

# Debtors' Dilemma: Status Of The Secured Creditor Under Chapter XIII Of The Bankruptcy Act

## I. INTRODUCTION

Chapter XIII of the Bankruptcy Act permits an insolvent wage earner to resolve his financial crisis by means of a judicially approved plan providing for payments out of future earnings. This plan may provide for an extension or composition of the debtor's outstanding obligations to achieve the relief desired.<sup>1</sup> Despite proposals to the contrary,<sup>2</sup> Chapter XIII of the Bankruptcy Act has retained its strictly voluntary character, a factor generally regarded as responsible for the large degree of success achieved by the wage earner plans in jurisdictions making extensive use of Chapter XIII.<sup>3</sup>

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<sup>1</sup>Bankruptcy Act § 623, 11 U.S.C. § 1023 (1968). An extension permits a debtor to extend the time period for payment, but requires payment in full of the debt. On the other hand, a composition reduces the payments made to less than 100% of the debt owed. 8 W. COLLIER, BANKRUPTCY 2.20 (14th rev. ed. 1963).

<sup>2</sup>The Consumer Bankruptcy Committee of the American Bar Association has previously sponsored various bills intended to make Chapter XIII compulsory in some instances. These measures have been singularly unsuccessful to date. Countryman, *Proposed New Amendments For Chapter XIII*, 22 BUS. LAW. 1151 (1967).

<sup>3</sup>*Id.* at 1152. For the reader desiring a more broadly based understanding of the Chapter, additional supplementary material extending beyond the scope of the present discussion may be found in several excellent articles dealing with Chapter XIII proceedings and secured creditors. *See generally* Copenhaver, *Bankruptcy - Rights and Powers in Chapter XIII*, 68 W. VA. L. REV. 375 (1966) [hereinafter cited as

As might be expected, the burgeoning growth of consumer credit, resulting in the extension of 122.5 billion dollars worth of credit in 1970, approximately 98 billion of which took the form of installment obligations, has been matched by a corresponding rise in the number of consumer or non-business bankruptcies filed.<sup>4</sup> Much of the modern consumer credit extended takes the form of secured obligations due to the widespread use of the Uniform Commercial Code, and the relative ease with which security interests may be perfected under Article Nine of the Code.<sup>5</sup> Regardless of whether the creditor's interest is secured or unsecured, the essence of the consumer credit system is that credit is extended in reliance upon, and is expected to be paid from, the debtor's future earnings. Interestingly enough, the wage earner plans of Chapter XIII are one of the few presently available methods envisioning the payment of past obligations via promises to pay out of future earnings (often the basic assumption behind the original creation of the debt).<sup>6</sup>

The basic Chapter XIII proceeding involves a debtor's petition stating his inability to meet his obligations as they become due and his need and desire for a composition or extension enabling him to pay his obligations out of future earnings.<sup>7</sup> This is followed by a creditor meeting called by the referee to determine the validity of claims and whether they should be allowed or disallowed. At this time, the debtor submits his plan for treatment of his creditors, and the creditors either accept or reject the plan.<sup>8</sup> Ordinarily, if the plan is accepted by the creditors and confirmed by the court, it will provide for weekly or monthly payments by the debtor to a Chapter XIII

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Copenhaver]; Cyr, *Bankruptcy Courts in Transition Toward Debtor Rehabilitation*, 22 ME. L. REV. 333 (1970) [hereinafter cited as Cyr]; Poulos, *The Secured Creditor in Wage Earner Proceedings*, 44 REF. J. 68 (1970) [hereinafter cited as Poulos].

<sup>4</sup>National Consumer Credit Association, FINANCE FACTS (March, 1970).

<sup>5</sup>See King, *Some Thoughts on Article 9 of the Uniform Commercial Code and the Bankruptcy Act*, 72 COM. L. J. 203 (1967).

<sup>6</sup>Alternative modes of relief which may be sought by the wage earning debtor include voluntary private debt adjustment with a budget planner or consolidation of debt by small loan. Selection of the Chapter XIII route, however, provides certain inherent advantages not made available by other methods of relief. These advantages stem from the Chapter XIII provisions for continual judicial supervision of the plan, and the ability of the bankruptcy court to invoke its injunctive powers in dealing with creditors rather than relying merely on persuasion. See Comment, *Relief for the Wage-Earning Debtor: Chapter XIII, or Private Debt Adjustment*, 55 NW. U. L. REV. 372 (1960) [hereinafter cited as *Private Debt Adjustment*].

<sup>7</sup>Bankruptcy Act § 623, 11 U.S.C. § 1023 (1968). "A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature and that he desires to effect a composition or an extension, or both, out of his future earnings or wages."

<sup>8</sup>*Id.* § 633(2), 11 U.S.C. § 1033(2). "At such meeting, . . . the debtor shall submit his plan. . . ."

trustee, who then distributes the amounts received in accordance with the plan. The statutory requirements for the provisions of the plan state that it shall deal with unsecured creditors generally upon any terms; may deal with secured debts severally, upon any terms; and may provide for priority of payment as between the secured and unsecured creditors.<sup>9</sup> Once confirmed, the plan is binding upon the debtor and all his creditors whether or not they are affected by or have accepted the plan.<sup>10</sup>

A prerequisite to confirmation is the written acceptance of the plan by a majority in both number and amount of all unsecured creditors affected by the plan, and by all secured creditors who are "dealt with" by the plan.<sup>11</sup> While this enables a debtor to establish a bona fide plan over the objection and through coercion of a minority of dissenting unsecured creditors,<sup>12</sup> it has the effect of making participation in the plan voluntary on the part of secured creditors and may place any single disapproving secured creditor in a position to exercise an effective veto over the entire plan. If the secured creditor rejects the plan it does not, of course, automatically fail. However, repossession by the secured creditor of collateral which is necessary to assure success of the plan may have the same effect indirectly.

The role and status of a secured creditor under Chapter XIII is an area that has received diverse and often confusing treatment by those courts which have had occasion to consider it. The result appears to be the emergence of two discernible, conflicting lines of authority respecting the rights of secured creditors and their role in the administration of wage earner proceedings.<sup>13</sup> To better understand and define the status of the secured creditor in this somewhat ambiguous statutory area requires a review and comparison of relevant cases to determine who is a secured creditor, at what point is

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<sup>9</sup>*Id.* § 646 (1) (2) (3), 11 U.S.C. § 1046 (1) (2) (3). One commentator has pointed out that the words "shall" and "may" are used in a purposeful manner throughout Chapter XIII to distinguish between the mandatory and permissive. Thus a debtor must deal with all unsecured creditors generally, but he may choose to deal with all, none, or some of his secured creditors. Copenhaver, *supra* note 3, at 380.

<sup>10</sup>Bankruptcy Act § 657, 11 U.S.C. § 1057 (1968). "Upon confirmation of a plan, the plan and its provisions shall be binding upon the debtor and upon all creditors of the debtor, whether or not they are affected by the plan or have accepted it. . . ."

<sup>11</sup>*Id.* § 652(1), 11 U.S.C. § 1052(1). ". . . an application for the confirmation of the plan may be filed . . . but not before . . . (1) it has been accepted in writing, if unsecured creditors are affected by the plan, by a majority in number of such creditors . . . which number shall represent a majority in amount of such claims, and by the secured creditors whose claims are dealt with by the plan. . . ."

<sup>12</sup>*Private Debt Adjustment*, *supra* note 6, at 374.

