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CHAPTER 13 OF THE BANKRUPTCY REFORM ACT OF 1978: AN ATTRACTIVE ALTERNATIVE

Melvin Kaplan*

Individual debtors with regular incomes may elect to repay their debts with a chapter 13 periodic payment plan. Mr. Kaplan points out the significant changes the new Bankruptcy Code effectuates in chapter 13 relief. He discusses the advantages available to consumer-debtors who wish to avoid a bankruptcy liquidation by choosing a rehabilitation plan under chapter 13. In conclusion, Mr. Kaplan predicts that eligible debtors increasingly will choose this form of relief as its value becomes apparent.

One of the least understood and most erratically applied of the federal bankruptcy statutes,¹ chapter XIII of the Bankruptcy Act² was intended as a rehabilitating device for insolvent wage earners.³ Chapter 13 of the Bankruptcy Reform Act of 1978,⁴ although it introduces significant changes, remains true to the original purpose. Chapter 13 allows the consumer-debtor to adopt a plan for making periodic payments to a bankruptcy trustee, who in turn distributes the funds to the creditors. The debtor is thus protected from creditor harassment and avoids the stigma of a bankruptcy liquidation.⁵

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1. S. REP. NO. 95-989, 95th Cong., 2d Sess. 12, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 3, 14 [hereinafter cited as SENATE REPORT].

2. Chapter XIII was added to the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1897-99), by the Chandler Act, ch. 575, 52 Stat. 930 (1938) (originally codified in 11 U.S.C. §§ 1001-1086 (1976)) (repealed 1979). Because chapter XIII of the Bankruptcy Act did not appear until 1938, with the passage of the Chandler Act, all citations to former chapter XIII will be to the Chandler Act. The rules that have been promulgated under the former Act will continue to govern bankruptcy practice to the extent that they are consistent with the provisions of the new Act. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 405(d), 92 Stat. 2549. While the Supreme Court has the authority to promulgate new rules for bankruptcy practice, 28 U.S.C. § 2075 (Supp. II 1978), this Article will cite to the rules presently in existence—those formulated under the former Act.

3. SENATE REPORT *supra* note 1, at 12.

4. 11 U.S.C. app. §§ 1301-1330 (Supp. II 1978). As this Article was prepared for publication, the most current codification of the Bankruptcy Code was the 1978 Supplement to the United States Code, in which title 11 is set forth in an appendix. Throughout this Article, title 11 will be cited as 11 U.S.C. app. § — (Supp. II 1978).

5. See *Perry v. Commerce Loan Co.*, 383 U.S. 392, 395 (1966), *rehearing denied*, 384 U.S. 934 (1966). While the debtor is making payments under the court-supervised plan, creditors may not move against the debtor through garnishments, attachments, or any other means. 11 U.S.C. app. § 362(a) (Supp. II 1978); SUP. CT. R. BANKR. P. 401.

Wage earner plans⁶ have been encouraged, and implemented successfully, in Chicago and many other areas⁷ as a realistic alternative to straight bankruptcy;⁸ in other districts, however, chapter 13 petitions have been filed rarely or never.⁹ Reasons for this diversity in use may be traced to flaws in the former Act,¹⁰ as well as to attorneys' and judges' hesitation to encourage what they may perceive to be an administratively burdensome procedure.¹¹

A debtor who considered filing a chapter XIII petition under the former Act was confronted with numerous barriers to achieving the ultimate goal of relief from creditor pressures. For example, to be eligible for a chapter XIII plan, the debtor had to be a person whose principal income was derived from wages or commissions.¹² Self-employed persons, such as sole proprietors—although their financial situation often was comparable to that of individual wage earners—were often unable to participate in chapter XIII relief. Additionally, debtors were ineligible for a hardship discharge unless they had been under the wage earner plan for three years.¹³ Other defects in the former chapter XIII included the requirement that a majority of unsecured creditors consent to the debtor's plan,¹⁴ the lack of protection for a

6. Under the former Bankruptcy Act, wage earner was defined to mean "an individual whose principal income is derived from wages, salaries or commissions." Chandler Act, ch. 575, § 606, 52 Stat. 930 (1938), as amended by Act of July 7, 1952, ch. 579, § 52, 66 Stat. 437 (originally codified at 11 U.S.C. § 1006(8) (1976)) (repealed 1979). The new Act eliminates the requirement that the debtor be a wage earner by substituting the phrase "individual with regular income." 11 U.S.C. app. § 101(24) (Supp. II 1978). See text accompanying notes 21-28 *infra*.

7. See THE COMMISSION REPORT ON THE BANKRUPTCY LAWS OF THE UNITED STATES, REPORT, H.R. DOC. NO. 93-137, 93d Cong., 1st Sess., part I, 157 (1973) [hereinafter cited as COMMISSION REPORT], where the Commission noted the extensive use of wage earner plans by judicial districts in Alabama, Ohio, California, Georgia, Tennessee, Kansas, and Maine.

8. The term "straight bankruptcy" generally refers to liquidation proceedings, and is now delineated in chapter 7 of the new Act. See 11 U.S.C. app. §§ 701-766 (Supp. II 1978).

9. COMMISSION REPORT, *supra* note 7, at 157. The Commission noted that while use of chapter 13 appears to follow regional lines, there has been a surprising variety in usage of wage earner relief among districts within the same area of the country and even within the same state.

