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Note: Secured Creditors in Wage Earner Proceedings: Interpreting the Validity of Bankruptcy Rule 13-307(d)

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SECURED CREDITORS IN WAGE EARNER PROCEEDINGS: INTERPRETING THE VALIDITY OF BANKRUPTCY RULE 13-307(d)

I. Introduction

On October 1, 1973 the Supreme Court promulgated rules[1] prescribing the practice and procedure to be followed in cases and proceedings governed by Chapters I-VII and Chapter XIII of the Bankruptcy Act (hereinafter "Act").[2] The procedural changes are extensive, permeating every stage of straight bankruptcy and Chapter XIII Wage Earner proceedings.[3] One of the more important rules is Bankruptcy Rule 13-307(d),[4] which deals with claims of secured creditors in Wage Earner proceedings under Chapter XIII. The rule provides:[5]

> If a secured creditor files a claim, the value of the security interest held by him as collateral for his claim shall be determined by the court. The claim shall be allowed as a secured claim to the extent of the value so determined and as an unsecured claim to the extent it is enforceable for any excess of the claim over such value . . .

Secured creditors have challenged the validity of Rule 13-307(d), claiming that the rule modifies the secured party's substantive right to full recovery of the contract price.[6] Thus, they allege that it is a substantive rule of law and outside the Supreme Court's rulemaking power.[7] Various courts have made conflicting decisions.[8] The resolution of this issue will have significant impact on future creditor-purchaser relations and on the future of Chapter XIII Wage Earner proceedings as a viable alternative to straight bankruptcy. A better understanding of the status of the secured creditor in this area of bankruptcy law requires a discussion of the legislative history be-

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1. Bankruptcy Rules and Official Bankruptcy Forms, 411 U.S. 989 (1973).
2. 11 U.S.C. §§ 1-1200 (1970).
3. *See* text accompanying notes 9-11 *infra*.
4. Bankruptcy Rules, 11 U.S.C. Rule 13-307(d) (Supp. V 1975).
5. *Id.*
6. *In re* McKee, 416 F. Supp. 652, 654 (E.D. Ark. 1976).
7. *Id.* at 653-54.
8. *Compare In re* Moralez, 400 F. Supp. 1352 (N.D. Cal. 1975) *with In re* Wall, 403 F. Supp. 357 (E.D. Ark. 1975). *See also In re* Garcia, 396 F. Supp. 518 (C.D. Cal. 1974).

hind Chapter XIII and the Bankruptcy Rules, and a review of the most recent post-rule cases.

II. Chapter XIII

Congress enacted Chapter XIII of the Act to ameliorate the harsh results and unsatisfactory solutions of a straight bankruptcy.[9] Chapter XIII relief is available to anyone whose principal income is derived from wages, salary or commissions,[10] and who is unable to pay his debts as they mature.[11] It allows a debtor relief to liquidate debts out of future earnings, without requiring a liquidation of assets.[12] Thus, it enables such a wage earning debtor to avoid the stigma and loss of property which accompany a straight bankruptcy discharge.

There are numerous reasons why the Chapter XIII Petition is a highly desirable method of debtor relief for individuals.[13] The debtor will be able to retain the property which constitutes the creditor's security, rather than relinquish all of his non-exempt property to a trustee in Bankruptcy.[14] There must be an allocation of future income among creditors,[15] but the debtor is protected from lawsuits, wage garnishments, and levies of execution by creditors holding non-dischargeable claims.[16] While the Act prohibits a debtor who receives a discharge in straight bankruptcy from receiving another discharge within six years,[17] there is no such prohibition under a Chapter XIII plan.[18] Nevertheless, a conflict arises between the im-

9. H.R. REP. No. 1409, 75th Cong., 1st Sess. 52-55 (1937).

10. 11 U.S.C. § 1006(8) (1970).

11. *Id.* at § 1023.

12. *Id.* at §§ 1001-86.

13. A report to the House of Representatives stated:

> [C]hapter XIII provides a highly desirable method for dealing with the financial difficulties of individuals. It creates an equitable and feasible way for the honest and conscientious debtor to pay off his debts rather than having them discharged in bankruptcy. The power of the court to change the amount and maturity of installment payments without affecting the aggregate amount of such payments makes Chapter XIII particularly applicable to the present day financial problems generated by heavy installment buying.

H.R. REP. No. 193, 86th Cong., 1st Sess. 2 (1959).

14. Property of the bankrupt is collected by the trustee in a straight bankruptcy under the provisions of section 75(a) of the Bankruptcy Act. 11 U.S.C. § 75(a) (1970).

15. Note, *Effectuating the Purpose of Chapter XIII of the Bankruptcy Act*, 22 Maine L. Rev. 401, 403 (1970).

16. 11 U.S.C. §§ 1011, 1014 (1970).