<sup>13</sup>See Comment, *The Partially Secured Creditor Under Chapter XIII of the Bankruptcy Act*, 3 PROSPECTUS 285 (1969-70) [hereinafter referred to as *Partially Secured Creditor*].

a secured creditor "dealt with" by a wage earner plan thereby making his acceptance necessary to its confirmation, and when is a security interest deemed "impaired". In addition, the most recent, comprehensive proposal seeking to amend and restructure the provisions of Chapter XIII dealing with secured and partially secured creditors will be examined against the background of case law and the objectives and philosophy of the Bankruptcy Act itself to determine if change is needed, and if so, which changes are most consistent with and best effectuate the policy of Chapter XIII.

## II. INTERPRETATIONS OF THE SECURED CREDITOR'S ROLE IN CHAPTER XIII

### A. THE "STRICT CONSTRUCTIONIST" VIEW

Similar to the powers of the court in straight bankruptcy the Chapter XIII court has exclusive jurisdiction over the debtor and his property, his earnings, and his wages during the consummation of the plan.<sup>14</sup> In addition, the court has the power to enjoin or stay upon notice and for cause shown any act of proceeding to enforce the lien of a secured creditor against the debtor's property.<sup>15</sup>

It is in this context that the problem of the secured creditor usually appears in the decided cases.<sup>16</sup> A secured creditor will reject the plan and then submit to the referee a petition for reclamation seeking to regain his security. Quite often the referee will disallow the petition and invoke his injunctive powers to stay enforcement of the secured creditor's lien against the property.

This was the basic fact pattern involved in *In re O'Dell*,<sup>17</sup> a Kansas district court case representing what might be termed the "strict constructionist" method of interpreting the provisions of Chapter XIII.<sup>18</sup> There the creditor held a note with an unpaid balance of

<sup>14</sup>Bankruptcy Act § 611, 11 U.S.C. § 1011 (1968). Straight bankruptcy refers to the ordinary mode of relief sought by the insolvent debtor, that of filing a petition for a discharge in bankruptcy. Unlike Chapter XIII, the debtor receives a complete discharge canceling all his prior financial obligations with the exception of certain non-dischargeable debts.

<sup>15</sup>*Id.* § 614, 11 U.S.C. § 1014.

<sup>16</sup>*See In re Copps*, 206 F. Supp. 329 (D. Kans. 1962).

<sup>17</sup>198 F. Supp. 389 (D. Kans. 1961).

<sup>18</sup>The term "strict constructionist" will be used herein to characterize those cases adopting a rigid posture toward application of the Chapter XIII provisions. These cases interpret the statutory language widely, holding that a secured creditor is

\$2,454 secured by an interest in a 1960 automobile. The debtor's plan proposed payment of \$37.00 per week to the trustee for satisfaction of his creditors, of which \$5.00 per week was earmarked for repayment of the obligation owed on the automobile. The secured creditor filed proof of its debt and objected to confirmation of the plan. The referee then confirmed the plan and payment to the trustee of \$37.00 per week, without mention of the debt owed to the dissenting secured creditor.<sup>19</sup>

On appeal, the district court noted that the weekly payment by the debtor was insufficient to meet the full amount of his secured contractual obligations and that the dissenting secured creditor would be subject to the potential injunctive power of the bankruptcy court under § 614 of the Bankruptcy Act to prevent enforcement of the secured lien, even though the referee had not yet invoked this power. It was held that, "under these circumstances it is unrealistic to say that its [the secured creditor's] claim is not dealt with by the plan."<sup>20</sup> This conclusion was based on the somewhat ill conceived reasoning that since the provisions of the statute might have an adverse affect upon the secured creditor, the plan itself was deemed to "deal with" his claim.

The *O'Dell* court was of the opinion that a plan which failed to provide for the payment of secured creditors according to the contractual provisions of the debt creating instrument ought not be confirmed unless accepted by all secured creditors.<sup>21</sup> In so holding, the district court made it clear that any modification of the contractual agreement between the secured creditor and the debtor would be construed as "dealing with" the secured creditor, thereby requiring his acceptance before confirmation. In addition, the secured creditor is "dealt with" if his claim might be subject to the court's injunctive power. This interpretation requires the acceptance of the plan by a secured creditor whether or not his interest is actually impaired.<sup>22</sup>

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"dealt with by the plan" even if he is not included in it. In practice, this tends to restrict the utility and operation of the debtor relief provisions available under Chapter XIII.

<sup>19</sup>198 F. Supp. 389, 390 (D. Kans. 1961).

<sup>20</sup>*Id.* at 391.

<sup>21</sup>According to the *O'Dell* court: ". . . a plan . . . which does not provide for assumption of executory contracts by the trustee or otherwise make provision for the payment of the claims of secured creditors according to the terms of the instrument creating the debt, does deal with such claims. A plan without such provisions should not be confirmed unless accepted by the secured creditors." *Id.* at 391.

<sup>22</sup>The mere possibility that his claim may be subject to the jurisdiction of the bankruptcy court is enough to make the plan "deal with" the secured creditor. The anomalous situation thus created is that a secured creditor is "dealt with" by a plan even if he is omitted, because of the external existence of the provisions of Chapter

*In re Pappas*<sup>23</sup> extended the *O'Dell* reasoning to a case involving a partially secured creditor.<sup>24</sup> Here, the creditor held a note on which \$753.72 was owing, secured by furniture worth approximately \$300.00. As confirmed, the plan contained a specific provision stating that it did not deal with this particular secured creditor who had rejected the plan. The remainder of the plan provided for an allocation of one half the amount received by the trustee to be distributed pro rata to the secured creditors accepting the plan, the other half being distributed among the unsecured creditors.

Because periodic payments under the plan would have been insufficient to meet the full monthly installments called for in the contractual agreement, the Ohio district court concluded that the involved creditor was forced to become an involuntary participant and was therefore "dealt with" by the plan.<sup>25</sup> Acceptance of the plan by the secured creditor was held a prerequisite to confirmation because the lesser periodic payments were deemed to constitute a modification of the secured creditor's contractual rights. In holding that the secured creditor was "dealt with" by the plan despite the plan's express stipulation that he was not, the court compounded the failure of the *O'Dell* court to differentiate between the effect of the statute itself upon the secured claim as opposed to the effect which the plan has on it.<sup>26</sup>

A somewhat more rigorous interpretation of the Chapter XIII provisions regarding secured creditors was adopted by an Arkansas district court in the case of *In re Rutledge*.<sup>27</sup> After rejection by a creditor having a security interest in the debtor's automobile, the debtor's plan was modified to provide for payment in full of the

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XIII. Because of the permissive nature of § 646, a secured creditor's failure to accept a plan from which he is excluded should not be a bar to confirmation. *See Copenhaver, supra* note 3, at 380.

<sup>23</sup>216 F. Supp. 819 (S.D. Ohio 1962).

<sup>24</sup>This case is but one example of a general failure on the part of most courts to differentiate between the treatment accorded a fully secured creditor and that given a partially secured creditor. To the extent a partially secured creditor is treated as fully secured in excess of the value of his security, he is given an unwarranted advantage vis-a-vis the unsecured creditors and the debtor. *See Partially Secured Creditor, supra* note 13, at 288.

<sup>25</sup>216 F. Supp. at 822.

<sup>26</sup>Cyr, *supra* note 3, at 350.