10. See text accompanying notes 12-17 *infra*.

11. See COMMISSION REPORT, *supra* note 7, at 158. See also SENATE REPORT, *supra* note 1, at 13, wherein it was noted that:

Chapter XIII cases can require considerable time and effort from both bankruptcy judges and debtor attorneys. . . . Certainly related to these difficulties are the lack of national uniformity in handling such cases, the length of time such cases must necessarily remain pending and the differences in state exemption and garnishment laws.

12. Chandler Act, ch. 575, § 606(3), (8), 52 Stat. 930, as amended by Act of Dec. 29, 1950, ch. 1193, 64 Stat. 1134 (originally codified at 11 U.S.C. § 1006(3), (8) (1976)) (repealed 1979).

13. Chandler Act, ch. 575, § 661, 52 Stat. 936 (1938), as amended by Act of July 7, 1952, ch. 579, § 52, 66 Stat. 437 (originally codified in 11 U.S.C. § 1061 (1976)) (repealed 1979).

14. *Id.*

debtor's co-signers,¹⁵ and the erratic treatment of secured creditors.¹⁶ The success of a debtor who proceeded with a plan in spite of these obstacles depended heavily on the chapter XIII expertise of both the debtor's attorney and the court administering the estate. An inexperienced attorney frequently would decide that it was simpler for the debtor to file for straight bankruptcy rather than to proceed with the administratively demanding wage earner plan.¹⁷ The bankruptcy judge also might be unenthusiastic about chapter XIII relief because the debtor's case would usually involve a lengthy docket tenure while the plan was being completed.

Another problem attendant upon court-administered wage earner plans involves the courts' inadequacy to supervise lengthy payout plans. This has led in some cases to the debtor's being forced to make repayments under the court's supervision for as much as seven to ten years—a situation uncomfortably analogous to indentured servitude.¹⁸ In an attempt to alleviate these and other recurring problems, the new chapter 13 offers significant reforms which should make it an attractive alternative for the increasing number of consumer-debtors,¹⁹ and also for those sole proprietors who may be able to obtain chapter 13 relief as well.²⁰

ELIGIBILITY

Chapter 13 of the new Bankruptcy Reform Act permits the financial rehabilitation of an "individual with *regular income*."²¹ This provision is an expansion of the 1938 Act, which had limited chapter XIII relief to those "whose principal income [was] derived from wages, salary, or commissions."²² The obvious impact of the new provision is that financially trou-

15. See SENATE REPORT, *supra* note 1, at 13. See also H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 121-22, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 289-93 [hereinafter cited as HOUSE REPORT].

16. See SENATE REPORT, *supra* note 1, at 13.

17. COMMISSION REPORT, *supra* note 7, at 158.

18. HOUSE REPORT, *supra* note 15, at 117.

19. The obsolescence of former chapter XIII is demonstrated by the dramatic increase in the number of consumer bankruptcies since that time. Between 1946 and 1967, the number of nonbusiness bankruptcies rose from 8,566 to 191,729, and the amount of personal debt outstanding increased from \$31.4 billion to \$338.2 billion in the same period of years. COMMISSION REPORT, *supra* note 7, at 33.

20. See notes 21-24 and accompanying text *infra*.

21. 11 U.S.C. app. § 101(24) (Supp. II 1978) (emphasis added).

22. Under the former Act, a chapter XIII "wage earner" was defined as "an individual whose principal income is derived from wages, salary or commissions." Chandler Act, ch. 575, § 606, 52 Stat. 930 (1938), as amended by Act of Dec. 29, 1950, ch. 1193, 64 Stat. 1134 (originally codified in 11 U.S.C. § 1006(8) (1976)) (repealed 1979). The courts have interpreted "wage earner" very broadly. *E.g.*, *In re White Birch Park*, 471 F. Supp. 159 (E.D. Mich. 1979) (debtors who received compensation for services to chapter XI estate adjudged wage earners); *In re Reed*, 368 F. Supp. 615 (E.D. Va. 1968) (self-employed carpenter who worked with his

bled sole proprietors and professionals with "regular income"²³ who wish to continue doing business while performing under the plan now will have an inexpensive alternative to the expensive and technical chapter 11 reorganization.²⁴ This significant change will affect, for example, doctors, accountants, and individual proprietors, who often have chosen to liquidate their assets in straight bankruptcy rather than deal with the complexities of a chapter 11 reorganization.²⁵ The new Act recognizes that the distinction between a self-employed barber or grocer and an employee-barber or grocer is slight; both should be able to enjoy the benefits of chapter 13 rehabilitation.²⁶

The expansion of chapter 13 eligibility compelled the enactment of a corresponding limitation not present in the old Bankruptcy Act. The new Act limits chapter 13 relief to individuals with less than \$100,000 in noncontingent, liquidated, unsecured debts and less than \$350,000 in noncontingent, liquidated, secured debts.²⁷ A second limitation is imposed on the non-wage earner seeking chapter 13 relief. He or she must have regular income—that is, income sufficiently stable and regular to enable him or her to make periodic payments under the plan.²⁸ Having satisfied these two

own tools for a number of different persons, none of whom withheld taxes from his earnings, deemed a wage earner); *In re Bradford*, 268 F. Supp. 896 (N.D. Ala. 1967) (debtor whose principal source of income was derived from social security benefits qualified as a wage earner); *Appeal of Shamma*, 117 N.H. 70, 369 A.2d 192 (1977) (debtor who earned his living by installing carpeting for many different customers hiring his services adjudged a wage earner). The new Act adopts this more liberal interpretation of the term "wage earner" and substitutes the term "individual with regular income." 11 U.S.C. app. § 101(24) (Supp. II 1978).

