not be adjudged a bankrupt either in a proceeding under this chapter or in any proceeding instituted under this Act, during the pendency of a proceeding under this chapter.

Since the debtor was not in default, he did not come under the provisions of section 666. The only other sections of Chapter XIII that dealt with releasing the debtor from his plan were sections 660 and 661, dealing with the discharge granted the debtor after satisfactory completion or performance under the plan. These were not applicable in the case.

But the court refused to place a narrow construction on the statutory provisions. A wage earner's plan is purely voluntary. An attempt to hold one against his will would be, for practical purposes, impossible. The court said:

. . . the historical considerations of the difficulties of administration of bankruptcy where the only "property" to be submitted to creditors' demands is the wage earner's ability and willingness to produce earnings from which his debts may be paid are inherent in the provisions of the Bankruptcy Act. A wage earner may only be adjudged a bankrupt with his consent; he is not subject to involuntary proceedings.<sup>66</sup>

The court's opinion was contrary to the expressions of the text writers.<sup>67</sup> Although the statutory language was stretched, the decision is basically a good one from the viewpoint of debt administration and debtor relief. The debtor could have defaulted, had the plan dismissed, and then filed in bankruptcy. Since the Bankruptcy Court has jurisdiction over the debtor's earnings during the course of the plan, the most expedient way for the debtor to default under the plan would be to quit or lose his job. Then the plan would be dismissed and the debtor free to file an ordinary petition. But this would be more harmful to creditors, to the debtor, and to society in general than to allow the debtor to voluntarily file before a default. Under *Rice v. Mimms*, then, a debtor may file for straight bankruptcy even though he is not in default.

One further aspect of this problem should be mentioned. No

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<sup>65</sup> 11 U.S.C.A. § 1068.

<sup>66</sup> *Rice v. Mimms*, 291 F.2d 823 (10th Cir. 1961).

<sup>67</sup> Both the standard texts, REMINGTON and COLLIER, had gauged incorrectly the course that would be taken by the courts. "The language of § 668 would appear to preclude the debtor from abandoning his plan on his own initiative while Chapter XIII proceedings were pending, and going into voluntary bankruptcy, thus regaining control of his subsequent earnings." 9 REMINGTON, *op. cit. supra* note 2, at § 3770. See also 14 COLLIER, *op. cit. supra* note 2, at 719.

cases have discussed the possible res adjudicata effect of the Chapter XIII confirmation on the debtor's discharge in ordinary bankruptcy.<sup>68</sup>

### CONCLUSION

The stepchild of bankruptcy has finally matured. The emergence of the Chapter XIII wage earner plan from its infancy has been swift. As noted previously, the number of cases have increased rapidly. With this increase in Chapter XIII proceedings has come complexity both in problems and administration.

The thinking toward wage earners' plans has evolved from skepticism<sup>69</sup> to enthusiasm.<sup>70</sup> The administration of the plan is now the function of specialists.<sup>71</sup> Where the facilities for handling many wage earner plans are centralized in one trustee, the resulting economies are proving a boon to creditors and debtors alike.<sup>72</sup>

In the future the wage earner plan will become increasingly popular. First, the plan allows the conscientious wage earner who is in financial difficulty an honorable remedy.<sup>73</sup> Second, the courts recognize the desirability of the plan and will liberally construe the provisions of Chapter XIII to benefit the debtor.<sup>74</sup> Third, the public will become aware of the advantages of a plan. Finally, and most

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<sup>68</sup> See COWANS, *BANKRUPTCY LAW AND PRACTICE* 95 (1963); MACLACHLAN, *op. cit. supra* note 14, at 375. It is Professor MacLachlan's view that the debtor can not obtain a discharge from his provable debts once a Chapter XIII plan has been confirmed.

<sup>69</sup> "Skepticism concerning the utility of Chapter XIII is founded upon the fact that it is a purely voluntary proceeding and does not give the bankrupt as prompt and extensive relief as he could obtain through a discharge in strict bankruptcy." MACLACHLAN, *BANKRUPTCY* 374 (1956).

<sup>70</sup> The Administrative office has reported to the Committee [on Bankruptcy Administration of the Judicial Conference of the United States] a continuing use of the provisions of Chapter XIII of the Bankruptcy Act . . . The Committee called attention to the value of the procedures under Chapter XIII as reflected in the amount paid to creditors. . . . The Administrative office is continuing to encourage the use of Chapter XIII in appropriate cases. 1961 REPORTS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 91.

<sup>71</sup> As an exception to General Order 14, General Order 55 allows the referee to appoint one trustee to handle all Chapter XIII cases.

<sup>72</sup> "The trustee will be allowed his actual expenses which usually run about 5% of the moneys he pays out under the plan. In addition he is allowed a fee not to exceed 5% of moneys paid out under the plan." COWANS, *op. cit. supra* note 67, at 92. See also Sloan, *Wage Earners' Plan*, 33 REF. J. 5, 6 (1959).

<sup>73</sup> There is not unanimous agreement on this point. Compare Walker, *Is Chapter XIII a Milestone on the Path to the Welfare State?*, 33 REF. J. 7 (1959) with Allgood, *Chapter XIII-Referee Allgood Replies to Referee Walker*, 33 REF. J. 51 (1959).

<sup>74</sup> The writer believes this is a valid conclusion to be drawn from the cases discussed in this comment. Also, as indicated *supra* at note 69, the judges who will construe the Act have advocated its expanded use. Such a favorable disposition should result in a liberal construction.

important, the practicing bar will recommend the plan where it is proper and helpful to clients.<sup>75</sup> Already this has been the single most important factor in the emergence of the plan. With more and more attorneys formally studying bankruptcy, the bar will become better acquainted with the plan's benefits.

*Theodore J. Biagini*

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<sup>75</sup> In California, the Continuing Education of the Bar recently held workshops on the provisions of the Bankruptcy Act. The text written by Referee Cowans, *op. cit. supra* note 68, was distributed to the bar under this series. Further, the American Bar Association has recently published a handbook on Chapter XIII proceedings. HILLIARD & HURT, WAGE EARNERS' PLANS UNDER CHAPTER XIII OF THE BANKRUPTCY ACT (1963).