<sup>27</sup>277 F. Supp. 933 (E.D. Ark. 1967). Despite the exacting requirements it imposed upon the debtor, *Rutledge* allowed amendment of the plan to exclude the secured creditor, thereby circumventing a possible veto by the creditor. As the collateral involved was an automobile whose retention was necessary to the plan's success, the probable effect of the decision was to eventually destroy the plan. Unless the debtor could make up the delinquent payments, the injunction was to be removed, and the reclamation petition granted.

monthly installments due under the contract. Delinquent payments existing prior to filing of the debtor's petition were to be brought current within a "reasonable length of time."<sup>28</sup> Finding that the amended plan would provide the secured creditor with his full contract price and make up delinquent payments within a reasonable time, the referee had invoked the injunctive power of the court to deny the creditor's petition for reclamation.<sup>29</sup>

On appeal, the *Rutledge* court found that the secured creditor was "dealt with" by the plan despite the fact that his interest was not materially affected.<sup>30</sup> The court held that the absence of a specific time limit for bringing the delinquent payments current was equivalent to an indefinite extension of a portion of the debt. Consequently, this was viewed as creating a variance with the contractual terms previously agreed upon, and thus, the secured creditor was "dealt with" by the plan.<sup>31</sup> This holding defines the point at which a secured creditor is "dealt with" as any time a plan modifies or varies the strict terms of the debt creating instrument in the slightest degree. The decision requires that all past due installments be brought current within a specific time limit before the court may use its injunctive power to prevent reclamation of property deemed essential to the success of the wage earner plan.<sup>32</sup>

The extent of the court's injunctive power under § 614 was again at issue, under a somewhat unique factual situation, in the case of *Hallenbeck v. Penn Mutual Life Insurance Company*.<sup>33</sup> While this case must be categorized as representing a continuation of the "strict constructionist" interpretation of the Chapter XIII secured creditor provisions, it contains elements of the "broad" constructionist interpretation, and appears to function as somewhat of a connecting bridge linking views which may or may not be as divergent as is

<sup>28</sup>*Id.* at 935.

<sup>29</sup>*Id.* at 934.

<sup>30</sup>*Id.* at 935. No mention was made of Bankruptcy Act § 607, 11 U.S.C. § 1007 (1968), which states: "A creditor shall be deemed to be affected by a plan only if his interest shall be materially and adversely affected thereby. In the event of controversy, the court shall, after hearing upon notice, summarily determine whether any creditor is so affected." Other courts have reached a different conclusion holding that "dealt with" is synonymous with "affected" and therefore, a creditor is "dealt with" only if his interest is "materially and adversely affected." *Terry v. Colonial Stores Employee's Credit Union of Atlanta*, 411 F.2d 553 (5th Cir. 1969); See discussion p. 286, *infra*, and cases cited note 53, *infra*.

<sup>31</sup>"When the time for payment is extended this varies the contract from what the parties have agreed upon. Thus, we feel Worthern's [the secured creditor] claim was 'dealt with' by this plan of payment." 277 F. Supp. 933, 935 (E.D. Ark 1967).

<sup>32</sup>"Before entering an injunction, the Referee should take steps to see that any delinquent payments are brought current within a specific set amount of time." *Id.* at 936.

<sup>33</sup>323 F.2d 566 (4th Cir. 1963).

sometimes assumed.<sup>34</sup>

In *Hallenbeck*, the secured creditor (Penn Mutual) held a mortgage on real estate owned by the debtors.<sup>35</sup> The debtors had defaulted on three consecutive payments, but had filed a Chapter XIII petition before Penn Mutual exercised its right of acceleration. The wage earner plan as confirmed by the referee provided for \$150.00 monthly payments to the trustee of which \$75.00 (the full amount of the installments) was to be paid to Penn Mutual. In addition, the full \$150.00 was to be distributed to Penn Mutual, before all other creditors, until such time as the defaults were made up.<sup>36</sup>

In spite of § 606 of the Bankruptcy Act,<sup>37</sup> the referee invoked the injunctive powers of the court to stay Penn Mutual's proposed foreclosure on the real estate involved. The injunction was subsequently set aside in favor of the creditor by a Virginia district court.<sup>38</sup> On appeal, the Fourth Circuit held the injunction was improperly set aside on the grounds that jurisdiction to issue the injunction was not subject to the same restrictions applicable to the scope of Chapter XIII plans.<sup>39</sup> In so holding, the court was taking the "broad constructionist" approach to the injunctive provision of Chapter XIII in interpreting it broadly enough to provide for the enjoining of a "claim" specifically excluded from the operation of Chapter XIII. However, in setting forth its criterion as the necessary conditions

<sup>34</sup>"Broad constructionist" will be used throughout as referring to those cases embracing a less restrictive and more flexible view regarding the application of the Chapter XIII provisions. As distinguished from the "strict constructionist" interpretation, the "broad constructionist" view reads the statutory language narrowly, thus limiting the instances in which a secured creditor is "dealt with" by a plan. Consequently, the secured creditor's veto is more frequently avoided. See also Comment, *Bankruptcy: Enforcing a Chapter XIII Wage Earner's Plan Over the Objection of a Secured Creditor*, 6 SAN DIEGO L. REV. 69, 76-77 (1969) [hereinafter cited as *Enforcing a Plan*]. Despite the differing approaches and conclusions represented by the two lines of authority, the practical result may often be the same. See note 79, *infra*.

<sup>35</sup>The debtors were Richard and Gertrude Hallenbeck, husband and wife, who were also tenants by entirety in the real estate. Originally, the husband alone had filed the petition, and was joined by his wife after a district court concluded that an injunction staying Penn Mutual's threatened foreclosure was improper because the property was owned as tenants by entireties, and the wife was not a party to the proceeding. *In re Hallenbeck*, 209 F. Supp. 263 (W. D. Va. 1962). A proposed bill seeks to avoid such situations in the future by amending Chapter XIII to provide that everywhere the word "debtor" appears, it is to be followed by the words "or a debtor's spouse." S. 3625, 91st Cong., 2nd Sess. (1970).

<sup>36</sup>323 F.2d 566, 568, (4th Cir. 1963).

<sup>37</sup>Section 606 of the Bankruptcy Act, 11 U.S.C. § 1006 (1968), provides that "claims" secured by real estate shall not be included in the definition of "claims" recognizable under Chapter XIII. It further provides that "creditor" shall mean the holder of any claim.

<sup>38</sup>*In re Hallenbeck*, 211 F. Supp. 604 (W. D. Va. 1962).

<sup>39</sup>323 F.2d 566, 569 (4th Cir. 1963).

precedent for use of the injunctive power,<sup>40</sup> the circuit court elucidated and reaffirmed some of the basic tenets of the "strict constructionist" view. These criteria have been used and adopted, with some modification, by virtually all courts considering the problem of the secured creditor under Chapter XIII.<sup>41</sup>

The general import of the "strict constructionist" cases is to treat as a secured creditor anyone holding an interest secured by collateral in the possession of the debtor irrespective of the relative value of the collateral itself. On this issue of who is considered to be a secured creditor, the wide scope accorded to the injunctive power of the Chapter XIII court by the *Hallenbeck* case includes creditors secured by interests in real estate, despite the statutory exclusion of such claims from the wage earner plans.<sup>42</sup>

The foremost problem involved in determining who shall be accorded the status of a secured creditor is the proper role assigned to the partially secured creditor. At present, the cases persist in treating the partially secured creditor exactly as a fully secured creditor, allowing him to recover in full on the secured portion of his claim as well as that portion which is unsecured.<sup>43</sup> It has been suggested that this practice is violative of the § 646(1) mandate that all unsecured debts be treated equally, in that both the secured and unsecured portions of the debt are dealt with severally.<sup>44</sup> Rulings such as that reached in *O'Dell* and *Pappas*, allowing a partially secured creditor to insist on either payment in full according to the contract terms, or the repossession of the collateral are not only inequitable as respecting other unsecured creditors, but may contravene well established general bankruptcy principles.<sup>45</sup> This judicial tendency to

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<sup>40</sup>"(1) The injunction or stay must be necessary to preserve the debtor's estate or to carry out the Chapter XIII plan; (2) the granting of the injunction must not directly or indirectly impair the security of the lien; (3) the owner of the secured indebtedness must not be required to accept less than the full periodic payments specified in his contract." *Id.* at 572.