It should be noted that the old Act contained two "wage earner" provisions. Section 1(32) exempted wage earners from involuntary bankruptcy under chapters I to VII. 11 U.S.C. § 1(32) (1976) (repealed 1979). At least one case had held that a person may be a wage earner for purposes of chapter XIII but not be one within the meaning of § 1(32). *Rice v. Mimms*, 291 F.2d 823 (10th Cir. 1961).

23. Even individuals on pensions, social security, or welfare may use chapter 13 if the income they receive is regular and stable enough for them to make periodic payments under a plan. HOUSE REPORT, *supra* note 15, at 119.

24. See 11 U.S.C. app. §§ 1101-1174 (Supp. II 1978). Chapter 11 provides for the reorganization of financially troubled business entities by adjustment of their debts and equity interests. SENATE REPORT, *supra* note 1, at 9.

25. HOUSE REPORT, *supra* note 15, at 119.

26. While petitions for liquidation or reorganization may be filed under chapters 7 and 11 for corporations, partnerships and individuals, 11 U.S.C. app. §§ 101(31), 109(b), (d) (Supp. II 1978), chapter 13 is limited exclusively to individuals. *Id.* § 109(e).

27. 11 U.S.C. app. § 109(e) (Supp. II 1978). See HOUSE REPORT, *supra* note 15, at 119, where these limits are interpreted as creating an irrebuttable presumption that chapter 13 is inappropriate for individuals with larger debts. Addressing the possibility that a small farmer with a \$350,000 mortgage would be denied chapter 13 relief, while a not-so-small business with less indebtedness could file for such relief, the report noted that the benefits the chapter provides to small proprietors outweigh any countervailing abuse caused by allowing coverage to these larger proprietors. *Id.*

28. 11 U.S.C. app. § 101(24) (Supp. II 1978). See note 23 *supra*. A husband and wife who file a joint petition present the only exception to the requirement that all persons filing a chapter 13 petition have regular income. A married couple is allowed to file a joint petition, and

requirements, the self-employed debtor will be able to avoid the chapter 11 reorganization and to share the chapter 13 benefits previously reserved for wage earners alone.

THE PLAN

As under former law, the debtor is given the exclusive right to submit to the court a plan²⁹ for the settlement, satisfaction, and discharge of his or her secured as well as unsecured debts. The debtor's plan may provide for an extension of time for the debt repayment, reduction in the amount to be paid, or both. The debtor is still required to provide for submission of all, or a sufficient portion of, his or her future earnings to the bankruptcy trustee in order to meet the obligations under the plan.³⁰ A new provision allows for part of the payment to come from a second source—the use or sale of the estate or property of the debtor.³¹ The new Act also attempts to prevent the prolonged servitude of unsupervised debtors³² by limiting the plan's duration to three years, with a possible extension for cause to a maximum of five years.³³

Of special interest in chapter 13 practice is the debtor's proposal for the treatment of claims. In a new provision, the revised Act specifically allows for modification of the rights of both secured and unsecured creditors.³⁴ An exception is provided for those secured claims secured solely by an interest in the debtor's principal residence.³⁵ The plan also may cure or waive any default³⁶—including default on a claim in which the last payment is due after the date of final payment under the plan.³⁷ An example of this type is a delinquent real estate mortgage. The plan must provide for the default to be cured within a reasonable time, and the regular mortgage payments must be maintained while the case is pending.³⁸ These liberal allowances for the

it is not essential that both spouses individually maintain a steady income. 11 U.S.C. app. § 109(e) (Supp. II 1978).

29. 11 U.S.C. app. § 1321 (Supp. II 1978). For a description of the plan's contents, see *id.* § 1322.

30. Compare 11 U.S.C. app. § 1322(a)(1) (Supp. II 1978) with Chandler Act, ch. 575, § 646, 52 Stat. 934 (1938) (codified in 11 U.S.C. § 1046(4) (1976)) (repealed 1979).

31. 11 U.S.C. app. § 1322(b)(8) (Supp. II 1978). It is essential, however, that part of the payments under the plan come from future income. *Id.* § 1322 (a)(1).

32. See note 18 and accompanying text *supra*.

33. 11 U.S.C. app. § 1322(c) (Supp. II 1978).

34. See text accompanying notes 41, 47-56 *infra*. The only creditors who must be promised payment in full under the plan are the holder of a priority claim specified in § 507 of the Act and the holder of a secured claim secured by the debtor's principal residence. 11 U.S.C. app. § 1322(a)(2), (b)(2) (Supp. II 1978). *But see* S. 305, 96th Cong., 1st Sess. § 1322(a)(2) (1979) [hereinafter cited as SENATE BILL] which would provide for full payment of all secured claims for tax liabilities of the debtor.

35. 11 U.S.C. app. § 1322(b)(2) (Supp. II 1978).

36. *Id.* § 1322(b)(3).

37. *Id.* § 1322(b)(5).

38. *Id.*

plan's contents are tempered only by requirements for the court's confirmation.³⁹ However, these requirements also have been liberalized.⁴⁰

CONFIRMATION

There are two significant changes in the new Act that affect the court's confirmation of the debtor's plan. First, consent of a majority of the debtor's unsecured creditors is no longer required.⁴¹ The former law discouraged the debtor from offering less than 100 percent repayment to creditors out of fear that they would not accept any compromise.⁴² Accordingly, the debtor often saddled him or herself with a repayment plan that was overly burdensome. Because of this, the debtor may have been forced later to abandon the plan and to liquidate assets in straight bankruptcy.⁴³ Because the consent of the unsecured creditors is no longer required,⁴⁴ the court will inspect the plan and confirm it⁴⁵ if all unsecured creditors will receive at a minimum the amount that would be obtainable under a chapter 7 liquidation.⁴⁶ This practical provision guarantees the unsecured creditor at least chapter 7 repayment and provides the debtor with incentive to elect this appealing alternative to liquidation.