<sup>41</sup>*See* *Cheetham v. Universal C.I.T. Credit Corporation*, 390 F.2d 234, 238 (1st Cir. 1968).

<sup>42</sup>Bankruptcy Act § 606, 11 U.S.C. § 1006 (1968), *see* note 37, *supra*. Another type of creditor excluded from the secured creditor category under Chapter XIII is a creditor secured by a lien in property which has been set aside to the debtor as exempt. *Lee, Who is a Secured Creditor in Wage Earner Proceedings?* 38 REF. J. 44 (1964) [hereinafter cited as *Lee*].

<sup>43</sup>*Partially Secured Creditor*, *supra* note 13, at 285, 286.

<sup>44</sup>*Copenhaver*, *supra* note 3, at 387. "A plan . . . shall include provisions dealing with unsecured debts generally . . ." Bankruptcy Act, § 646(1) 11 U.S.C. § 1046(1) (1968).

<sup>45</sup>*See Lee*, *supra* note 42, at 45. Those principles violated are (1) that a creditor is secured only to the extent of the value of his non-exempt security, and (2) that interest is allowable on secured debts only in those instances where the security is sufficient to cover both principal and interest.

treat all secured creditors equally, disregarding variations in the value of their security, permits the partially secured creditor to realize an advantage exceeding the extent of his security.<sup>46</sup> Consequently, the partially secured creditor presently receives more favorable treatment than he justly deserves, in view of the equitable rights to which he is entitled.

The unyielding stance championed by the *O'Dell* and *Pappas* courts gives an effective veto power to each secured creditor having an interest in some item essential to the success of the plan. Under *O'Dell*, a debtor wishing to retain the security must provide in the plan for full payment of the secured creditor in strict compliance with the terms of the instrument creating the debt. The power to destroy a plan is placed at the disposal of any secured creditor whose contractual obligations are not included in and fully assumed by the plan. The line of reasoning adopted by the *O'Dell* and *Pappas* decisions emphasizes the statutory powers given to the courts under Chapter XIII. It is the possibility that the secured creditor's plan may be affected by the broad jurisdictional and injunctive powers of the courts which is determinative of when his claim is "dealt with" by a plan. Consequently, the degree of flexibility which may be exercised in drafting a plan is limited to two options. Either the secured creditor's assent to inclusion in the plan is obtained, or he must be allowed to repossess his security.<sup>47</sup>

The practical dilemma created by this interpretation becomes apparent when viewed within the context of a typical wage earner's plan. Assume that D, a wage earning debtor, files a petition invoking the statutory provisions of Chapter XIII and alleging his inability to meet present outstanding obligations. At the time of filing, D owes \$1,100.00 on a debt secured by his automobile, payable to creditor C in monthly installments of \$110.00. In addition, D has other unsecured debts amounting to \$1,900.00. D's automobile has depreciated during the interim between purchase and filing to a present value of \$500.00. After allowance for such necessities as food, rent, and clothing, the proposed plan provides for a \$25.00 weekly payment by D to the trustee. The plan is to terminate in thirty months, when D's total debt burden of \$3,000.00 has been completely satisfied.

If D intends to retain possession of the vehicle, the "strict constructionist" approach would require that the \$110.00 monthly payment to C be continued in full, whether C is mentioned in the plan or not. Obviously, D's financial situation is such that he cannot con-

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<sup>46</sup>Comment, *Nonassenting Secured Creditors to Chapter XIII Wage Earner Plans*, 47 TEX. L. REV. 302, 306 (1968-69).

<sup>47</sup>*Partially Secured Creditor*, *supra* note 13, at 289.

tinue the full monthly payments. Even if he could manage to meet the \$110.00 monthly car payment, his unsecured creditors would receive nothing for several months.

If the plan provided for less than C's full \$110.00 payment, his claim would be "dealt with" by the plan, and it could not be confirmed without his consent. If C, as a dissenting secured creditor, were expressly omitted from the plan's provisions, the plan would still be construed as "dealing with" his claim, and again it would not be confirmed without C's consent.

This "Catch 22" approach (if the plan provides for C, it "deals with" his claim, if C is omitted from the plan, his claim is still "dealt with") may create a serious obstacle to completion of the plan. In the hypothetical situation, D's retention of the automobile may well be essential to the success of the entire plan. Loss of the vehicle through repossession may adversely affect D's earning capacity or compel him to seek a replacement with a similar or more onerous credit burden. Either event would tend to destroy D's ability to continue or effectively complete the plan, and perhaps force him into straight bankruptcy.

## B. THE "BROAD CONSTRUCTIONIST" VIEW

Prior to the emergence of the *O'Dell et. al.* line of reasoning, a Virginia district court *In re Duncan*<sup>48</sup> had taken a novel stand in upholding an injunction staying possession of the collateral, regardless of the plan's modification of the strict contractual terms of a security agreement. The plan called for a resumption of the \$6.90 monthly installment payments on a refrigerator required by an installment sales contract until the entire unpaid balance was amortized. Unlike *Rutledge*, no special provision was included regarding several defaults incurred by the debtor prior to filing of his Chapter XIII petition. Despite the effect of the extension and its supporting injunction, the injunction was upheld on the basis that the debtor had substantial equity in the refrigerator, and that the refrigerator was a necessity essential to the plan's success. Additional emphasis was placed on the secured creditor's previous acquiescence in the debtor's defaults by failing to pursue its contractal remedies when the defaults occurred.<sup>49</sup>

Furthermore, by reference to the case of *Wright v. Union Central*

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<sup>48</sup>33 F. Supp. 997 (E. D. Va. 1940).

<sup>49</sup>*Id.* at 999.

*Life Insurance Company*,<sup>50</sup> the *Duncan* court ruled that the Chapter XIII injunctive power could be used to protect a plan which modified to some degree the provisions of a conditional sales agreement.<sup>51</sup> While the court's decision was based in part on grounds later articulated in *Hallenbeck* (i.e., the collateral was necessary to the preservation of the plan, and the security was not impaired due to the creditor's right to vacate the injunction if default occurred under the plan), the crucial factor involved was the subsequent final condition of *Hallenbeck* that the secured creditor not be required to accept less than his full periodic payments. Under *Duncan*, the creditor was given payment in full via an extension of the period provided for in the contract.

In *In re Wilder*,<sup>52</sup> a case involving a fact pattern similar to that of *Duncan*, a Georgia district court reached a result in accord with the *Duncan* reasoning while discussing more fully the extent to which a secured creditor's rights might be modified by a Chapter XIII plan. The creditor rejecting the plan held a security interest in various household goods and furniture purchased pursuant to a sales contract providing for monthly installments of \$36.75. Payments under the plan were set up on a weekly basis to equal or exceed the amount of payments required under the contract. However, as the debtor was unable to repay two previously delinquent payments, the effect of the plan was to extend the original contract period for full payment from twenty-four to twenty-six months.

Treating the phrase "dealt with" as synonymous with "affected", the *Wilder* court held that the creditor's interest was not "materially and adversely" affected by the plan, and therefore his acceptance was not a prerequisite to confirmation of the plan.<sup>53</sup> In upholding

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<sup>50</sup>304 U.S. 502 (1938). In *Wright*, a now obsolete statute, Bankruptcy Act § 75, 49 stat. 942, which authorized an extension of the period of redemption, was applied to a mortgagee of farm land and he was enjoined from foreclosing on the land. Confronted with the argument that extension of the time for redemption was an unconstitutional taking of property without due process in violation of Fifth Amendment, the Supreme Court upheld the statute and the modification of the secured creditor's property rights. The court held that the bankruptcy courts possess the power to modify a creditor's property rights and to enjoin sale of the collateral if it would damage a rehabilitative plan. By way of analogy, *Wright* and similar cases have been interpreted as resolving the historical constitutional objection that modification of a secured creditor's rights violates the Fifth Amendment in favor of the Chapter XIII courts. See Poulos *supra* note 3, at 72-73.

<sup>51</sup>33 F. Supp. at 999.

<sup>52</sup>225 F. Supp. at 67 (M. D. Ga. 1963).

<sup>53</sup>*Id.* at 69. § 652(1) requires an acceptance in writing by a majority of all unsecured creditors "affected" by the plan, whose claims have been proven and allowed, and all secured creditors who are "dealt with" by the plan. § 607 provides that a creditor is "affected" only if the plan "materially and adversely" affects his interest. See

the confirmation order, the debtor's substantial equity in the household necessities was noted, and an attempt was made to define when a security interest would be deemed "materially and adversely" affected.<sup>54</sup> On this issue, the district court applied a *de minimis* line of reasoning in holding that a two month delay of payments under a contract requiring two year for consummation did not *seriously* delay payments.<sup>55</sup> Unless the plan *seriously* affects the creditor's security interest, his plan is not to be deemed impaired, and his acceptance is not necessary to confirmation. The fact that the creditor acquiesces in the default by not immediately pursuing his contractual remedies is some proof that he does not consider the default as seriously affecting his interest.<sup>56</sup>

If *Hallenbeck* may be regarded as somewhat of a bridge linking the differing interpretations concerning the Chapter XIII treatment of secured creditors, then *Cheetham v. Universal C.I.T. Credit Corporation*<sup>57</sup> may be characterized as the cornerstone for the progressive view circumscribing the veto power of the secured creditor and allowing a larger degree of flexibility in the operation of the wage earner plans. *Cheetham* represents the first case to specifically reject the *O'Dell* notion that because the court has the statutory power to adversely affect the claim of a dissenting secured creditor, all secured creditors must agree to the plan whether omitted or not.<sup>58</sup>

In *Cheetham*, a fully secured creditor rejected the plan, which was confirmed with the express proviso that disapproving secured creditors were not dealt with nor affected by it. No other provision for the secured creditor was made in the plan, but the statute itself limited the creditor's ability to bring suit or enforce its lien.<sup>59</sup> Under these circumstances, the First Circuit held that the plan did not "deal with" the secured creditor because the plan on its face, did not men-

*supra* note 30. This construction of the statute has been adopted by the "broad constructionist" courts, differing results stemming from the determination of when a secured creditor is "materially and adversely" affected. Bankruptcy Act § 607, § 652 (1), 11 U.S.C. 1007, 1052(1) (1968). See *Cheetham v. Universal C.I.T. Credit Corporation*, 390 F.2d 234 (1st Cir. 1968).

<sup>54</sup>"There must be more than a nominal or minute alteration in the creditor's interest . . . Comparing creditor's position as it existed as of the moment of confirmation of debtor's plan with its position immediately following that confirmation the court fails to see that creditor's interest was 'materially and adversely' affected. The confirmation of the plan did not give rise to the arrearage complained of." 225 F. Supp. 67, 69 (M. D. Va. 1963).

<sup>55</sup>*Id.*

<sup>56</sup>*Id.*

<sup>57</sup>390 F.2d 234 (1st Cir. 1968).

<sup>58</sup>*Enforcing a Plan, supra* note 34, at 75.

<sup>59</sup>This latter point was the basis for the decision in *O'Dell* that all secured creditors must accept the plan.

tion or restrict the contractual rights of the creditor.<sup>60</sup> The court thus obviated the necessity of acceptance by a secured creditor who is omitted from the plan.

However, the First Circuit did reaffirm its adherence to the *Hallenbeck* conditions that an injunction must not impair the security interest and that the creditor must not be required to accept less than the full periodic payments called for by the contract.<sup>61</sup> Thus, while *Cheetham* allows confirmation of a plan not mentioning a secured creditor, the available debtor options it sanctions are substantially similar to those allowed by the "strict constructionist" interpretation. The first option is limited to inclusion of the secured creditor in the plan with provision for full compliance with the contract terms (otherwise the plan would "expressly limit the amount recoverable"). The alternate method is to omit the creditor from the plan, with either continuation of full payments outside the plan or allowance of the creditor's right to reclamation. The rather narrow scope given to the *Cheetham* decision is reinforced by the court's express refusal to determine the extent to which it would approve those cases allowing some contractual modification of the security agreements.<sup>62</sup>

Prior to the *Cheetham* decision, the Seventh Circuit had reached a similar conclusion in the case of *In re Clevenger*.<sup>63</sup> Only two secured creditors were involved, one holding a debt secured by an automobile and the other by a television set and both rejected the debtor's plan. Following confirmation of the plan, both secured creditors filed petitions for reclamation which were denied, and were further enjoined from proceeding with reclamation by the referee's invocation of the injunctive power. On the issue of whether these secured creditors were "dealt with" by the plan, the court held they were not, despite assumption by the Trustee of the two executory contracts. Because the plan provided that "secured debts held by creditors who accept the plan shall have priority over the unsecured debts . . .," the Seventh Circuit reasoned that the refusal of the creditors to accept the plan took them out of the classification of secured debts "dealt with" by it, and their acceptance was not necessary for

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<sup>60</sup>" . . . we hold that secured claims are dealt with only when the plan expressly limits the amount recoverable on the claim, or restricts the creditor's security interest." 390 F.2d 234, 238 (1st Cir. 1968).

<sup>61</sup>*Id.* at 238.

<sup>62</sup>The First Circuit noted the general equity principle illustrated by such cases as *Duncan* and *Wilder* and others, but declined the opportunity to fully discuss the crucial issue of the extent to which contractual modification of security agreements would be allowed. "We do not presently decide to what extent we may agree with these cases beyond *Rutledge*." *Id.* at 238.

<sup>63</sup>282 F.2d 756 (7th Cir. 1960).

confirmation.<sup>64</sup>

However, *Clevenger* did hold that assumption of these executory contracts by the Trustee imposed upon him a duty to make payments in an amount at least as large as those called for in the agreements.<sup>65</sup> The final result is in accord with *Cheetham*, in that it allows exclusion of the secured creditor from the plan and confirmation without his assent but seems to require either the debtor's full compliance with contract terms or reclamation of the security if the secured creditor is "outside" the plan. The significant aspect of the *Clevenger* decision is that the court did realize the possibility of contractual modification and impliedly authorized it to a certain extent in affirming the referee's order.<sup>66</sup>

A still broader interpretation of the Chapter XIII provisions relating to the degree of flexibility allowable when dealing with a secured creditor was subsequently reached by an Arkansas district court in the *In re Pizzolato* cases.<sup>67</sup> In *Pizzolato I*, a conditional automobile sales contract, as refinanced, provided for sixteen monthly payments of \$70.00 with a seventeenth and final "balloon payment" of \$435.36. The wage earner plan proposed a continuance of the \$70.00 monthly installments until the full amount of the note had been paid off. No separate provision was made for the final "balloon payment". The secured creditor rejected the plan and appealed a subsequent order enjoining reclamation of the vehicle.<sup>68</sup>

The district court in *Pizzolato I* made a vital and important distinction in recognizing that while "dealing with" a dissenting secured creditor and exercising the court's injunctive power to prevent his foreclosure were related propositions, they were not inseparable. The court concluded that a secured creditor was "dealt with" if he would receive less than his full contractual payments under the plan.