The Act also has modified significantly the rights of the secured creditor in this area. Under the former statute, the debtor needed to secure the approval of any secured creditor "dealt with" by the plan.⁴⁷ Some judicial opinions interpreted this provision to include secured creditors whose contract rights were affected in any way.⁴⁸ This strict interpretation was

39. See notes 41-56 and accompanying text, *infra*.

40. *Id.* Under § 1327(a), creditors are bound by the debtor's confirmed plan, whether or not they object to it. This is true even though a creditor's interest is not provided for in the plan. Another section provides for modification of the debtor's plan after confirmation. 11 U.S.C. app. § 1329 (Supp. II 1978).

41. Compare 11 U.S.C. app. § 1325 (Supp. II 1978) with Chandler Act, ch. 575, § 652, 52 Stat. 934 (1938) (originally codified in 11 U.S.C. § 1052(1) (1976)) (repealed 1979).

42. See Chandler Act, ch. 575, § 661, 52 Stat. 936 (1938), as amended by Act of July 7, 1952, ch. 579, § 52, 66 Stat. 437 (originally codified in 11 U.S.C. § 1061 (1976)) (repealed 1979), which provided for a suspension of the statutes of limitations affecting claims and interests while a proceeding was pending under this chapter.

43. See HOUSE REPORT, *supra* note 15, at 123.

44. See note 41 *supra*.

45. There are certain procedural and good-faith prerequisites to confirmation that also must be met. See 11 U.S.C. app. § 1325(a)(1)-(3), (6) (Supp. II 1978).

46. 11 U.S.C. app. § 1325(a)(4) (Supp. II 1978). In deciding whether the debtor's plan will provide the creditors with repayment equal to that available under a chapter 7 liquidation, the bankruptcy court will consider the value of the exemptions which would be available to the debtor in a chapter 13 proceeding. See 11 U.S.C. app. § 522 (Supp. II 1978).

47. Chandler Act, ch. 575, § 652, 52 Stat. 934 (1938) (originally codified in 11 U.S.C. app. § 1052(1) (1976)) (repealed 1979).

48. See, e.g., *In re Rutledge*, 277 F. Supp. 933 (D.C. Ark. 1967) (secured creditor could reject a plan that proposed full monthly payments and curing of delinquent payments within "a

eroded somewhat by more recent cases,⁴⁹ and the new Act further limits the rights of secured creditors. If the secured creditor accepts the plan as proposed, there is, of course, no confirmation problem.⁵⁰ If the creditor objects to the debtor's plan, however, the court will nonetheless, if the debtor returns the security to the creditor, confirm the plan.⁵¹ If the creditor objects to the plan, and the debtor wishes to retain the security, the court will confirm the plan provided that the creditor is allowed to retain the lien securing the claim and the debtor proposes payments equal to the value of the security.⁵² This "cram down" provision will force the secured creditor to accept any plan that offers repayment of the actual value of the security.⁵³ Any remaining contract balance will be considered an unsecured claim and treated as identical to other unsecured claims, *i.e.*, it will usually be scaled down.⁵⁴

The rights of the secured creditor can be affected in one final manner by the confirmation of the chapter 13 plan. The chapter 13 debtor is allowed to exempt certain collateral under state law or the liberal federal provision.⁵⁵ Upon the debtor's exercise of this right, the holder of either a judicial lien or a non-possessory, non-purchase money security interest in certain of the

reasonable length of time"); *In re Pappas*, 216 F. Supp. 819 (D.C. Ohio 1962) (debtor's plan "dealt with" secured creditor who would not have been paid according to the terms of the instrument creating the debt and thus would have become an involuntary participant in the plan, if such was confirmed).

49. *See, e.g.*, *Thompson v. Ford Motor Credit Co.*, 475 F.2d 1217 (5th Cir. 1973) (under certain circumstances, for equitable reasons, a court can enjoin secured creditor from reclaiming chattel after disabled debtor failed to meet plan payments); *In re Garcia*, 396 F. Supp. 518 (C.D. Cal. 1974) (creditor's claim was secured only to the value of the chattel, and he was not "dealt with" by a plan including payments to that extent); *In re Wilder*, 225 F. Supp. 67 (M.D. Ga. 1963) (creditor was forced to accept a plan that included gradual repayment of a two month arrearage).

50. 11 U.S.C. app. § 1325(a)(5) (Supp. II 1978).

51. *Id.* § 1325(a)(5)(C).

52. *Id.* § 1325(a)(5)(B).

53. While upon first inspection this provision appears to be unfair to the holder of a security interest, it merely recognizes the financial realities of the secured creditor-debtor relationship. If the debtor elects not to seek chapter 13 relief, the creditor will be forced to repossess the secured goods and to sell them at a price that is quite possibly below their value to the debtor. Under the statute, the court will insist that the plan compensate the creditor for the value of the secured goods, yet the debtor will retain possession of the goods and avoid the high cost of their replacement. *See* HOUSE REPORT, *supra* note 15, at 124. *See also* 11 U.S.C. app. § 722 (Supp. II 1978) (allowing the debtor in a straight bankruptcy proceeding to redeem personal property by paying the amount of the secured claim).