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<sup>64</sup>*Id.* at 757.

<sup>65</sup>*Id.*

<sup>66</sup>*Id.* The restraining order provided: "If, in the future, circumstances should arise which would impair their security or seriously delay payments to them, then of course these creditors would be entitled, upon application, to such relief as might be appropriate." (Presumably, repossession of their collateral). This implies that the court might have upheld something less than full compliance with the terms of the conditional sales agreements, so long as the security interest was not seriously impaired nor payments seriously delayed.

<sup>67</sup>Two separate decisions regarding the same (but highly persistent) secured creditor and the same debtor but regarding different items as collateral were rendered by the court. The first, *In re Pizzolato*, 268 F. Supp. 353 (W. D. Ark. 1967), [hereinafter referred to as *Pizzolato I*], involved an automobile sold on a conditional sales contract. The second, *In re Pizzolato*, 281 F. Supp. 109 (W. D. Ark. 1967), [hereinafter referred to as *Pizzolato II*], concerned a mortgage held on the debtor's real property.

<sup>68</sup>268 F. Supp. 353, 354, (W. D. Ark. 1967).

Thus by definition the secured creditor was “dealt with” by the plan involved in this case.<sup>69</sup>

Regardless of that conclusion, it was found that the injunction preventing reclamation was proper and should be upheld. The court was of the opinion that such an injunction should issue “. . . when in the sound discretion of the court, such an injunction is necessary, to meet the ends of equity and justice.”<sup>70</sup> Indicative of the factors considered to be relevant in determining if an injunction is necessary to do “equity and justice” was mention of the debtor’s substantial equity in the collateral, the “essential” relation of the collateral to the success and preservation of the rehabilitative plan, the “highly unlikely” possibility that the security would be impaired, and the fact that payments would not be “seriously” delayed.<sup>71</sup> Impairment of the security was considered “highly unlikely” due to the vehicle’s value being much larger than the amount owed on the note.<sup>72</sup> In addition, the extension of seven or eight months occasioned by the failure to make the “balloon payment” on the specified contract date was not felt to be a “serious” delay in payment.<sup>73</sup> In allowing the degree of contractual modification and enforcing it over the secured creditor’s objection, the court was apparently influenced by the equitable realization that reclamation would have the effect of destroying the plan and forcing the debtor into straight bankruptcy. The detrimental consequences of such an event would not be suffered by the debtor alone but would affect other secured and unsecured creditors as well, causing them to recover significantly less on their claims. Given these considerations, it was decided that although the dissenting secured creditor’s contract was technically “dealt with”, his claim was not “materially and adversely affected” by the plan and it could be confirmed without his acceptance.<sup>74</sup>

Confronted with similar facts in a slightly different setting, the same district court reached a predictable result in *Pizzolato II*.<sup>75</sup> Here the referee had issued an order enjoining the same bank involved in *Pizzolato I* from foreclosing a first mortgage it held on the debtor’s home.<sup>76</sup> Prior to filing the Chapter XIII petition, the

<sup>69</sup>*Id.* at 355.

<sup>70</sup>*Id.* at 256.

<sup>71</sup>*Id.* at 357.

<sup>72</sup>*Id.*

<sup>73</sup>*Id.*

<sup>74</sup>“Technically the contract of petitioner was ‘dealt with’ but was not materially and adversely affected.” *Id.*

<sup>75</sup>281 F. Supp. 109 (W. D. Ark. 1967).

<sup>76</sup>*Id.* at 111. As in *Hallenbeck*, the injunctive power of the Chapter XIII court was held applicable to real property security agreements despite the statutory exclusion

debtor had incurred a deficit of \$299.58 in monthly payments. The mortgage terms specified a monthly payment of \$53.00 which the plan proposed to resume and continue at that rate.

In determining whether the creditor's interests were "materially and adversely affected", so that the plan could be said to deal with the secured creditor, the Arkansas district court looked to the equitable elements that it had deemed decisive in *Pizzolato I*. Again, no impairment of the creditor's security interest was found because the market value of the house exceeded the amount owing on the mortgage. While the contractual time period for payment of the debt was extended by approximately eight months, this was deemed not to seriously delay collection. Emphasis was again placed on the essential role of the security in successful consummation of the plan and the probable destruction of the plan should foreclosure be allowed. Viewing the second mortgagee as united in interest with the debtor, because of their common desire to avoid foreclosure, the court considered the equity under the second mortgage to be that of the debtor and concluded that the debtor possessed substantial equity in the home. Under this balancing of the respective equities approach, it was found that while injury to the bank would be minor, the consequences of foreclosure upon the debtor were severe enough to demand equitable action in the form of an injunction restraining reclamation of the security.<sup>77</sup>

The equitable considerations stressed in the *Pizzolato* cases lend a new and needed dimension to the judicial interpretations placed on the statutory provisions of Chapter XIII by those courts adopting the "broad constructionist" view. The *Cheetham* case, while successful in removing the unnecessary impediment to confirmation raised by the *O'Dell* line of cases, is not to be regarded as representing a complete departure from the *O'Dell* standards. As previously mentioned, it continued the requirement that the secured creditor receive either his full contractual payments or be allowed to reclaim his security.<sup>78</sup>

Nevertheless, *Cheetham* does increase the viability and flexibility of Chapter XIII plans by circumscribing the veto power possessed by a dissenting secured creditor. A judicially sanctioned method of avoiding the veto may be achieved by simply omitting from the plan those secured creditors who refuse to accept it.<sup>79</sup>

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of such agreements from the "claims" cognizable under Chapter XIII.

<sup>77</sup>*Id.* at 112.

<sup>78</sup>See discussion p. 286, *supra*.

<sup>79</sup>It has been suggested that the effect of *Cheetham* was merely to postpone the secured creditor's ability to destroy the plan. The debtor is still required to make full

The limited practical usefulness of the *Cheetham* approach, from the debtor's standpoint, may be demonstrated by reference to the previously posed situation involving the hypothetical debtor D and the unpaid secured debt on his automobile in the amount of \$1,100.00. The *Cheetham* view would allow D to exclude any dissenting secured creditor from the plan entirely, thus permitting confirmation of the plan without C's assent. However, D might be required to continue the full \$110.00 monthly payments outside the plan as a precondition to the exercise of the bankruptcy court's injunctive power. The final result may be quite similar to that reached under the "strict constructionist" interpretation. If the particular collateral concerned is necessary to D's continuance of the plan, he may eventually be forced into straight bankruptcy if C is not enjoined from attempts to reclaim his security.