54. 11 U.S.C. app. § 506(a) (Supp. II 1978). *See* SENATE REPORT, *supra* note 1, at 68. By limiting the secured creditor's veto power to those plans that have not proposed payment of the value of the collateral, the new Act radically restricts the secured creditor's former power to veto any plan that adversely affects his or her claim. *See* notes 47-48 and accompanying text *supra*.

55. *See* 11 U.S.C. app. § 522(b) (Supp. II 1978); *id.* § 103(a).

exempt property will have the lien set aside and will be treated as an unsecured creditor to the extent of this claim.⁵⁶

THE EFFECT OF FILING

The chapter 13 proceeding can be initiated only by the voluntary petition of an eligible debtor.⁵⁷ Chapter 13 relief can be sought either in an original petition or in a conversion from a pending chapter 7 or chapter 11 proceeding.⁵⁸ A new provision permits a husband and wife to file jointly under one petition. The court then determines, for ease of administration, the extent to which the debtors' estates should be consolidated.⁵⁹

As under former law, the voluntary filing of the chapter 13 petition constitutes the order for relief.⁶⁰ Unless the plan or order of confirmation specifies to the contrary, the debtor will be allowed to remain in possession of his or her property after filing.⁶¹ This provision will have a great impact under the new Act because it will be applied in conjunction with the expanded eligibility requirements.⁶² The sole proprietor who elects chapter 13 relief now may retain possession of his or her business assets and thus continue business operations during administration of the plan.⁶³ Indeed, with certain limitations, the small business debtor will be able to use, lease, or sell property of the estate in the normal course of business,⁶⁴ and to

56. *Id.* § 522(f). Included in this list are exempt household furnishings, household goods, wearing apparel, appliances, books, animals, crops, some jewelry and musical instruments, tools of trade, professional books, and professionally-prescribed health aids. *See also id.* § 522(d).

57. *Id.* §§ 301, 303(a). The House Committee on the Judiciary of the 90th Congress considered and "firmly rejected" the idea of an involuntary or mandatory chapter 13 proceeding, citing a possible violation of the thirteenth amendment prohibition against involuntary servitude. HOUSE REPORT, *supra* note 15, at 120, citing *Hearings on H.R. 1057 and H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Cong., 1st Sess. (1967). The House also noted the difficulties of forcing an unwilling debtor to cooperate in a repayment plan requiring prolonged cooperation from all parties. HOUSE REPORT, *supra* note 15, at 120. This same policy consideration was cited by the Bankruptcy Commission in rejecting a proposal that a debtor be permitted to file for straight bankruptcy only if he or she could show that chapter 13 relief was inappropriate. COMMISSION REPORT, *supra* note 7, at 158-59.

58. *See* 11 U.S.C. app. § 706(a), 1112(d) (Supp. II 1978). A debtor may also convert from a chapter 13 proceeding to a chapter 7 proceeding. 11 U.S.C. app. § 1307(a) (Supp. II 1978). The court will not enforce waivers of the right to convert from either chapter 7 to chapters 13 or 11, nor from chapter 13 to chapter 7, *id.* §§ 706(a), 1307(a). In addition, a debtor may request a dismissal of the chapter 13 proceeding at any time, unless it has been converted under § 706 or § 1112(a). 11 U.S.C. app. § 1307(b) (Supp. II 1978).

59. 11 U.S.C. app. § 302 (Supp. II 1978). The spouses' aggregate debts cannot exceed the debt ceiling that is imposed upon the individual chapter 13 debtor. *Id.* § 109(e). *See* note 27 and accompanying text *supra*. It is merely required, however, that only one of the two spouses maintain a regular income. 11 U.S.C. app. § 109(e) (Supp. II 1978).

60. *Id.* § 301.

61. *Id.* § 1306(b).

62. *See* notes 21-28 and accompanying text *supra*.

63. 11 U.S.C. app. § 1304(b) (Supp. II 1978).

64. *Id.* § 363(c)(1). While the debtor enjoys liberal rights to deal with the physical property of the estate, he or she may not use, sell, or lease "cash collateral" unless either the consent of

issue certificates of indebtedness to obtain cash or physical property necessary to continue operations.⁶⁵ The potential impact of this is substantial. To the debtor, continued business operations may mean a fresh start and greater self-respect; to the creditor, it may mean collecting part or all of the amount owing.

The filing of the chapter 13 petition also effectuates an automatic stay of the commencement or the continuation of any action against the debtor, or his or her property, arising after the filing of the petition.⁶⁶ Creditors may not create, perfect, or enforce liens against the debtor's property; they may not enforce previously obtained judgments or preexisting claims against the debtor; nor may they pursue the self-help or setoff to effect any recovery.⁶⁷ Not all proceedings against the debtor are automatically stayed; a criminal proceeding, for example, is one of the exceptions.⁶⁸ However, even the actions that are not automatically stayed may be enjoined under other statutory provisions.⁶⁹

A second type of creditor stay makes its debut in the new chapter 13. Claims against *co-signers* on a consumer debt now will be automatically stayed.⁷⁰ This provision should encourage the use of chapter 13 relief because the debtor will be able to complete an orderly repayment plan without

all parties having an interest in the collateral or court authorization has been obtained. *Id.* § 363(c)(2). The section defines "cash collateral" as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and another entity have an interest, *Id.* § 363(a). Thus, the chapter 13 business debtor is prohibited from entering transactions for the transfer of this "soft collateral" when it is subject to a lien or the co-ownership rights of another person. This restriction applies also to "hard collateral" that is subject to a lien at the time of confirmation of the plan, is disposed of by the debtor, and comes back into the estate as "soft" or cash collateral. The property in this new form again will be subject to the § 363 restrictions on free transfer. *See* SENATE REPORT, *supra* note 1, at 55. *But see* SENATE BILL, *supra* note 34, at § 363(a), which would also include the proceeds, products, offspring, rents, or profits of property subject to a security interest within the definition of the term cash collateral.

65. 11 U.S.C. app. § 364(a) (Supp. II 1978). This provision allows the business debtor to incur unsecured debts in the ordinary course of business. Secured debts can be incurred only if the debtor complies with further requirements of the section. *See id.* § 364(c), (d); HOUSE REPORT, *supra* note 15, at 346-47.

66. 11 U.S.C. app. § 362(a) (Supp. II 1978).

67. *Id.* § 362(a). The automatic stay provision also existed in the old Bankruptcy Act. *See* Chandler Act, ch. 575, § 614, 52 Stat. 931 (1938) (originally codified in 11 U.S.C. § 1014 (1976)) (repealed 1979); SUP. CT. R. BANKR. P. 401. However, the Reform Act includes a more detailed listing of actions stayed by commencement of the case. Furthermore, inclusion of the stay provision in chapter 3 of the new Act makes it applicable to bankruptcy proceedings under all chapters of the act. *See* 11 U.S.C. app. § 103(a) (Supp. II 1978).

68. 11 U.S.C. app. § 362(b) (Supp. II 1978). Other exceptions include certain attempts to recover alimony or support, and certain governmental actions against the debtor.

69. *See, e.g.*, The All Writs Statute, 28 U.S.C. 1651 (1970). Accordingly, when confronted by an action that is excepted from the automatic stay provision, the debtor must petition the court for an injunction, and the court will decide whether the requested stay would be equitable in light of the particular facts of the case, *See* HOUSE REPORT, *supra* note 15, at 342.

70. 11 U.S.C. app. § 1301 (Supp. II 1978).

yielding to the indirect pressures from creditors seeking repayment from the debtor's co-signing friends or relatives.⁷¹ If the co-signer is a guarantor or surety that has guaranteed the debt in the regular course of a guaranty business, however, the stay will not be operative.⁷² Further, the automatic stay of collection actions against the debtor's co-signers is intended to apply only to consumer debts,⁷³ *i.e.*, those incurred primarily for a "personal, household, or family purpose,"⁷⁴ because the co-signer of a business debt is more likely to foresee the possibility of default and eventual creditor pressure.

CONVERSION

The provisions of chapter 13 offer the debtor significant incentives for choosing a periodic repayment plan over other, more drastic forms of relief. There will be occasions, moreover, when an eligible debtor's most appropriate remedy will be converting to a chapter 13 plan from straight bankruptcy under chapter 7⁷⁵ or reorganization under chapter 11.⁷⁶

While creditors cannot file an involuntary chapter 13 case against a debtor,⁷⁷ eligible debtors have the right to convert their involuntary chapter 7 or chapter 11 proceedings into a chapter 13 proceeding.⁷⁸ This right remains unchanged from the former law,⁷⁹ yet because of the previously discussed expansion of chapter 13's advantages, more debtors will use the conversion provisions. The new Act, however, effectuates two changes in conversion practice. The first is a provision allowing the court to convert, after notice and a hearing, a chapter 13 case to a chapter 11 case at the preconfirmation request of any interested party.⁸⁰ This situation—although

71. As noted in HOUSE REPORT, *supra* note 15, at 121, most of these co-signers are not aware of the consequences of their action and have signed merely as a favor to the debtor. Accordingly, the advantage given to creditors, who are in a position to apply moral pressure to the debtor by moving against his or her friends and relatives, was seen as an unfair advantage and disproportionate to the legitimate financial considerations of co-signing.

72. 11 U.S.C. app. § 1301(a)(1) (Supp. II 1978).

73. *Id.* § 1301(a).

74. *Id.* § 101(f). See HOUSE REPORT, *supra* note 15, at 122. The stay of actions against co-signers is not unlimited, however. The stay will be lifted to the extent that the debtor's repayment plan will not pay a portion of the creditor's claim. 11 U.S.C. app. § 1301(c)(2) (Supp. II 1978). The stay also will not apply if the co-debtor received consideration for the claim and thus was an actual debtor. *Id.* § 1301(c)(1). Finally, the stay will be lifted if the continuance of the stay would result in irreparable harm to the creditor. *Id.* § 1301(c)(3). Thus, the creditor could seek to have the stay lifted if it appeared that for some reason the co-debtor soon would be unable to meet his or her obligation should the debtor default. See HOUSE REPORT, *supra* note 15, at 122.

75. 11 U.S.C. app. §§ 701-66 (Supp. II 1978).

76. *Id.* §§ 1101-74.

77. See note 57 *supra*.

78. See 11 U.S.C. app. §§ 706(a), 1112(d) (Supp. II 1978).

79. See Chandler Act, ch. 575, §§ 621-622, 52 Stat. 931 (1938) (originally codified in 11 U.S.C. §§ 1021-1022 (1976)) (repealed 1979).