Perhaps the most reasonable interpretation of the secured creditor provisions of Chapter XIII appears in those cases compatible with the *Cheetham* conclusion as to when a secured creditor is "dealt with" but not restricted by its apparent rigid adherence to the "full periodic payments" doctrine of *Hallenbeck*. In both *Duncan* and *Wilder*, the concept of requiring payment in full of the secured debt was retained, but this end was accomplished through means of an extension in the payment period provided in the contracts. The contractual modifications occasioned by the extension were justified by reference to the equitable elements and practical exigencies involved in the respective situations. Both courts were influenced by the realistic considerations that the debtor in each case was possessed of substantial equity in the collateral, the collateral was essentially related to success of the plan, and the creditor's interest would not be greatly impaired by the modifications.<sup>80</sup> Following this practical approach a still broader interpretation of the injunctive power granted under Chapter XIII was expressed in *Pizzolato I* and *Pizzolato II*.<sup>81</sup> Consideration was given to the inability of the debtor to make full payments under the contractual schedule and extensions were allowed to make eventual complete payment possible. These contractual modifications, as in *Duncan* and *Wilder*, were viewed as necessary to assure successful completion of the plan. Supporting

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payments outside the plan to the omitted creditor or allow reclamation. If the collateral is essential to the plan's success (as the automobile in *Cheetham* probably was) either the burden of full payments or reclamation may destroy the debtor's ability to complete the plan. See *Enforcing a Plan*, *supra* note 34, at 75.

<sup>80</sup>33 F. Supp. 997, 999 (E. D. Va. 1940); 225 F. Supp. 67, 69 (M. D. Ga. 1963).

<sup>81</sup>"The statement, 'for cause shown', indicated that Congress intended the injunction should be issued when, in the sound discretion of the court, such an injunction is necessary to meet the ends of equity and justice." 268 F. Supp. at 356.

this decision to allow contractual modification was the detrimental effect failure of the plan would have not only on the debtor but on the unsecured creditors as well.

Within the context of the illustrative example involving D, the hypothetical debtor, and C, the hypothetical creditor, this variant of the "broad constructionist" interpretation would allow confirmation of D's plan despite a possible failure to comply exactly with the terms of C's secured debt. This view permits use of the injunctive power to prevent reclamation of the security, and thus probable destruction of the plan, if payments under the plan would not severely effect the secured creditor's rights. Minor modification in the payments to C might be allowed under this approach. For example, assume D had defaulted and was delinquent on three payments when the plan began. He would be allowed to begin payments under the plan, postponing payment of the delinquencies until all regular payments had been completed.

### C. CONSIDERATION OF THE CONFLICTING INTERPRETATIONS

The conflicting stands taken by the courts regarding the point at which a secured creditor is "dealt with" by a wage earner plan reflect two basic opposing viewpoints.<sup>82</sup> The less restrictive view expressed by the court in *Cheetham* represents an interpretation that may be more in accord with the spirit of Chapter XIII.<sup>83</sup> *Cheetham* emphasized that the secured creditor was not "dealt with" unless the terms of the plan itself adversely affected his claim. A distinction was drawn between the general indirect effect upon the secured creditor resulting solely from the nature of the proceeding and the more direct consequences ensuing from the provisions of the plan.<sup>84</sup> Unlike *O'Dell*, *Pappas*, and *Rutledge*, the secured creditor's acceptance was necessary only if his contractual rights were detrimentally affected by the plan itself.

The extent to which contractual modification of a secured credi-

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<sup>82</sup>See *Partially Secured Creditor*, *supra* note 13, at 289.

<sup>83</sup>The original reason for allowing the secured creditor a veto power was a fear that the failure to do so might subject the provision to objection on constitutional grounds. By way of analogy to the treatment of secured creditors in straight bankruptcy, this objection appears to have lost any validity it may have had. See *Wright v. Union Central Life Insurance Company*, 304 U. S. 502 (1938), upholding reasonable modifications of a secured creditor's rights. See also Pasky, *Some Procedural Aspects of Administering Encumbered Properties and the Treatment of Secured Creditors in Ordinary Bankruptcy*, 44 REF. J. 54 (1970).

<sup>84</sup>Poulos, *supra* note 3, at 74.

tor's claim will be allowed and enforced through use of the injunctive power is the crucial issue separating the various interpretations of the Chapter XIII provisions. The "strict constructionist" view represented by *O'Dell et.al.* concludes that a secured creditor is "dealt with" by a plan if the proceeding may in any way affect his claim. Any modification, variance, or restriction of the contractual terms, however slight, is deemed to impair the security interest.

The rationale for the "broad constructionist" interpretation is based on the determination that a secured creditor is not "dealt with" by a plan unless it limits the amount he may recover or restricts his security interest.<sup>85</sup> Equitable considerations may dictate that a creditor technically "dealt with" be enjoined from enforcing his security interest if reclamation would destroy the plan.<sup>86</sup> Rather than treating any restriction upon contract rights as impairing the security interest, contractual modifications will be granted providing they do not "seriously" impair or are "highly unlikely" to impair the creditor's right to reclaim and realize the value of his collateral.<sup>87</sup>

Included in this category are *Duncan*, *Wilder*, *Clevenger*, *Pizzolato I*, and *Pizzolato II*. The exact status of *Hallenbeck* and *Cheetham* is somewhat nebulous. *Hallenbeck* has been variously cited as in accord with the *O'Dell et. al.* reasoning<sup>88</sup> and as following the *Clevenger* type analysis.<sup>89</sup> Perhaps nearer to the mark is the possibility that *Hallenbeck* may be interpreted as representing either view.<sup>90</sup> *Cheetham's* rejection of the "strict constructionist" interpretation explains its classification as "broad constructionist," although its holding is limited to authorization of the omission of the secured creditor from the plan thereby permitting confirmation over the creditors objection. Unfortunately, the factual situation presented did not require the *Cheetham* court to take a definite stand on the extent to which it would authorize modification of the secured creditor's contract rights. This issue was confused by the adoption of the *Hallenbeck* "full periodic payments" requirement while simultaneously recognizing the reliance on equitable principles stressed

<sup>85</sup>390 F.2d 234, 238 (1st Cir. 1968).

<sup>86</sup>268 F. Supp. 353, 357 (W. D. Ark. 1967).

<sup>87</sup>*Id.*

<sup>88</sup>See Poulos, *supra* note 3, at 69.

<sup>89</sup>See *Partially Secured Creditor*, *supra* note 13, at 292.

<sup>90</sup>It has been suggested that if the condition of "full periodic payments" expressed in *Hallenbeck* allows the type of extension permitted in *Duncan* and *Wilder*, then the court may enforce a reasonable curtailment of the secured creditor's contract rights to ensure the success of a wage earner plan. If it means that all defaulted payments must be brought current in order to authorize use of the injunctive power then it reaffirms the *O'Dell* and *Rutledge* proposition that the secured creditor's rights may not be varied in the slightest. See *Enforcing a Plan*, *supra* note 34, at 77.

by *Pizzolato II*.<sup>91</sup>

The approach taken by the "broad constructionist" courts permits a greater degree of flexibility in the application of Chapter XIII plans to specific situations encountered by wage earning debtors. In addition to providing the debtor with a means of sidestepping a secured creditor's rejection by omitting him from the plan, minor modifications of the creditor's contractual rights may also be sanctioned. While having little detrimental effect upon the creditor's interest, these modifications are often significant in determining the debtor's ability to successfully complete the plan.

### III. PROPOSED ROLE OF THE SECURED CREDITOR IN CHAPTER XIII

The statutory provisions regulating the status of the secured creditor have been perpetuated virtually without modification since the inception of Chapter XIII in 1938. Judicial variance in the interpretation and application of the statutory scheme dealing with the secured creditor indicates the appropriateness of a legislative solution. Of all the Chapter XIII provisions, none is in more urgent need of reform and clarification than those delineating and defining the role of the secured creditor.

A growing awareness of this need for revision has resulted in the introduction of three successive bills designed to effectuate changes in the current statute.<sup>92</sup> The proposal most likely to be introduced in the recently convened 92nd Congress is the Draft Omnibus Chapter XIII Bill currently under consideration by the Consumer Bankruptcy Committee of the American Bar Association. This bill embodies proposals substantially similar to its ill-fated predecessors but represents the most comprehensive revision of the statutory scheme yet attempted.<sup>93</sup>

Initially, the draft bill attempts to widen the injunctive power by authorizing the courts to enjoin any creditor from bringing suit

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<sup>91</sup>See note 62, *supra*.