80. 11 U.S.C. app. § 1307(d) (Supp. II 1978). This provision does not apply if the debtor is a farmer. *Id.* § 1307(e). See *id.* § 101(17), (18) (definitions of farmer and farming operation).

some courts allowed it—should not have arisen under the former Bankruptcy Act, for any business debtor eligible for chapter 11 relief would not have been able to file a chapter 13 petition initially.⁸¹

A second revision of conversion proceedings allows the court, for “cause,”⁸² to dismiss a chapter 13 case or to convert it to a chapter 7 case without the debtor’s consent, as long as there is notice and a hearing.⁸³ The court must decide what is in the best interests of both creditors and the estate.⁸⁴ A potential problem may arise under this new provision. Should the court determine that conversion to a chapter 7 liquidation proceeding would be appropriate, a literal reading of the chapter 13 definition of “property of the estate”⁸⁵ could harm the defendant’s chances for eventual relief. Because the chapter 13 estate includes all property and earnings which the debtor has acquired after commencement of the case, but before its conversion or dismissal,⁸⁶ this after-acquired property must be turned over to a trustee and become available to creditors in the converted chapter 7 case.⁸⁷ Thus, despite the fact that in most cases a debtor already has spent his or her post-petition income on living expenses and payments to the chapter 13 trustee, he or she could be denied a chapter 7 discharge for refusing to obey a court-ordered turnover to these earnings to the chapter 7 trustee.⁸⁸ To avoid this dilemma a debtor should not move to convert an unsuccessful chapter 13 to chapter 7. Instead he or she should attempt to convince the court to dismiss the case and then file an original chapter 7 petition.

DISCHARGE

The scope of the chapter 13 discharge has been expanded by the new Act. Under the old Act, a two-step process was required before a debtor could be

Also, the court will exercise its discretion in granting the conversion and will consider, among other factors, the nature of the debtor’s business. HOUSE REPORT, *supra* note 15, at 428. For definition of the phrase “after notice and a hearing,” see 11 U.S.C. app. § 102(1) (Supp. II 1978).

81. See notes 21-24 and accompanying text *supra*.

82. 11 U.S.C. app. § 1307(c) (Supp. II 1978). Possible causes listed in the section include: unreasonable and prejudicial delay by the debtor, court denial of confirmation of the chapter 13 plan, and material default by the debtor under an existing plan.

83. *Id.* The court may not, however, convert a chapter 13 case to a chapter 7 or 11 case if the debtor is a farmer. *Id.* § 1307(e).

84. *Id.* § 1307(c).

85. *Id.* The section defines estate property as including all of the properties specified in 11 U.S.C. app. § 541 (Supp. II 1978) (the general estate property provision), as well as property acquired after commencement of the case but before its dismissal, conversion, or completion.

86. 11 U.S.C. app. § 1306 (Supp. II 1978).

87. Compare 11 U.S.C. app. § 1306(b) (Supp. II 1978) (the chapter 13 debtor remains in possession of estate property) with 11 U.S.C. app. § 521(3) (Supp. II 1978) (the bankruptcy debtor will surrender to the trustee all estate property).

88. See 11 U.S.C. app. § 727(a)(2)(A) (Supp. II 1978).

discharged from his or her debts.⁸⁹ First, the court would make a determination whether the debtor might be granted a discharge.⁹⁰ At that time, the debtor could have waived the right to discharge.⁹¹ Also, the court would entertain objections to discharge from the creditors.⁹² If the discharge was not granted, the creditors could proceed with their collection efforts. If the discharge was granted, the court proceeded to the second step, which was a determination of the dischargeability of specific debts.⁹³ Under the new Act, this procedure is eliminated and an automatic two-step procedure is substituted. First, the debtor files a plan that provides a schedule whereby the debtor's assets will be used to satisfy all debts included in the periodic repayment plan.⁹⁴ Second, after completion of all payments under an approved plan, the court shall grant a discharge to the debtor of all debts included within the plan⁹⁵ except for certain non-dischargeable debts: alimony, child support, or maintenance,⁹⁶ or certain secured long-term obligations.⁹⁷

Another modification of the discharge provision involves the so-called "hardship" discharge. Under the old Act, the court, after three years from confirmation of the plan, might have granted a discharge, even though the debtor had not completed the payments, where failure to do so was the result of circumstances for which the debtor could not be held accountable.⁹⁸ The new Act provides that the court may grant a discharge *at any*

89. Chandler Act, ch. 575, §§ 14, 17, 52 Stat. 850, 851 (1938) (originally codified in 11 U.S.C. §§ 32, 35 (1976)) (repealed 1979). See generally D. GILL, *PERSONAL BANKRUPTCY AND WAGE EARNER PLANS* § 7.1 (1971).

90. Chandler Act, ch. 575, § 14(a), 52 Stat. 850 (1938) (originally codified in 11 U.S.C. § 32(a) (1976)) (repealed 1979).

91. *Id.*

92. *Id.* § 14(b) (11 U.S.C. § 32(b)(1)).

93. *Id.* Among non-dischargeable debts under the old Act were taxes which became due and owing the United States or any state or subdivision thereof within three years preceding bankruptcy; any property or money obtained by false pretenses or false representations or any property acquired by credit which was obtained in reliance upon a material false statement in writing; debts not properly scheduled in time for proof and allowance; debts created by fraud, misrepresentation, embezzlement, misappropriation, or defalcation while the debtor was acting as an officer in any fiduciary capacity; wages or earnings due an employee for services rendered or earnings retained by the employer; alimony, maintenance, child support, seduction of an unmarried female, breach of promise to marry accompanied by seduction, or criminal conversion; liabilities for wilful or malicious injury to the person or property of another. *Id.* § 17, 52 Stat. 851 (11 U.S.C. § 35).

94. 11 U.S.C. app. § 1322 (Supp. II 1978).

95. *Id.* § 1328(a).