<sup>92</sup>H. R. 11965, 89th Cong., 1st Sess. (1965); H. R. 2520, 90th Cong., 1st Sess. (1967); H. R. 6792, 91st Cong., 1st Sess. (1969).

<sup>93</sup>While portions of the draft bill have been adopted verbatim from H. R. 6792, 91st Cong., 1st Sess. (1969), the draft includes additional language and provisions giving it a somewhat wider scope than the previous proposals. To avoid repetitious comment and duplication, the draft bill alone will be considered herein. For an analysis of the provisions contained in H. R. 6792, see *Partially Secured Creditor*, *supra* note 12, at 297—300.

against the debtor “. . . including those [creditor claims] not dealt with by and those excluded from the plan. . .”<sup>94</sup> One limitation on this power is the proviso that the injunction may not continue after confirmation unless defaulting payments are made pursuant to conditions fixed by the court.<sup>95</sup> The purpose of this proposed change is to promote additional flexibility and avoid the harsh results occasioned by the acceleration clauses so often contained in consumer security agreements. The flexibility is accomplished by authorizing a broader use of the injunctive power and permitting a more relaxed approach in the formation of conditions for repayment of defaults. The importance of this change is more readily apparent when proposed § 614 is read in conjunction with proposed § 652.

As amended, § 652 would empower the court to confirm a plan over the objection of any creditor if it finds that the plan adequately provides for the preservation of the value of the creditor's claim.<sup>96</sup> The secured creditor's veto may be overridden despite contractual modification of the instrument creating his security interest.<sup>97</sup> Protection of the secured creditor's rights is achieved by means of the requirement of “adequate. . . preservation” of his claim, and the provision permitting reclamation of his collateral should a default “substantially impairing” his rights occur under the plan.<sup>98</sup> The net effect of proposed sections 614 and 652 (b) and (c) is to reject the theory expressed in the “strict constructionist” cases that the secured creditor is entitled to either precise compliance with his contract or

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<sup>94</sup>§614, *Comparative Print, Draft Omnibus Chapter XIII Bill*, Consumer Bankruptcy Committee, American Bar Association, December, 1969 [hereinafter cited as *Draft Omnibus Bill*]. This is a proposed draft and its amendments are still subject to change. The discussion of the proposal will be limited to those amendments concerning security interests and secured creditors. For a more complete analysis of the draft bill see also Comment, *Number Eight and Still Trying Harder-An Analysis of Chapter XIII in Sacramento*, 4 U.C.D. L. REV. 301 (1971).

<sup>95</sup>§614, *Draft Omnibus Bill*.

<sup>96</sup>“. . . (1) the court may confirm the plan without the acceptance of any creditor or class of creditors if it finds that the plan adequately provides for the preservation by such creditor or class of creditors of the value of its claim or claims against the property and future earnings of the debtor and provides for equal treatment for each creditor of the same class; . . .” § 652 (b) (1) *Draft Omnibus Bill*.

<sup>97</sup>“. . . (2) the court may find under paragraph (1) of this subdivision (b) that the plan adequately provides for the preservation by a secured creditor of the value of his claim against his collateral notwithstanding that the terms of his contract may be modified by the plan; . . .” § 652 (b) (2) *Draft Omnibus Bill*.

<sup>98</sup>“If the court finds that 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 a secured debt . . . the rights of the secured creditor in his collateral shall not thereafter be affected by the plan or by any discharge . . .” § 652 (c) *Draft Omnibus Bill*.

to enforce his security interest.<sup>99</sup> The proposals seek to eliminate the dilemma confronting the debtor when a security interest is held in an item essential to the plan. If the collateral (e.g., the debtor's only automobile) is reclaimed, the plan's success may very well be doomed. On the other hand, full compliance with the contractual terms may impose a burden the debtor is incapable of sustaining and thus directly lead to the plan's destruction.<sup>100</sup>

The authority to modify the contractual terms of a secured creditor's claim would be expressly given to the courts by another amendatory provision.<sup>101</sup> Elimination of the present procedure requiring priority of payment for the secured creditor is proposed, its replacement permitting the option of continued priority payments or concurrent payments among both the secured and unsecured creditors.<sup>102</sup> These amendments are based on the theory that there is nothing in Chapter XIII supporting the notion that a plan cannot be confirmed, or a secured creditor's reclamation petition cannot be enjoined, unless the plan provides for strict compliance with the terms of his agreement.<sup>103</sup> The combined effect of these proposals is to reduce the present preferred status of the secured creditor to correspond with the extent of his secured interest and to mitigate the harsh consequences attendant upon total adherence to contractual terms.<sup>104</sup>

The proposed statutory scheme deals decisively with the problem of the partially secured creditor. First, the actual value of his security is ascertained by the court. Secondly, he is treated as a secured creditor to the extent of his security and as an unsecured creditor regarding the excess of his claim over the value of the security.<sup>105</sup> This proviso will establish uniformity of treatment among creditors by recognizing the partially secured creditor as the holder of two

<sup>99</sup>*Section-by-Section Explanation of Changes to be made in the Bankruptcy Act*, at 7, (non-published report by The Consumer Bankruptcy Committee of the American Bar Association on file at University of California at Davis Law Library).

<sup>100</sup>This approach is in accord with the position taken by the *Duncan, Wilder, Pizzolato I*, and *Pizzolato II* cases. See discussion pgs. 285-286, 289-291, *supra*.

<sup>101</sup>"A plan . . . may include provisions dealing with secured debts severally, upon any terms and may alter or modify the rights of the holders of such debts; . . ." § 646 (2) *Draft Omnibus Bill*.

<sup>102</sup>"[A plan] shall provide for payments of unsecured debts dealt with under the plan although such payments may be weighted in favor of secured debts; . . ." § 646 *Draft Omnibus Bill*.

<sup>103</sup>See explanation in note 83, *supra*.

<sup>104</sup>*Id.*

<sup>105</sup>" . . . and the value of the security of a secured creditor, whether or not his claim is proved and whether his claim is secured by an interest in real property, chattel real, or personal property, shall be determined as provided in subdivision h of section 57 of this Act. and so much of the claim as exceeds the value so determined shall be an unsecured claim. . . ." § 606(1) *Draft Omnibus Bill*.

claims, one secured and the other unsecured. Consequently, the veto power of the partially secured creditor is no longer the equivalent of that possessed by the fully secured creditor but reflects the inadequate value of his collateral.

The proposed amendments to the secured creditor provisions will be of added significance if Congress chooses to adopt one other crucial revision of the present statutory framework contained in the Draft Omnibus Chapter XIII Bill. The debtor relief provisions of Chapter XIII are now available only to those persons fitting the definition of "wage earner."<sup>106</sup> This restrictive definition would be deleted and the classification of "debtors" who may file Chapter XIII provisions would be extended to cover any "natural person".<sup>107</sup> The prediction that this expanded definition may lead to a vast proliferation in the number of Chapter XIII petitions filed is indicative of the need for modern comprehensive revision of the present statutory scheme.

*Jack V. Lovell*

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<sup>106</sup>"... 'wage earner' shall mean an individual whose principal income is derived from wages, salary or commissions." Bankruptcy Act, § 606(8) 11 U.S.C. § 1006(8) (1968).

<sup>107</sup> § 606(3) *Draft Omnibus Bill*.