96. *Id.* § 523(a)(5). Alimony and child support are not excepted if they have been assigned to another. *Id.* § 523(a)(5)(A). See also Swann, *Dischargeability of Domestic Obligations in Bankruptcy*, 43 TENN. L. REV. 231 (1976).

97. 11 U.S.C. app. § 1322(b)(5) (Supp. II 1978).

98. Chandler Act, ch. 575, § 661, 52 Stat. 936 (1938), as amended by Act of July 7, 1952, ch. 579, § 52, 66 Stat. 437 (originally codified in 11 U.S.C. § 1061 (1976)) (repealed 1979).

time after confirmation of the plan if the debtor's failure to complete payments under the plan was due to circumstances for which the debtor should not justly be held accountable,⁹⁹ but only if the creditors have already received the same amount they would have under a straight bankruptcy¹⁰⁰ and where modification of the plan is not practicable.¹⁰¹ Debts discharged under this provision are subject to the same exceptions as those under a regular chapter 7 discharge.¹⁰²

The debtor who receives either a regular or hardship discharge under chapter 13 may not file a chapter 7 liquidation for six years after commencement of the chapter 13 proceeding, unless payments under the plan totalled 100 percent of the allowed unsecured claims¹⁰³ or 70 percent of such claims, and the plan was proposed by the debtor in good faith and was the debtor's "best effort."¹⁰⁴ There is no similar six year bar in chapter 13 itself. Thus, a debtor who has received a discharge under chapter 7, or under a chapter 13 composition plan, may file under chapter 13 and receive a discharge under any kind of plan without waiting six years.¹⁰⁵

THE CHAPTER 13 TRUSTEE

Under the new Act, the court may appoint one person to serve as a standing chapter 13 trustee.¹⁰⁶ However, in eighteen designated judicial districts a United States Trustee shall be appointed.¹⁰⁷ The United States Trustee will then appoint a standing trustee who will serve as trustee in the case,¹⁰⁸ or, where no standing trustee is appointed, the United States Trustee

Circumstances beyond the debtor's control would include injury that restricted the debtor's earning ability and, therefore, his or her performance under the wage earner plan. Thomson v. Ford Motor Credit Co., 475 F.2d 1217 (5th Cir. 1973).

99. 11 U.S.C. app. § 1328(b)(1) (Supp. II 1978).

100. *Id.* § 1328(b). The House Judiciary Committee has predicted that this provision will increase the success rate of chapter 13 plans because debtors will have lost the existing "unnatural incentive" to propose precisely a three year plan regardless of their circumstances. Also, courts will be able to grant an early discharge in cases involving truly exceptional hardships. HOUSE REPORT, *supra* note 15, at 125.

101. 11 U.S.C. app. § 1329 (Supp. II 1978). After confirmation, but prior to completion of payments, the plan may be modified to increase or decrease the amount of the payments, to alter the time permitted for the payments, to change the amount to be distributed to a creditor under the plan, or to take account of any payment or claim made outside of the plan.

102. See notes 8 & 9 and accompanying text *supra*.

103. 11 U.S.C. app. § 727(a)(9)(A) (Supp. II 1978).

104. *Id.* § 727(a)(9)(B). The factors which the court should take into account to determine the debtor's "best effort" include the debtor's assets, reasonable expenses, stability of debtor's employment, age of the debtor, and the number of the debtor's dependents. 124 CONG. REC. S 17415 (daily ed. Oct. 6, 1978) (remark of Rep. DeConcini), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 6529.

105. 11 U.S.C. app. § 1328(a) (Supp. II 1978).

106. 11 U.S.C. app. § 1302(d) (Supp. II 1978). See generally, HOUSE REPORT, *supra* note 15, at 101-02.

107. 11 U.S.C. app. § 1501 (Supp. II 1978).

108. *Id.* § 151302.

will serve as trustee in the case.¹⁰⁹ The duties of *all* trustees include accounting for property received into the estate, investigating the financial affairs of the debtor, examining proofs of claims, opposing discharge if advisable, furnishing necessary information on the estate to any party in interest requesting it, and making a final report and accounting to the court.¹¹⁰ In addition to these duties, the chapter 13 trustee must be present and afforded an opportunity to be heard at any hearing concerning the value of property subject to a lien confirmation or modification of the plan, and shall advise the debtor on all non-legal matters relating to the plan.¹¹¹ When the United States Trustee acts as trustee in the case, he or she may be paid no compensation out of the estate, thus providing more available funds for creditors.¹¹²

CONCLUSION

The underlying premise of the Bankruptcy Reform Act appears to be that liquidation under chapter 7 should be used as a last resort and that eligible debtors should instead attempt a chapter 13 rehabilitation plan. There should be a marked increase in the number of chapter 13 cases filed nationally because of the new statute. Practitioners will realize the potential of chapter 13 as an inexpensive, effective means of rehabilitating a qualified debtor because of its liberalized provisions: automatic stays of actions against both debtors and co-debtors, confirmation of plans without unsecured creditors' consent, cram down provisions against secured creditors, avoidance of most chapter 7 and 11 exceptions to discharge, and the availability of a hardship discharge at any time after confirmation.

109. *Id.* § 151302(a).

110. *Id.* § 704(2), (4), (5), (6), (8). *But see* SENATE BILL, *supra* note 34, § 704(8), which would add to the trustee's duties the obligation of interim reports on the condition of the estate.

111. *Id.* § 151302(b).

112. *Id.* § 151326. *See also* Bankruptcy Reform Act of 1978, EXPLANATION (CCH) ¶ 1505 (December, 1978).