17. *Id.*

18. Perry v. Commerce Loan Co., 383 U.S. 392 (1966).

plementation of these features of Chapter XIII and the wishes of a secured creditor to reclaim his secured property, or realize full periodic payments as specified in his contract with the debtor.

III. Pre-Rule Cases

Prior to the Bankruptcy Rules, courts which considered the role of the secured creditor, often generated conflicting opinions.[19] Differences arose out of the interpretation of section 652, the "dealt with" clause of the Act, whereby every secured creditor whose claim is "dealt with" must consent before a court can accept a Wage Earner Plan.[20] The manner in which courts interpreted this clause determined the rights and status of the secured creditor and often allowed such a creditor to destroy the viability of a Chapter XIII plan.

A. The Strict Interpretation Cases

One line of cases, wherein courts strictly interpreted the "dealt with" clause, basically held that a secured creditor was "dealt with" if his contracts were in any way changed.[21] These decisions prohibited the acceptance of a Chapter XIII plan when there were non-

19. *Compare In re* Pappas, 216 F. Supp. 819 (S.D. Ohio 1962); *In re* Copes, 206 F. Supp. 329 (D. Kans. 1962); *In re* O'Dell, 198 F. Supp. 389 (D. Kan. 1961) *with In re* Pizzolato, 268 F. Supp. 353 (W.D. Ark. 1967); *In re* Wilder, 225 F. Supp. 67 (M.D. Ga. 1963). *See* notes 21 and 25 *infra*.

20. 11 U.S.C. § 1052(1) (1970).

21. *See In re* O'Dell, 198 F. Supp. 389 (D. Kan. 1961). The court in that case held that a Wage Earner Plan must provide full payments to all secured creditors according to the contract terms. In *O'Dell*, the plan provided for a payment of $37 per week to a creditor whose contract called for payment of $38. *Id.* at 390-91.

The court in *In re Copes*, 206 F. Supp. 329 (D. Kan. 1962) rejected a plan which called for payment of $27 per month to a partially secured creditor when the contract required $45 per month. *Id.* at 330.

In *In re Pappas*, 216 F. Supp. 819 (S.D. Ohio 1962), a partially secured creditor held a note for $753 secured by furniture worth $300. *Id.* at 820. The court held that where a secured creditor under the plan would not receive payment sufficient to meet the obligation of the debtor according to the terms of the instrument creating the debt, the acceptance of that secured creditor was necessary for confirmation of the Wage Earner Plan. *Id.* at 822. The case is an example of the failure of most courts to distinguish between a partially secured and a secured creditor.

The District Court for the Eastern District of Arkansas in *In re Rutledge*, 277 F. Supp. 933 (E.D. Ark. 1967), considered the failure of the Bankruptcy Court to provide for payment of arrears within a specific time period as "dealing with" the creditor, since the extension varied the contract from what the parties had agreed on. *Id.* at 934-35. *See also* Terry v. Colonial Stores, 411 F.2d 553 (5th Cir. 1969).

assenting secured creditors.[22] They allowed even a partially secured creditor to obtain full payment under the contract terms by using the strength of his secured creditor status.[23] Apparently, these courts considered the creditor's contract rights to be more important than the formulation of a viable Wage Earner Plan.[24] This restrictive approach severely limited the utility and operation of the Wage Earner procedure.

B. The Less Restrictive Approach

Other courts adopted a more enlightened stance prior to the new rules. They allowed the debtor under the Chapter XIII plan to modify a secured creditor's contract when it was necessary to preserve the plan.[25] Specifically, these courts assumed that it was more equitable to subject the creditor to a slight delay in payment than to destroy a Chapter XIII plan and possibly force a debtor into straight bankruptcy.[26] By construing the phrase "dealt with" as being synonymous with the term "affected," the courts made use of section 607 of the Act,[27] which states that "[a] creditor shall be deemed to be affected by a plan only if his interest shall be materially and adversely affected thereby."[28] The courts interpreted this section to permit confirmation of a plan which modified a secured creditor's payment rights if the objecting creditor's interest was not "materially and adversely affected."[29] Thus, one court applying this approach believed that the court could use its injunctive power to protect a plan which modified to some degree the provisions of an

22. *See In re* Rutledge, 277 F. Supp. 933, 934 (E.D. Ark. 1967); *In re* Pappas, 216 F. Supp. 819, 822 (S.D. Ohio 1962); *In re* Copes, 206 F. Supp. 329, 330 (D. Kan. 1962).

23. *See* 277 F. Supp. at 934-35; 216 F. Supp. at 822; 206 F. Supp. at 330.

24. *See* note 21 *supra.*

25. *See In re* Wilder, 225 F. Supp. 67 (M.D. Ga. 1963). The court in *Wilder* allowed a slight modification of a secured creditor's rights in order to preserve the Wage Earner Plan. The court said that a two month delay did not seriously affect payments, and thus, the plan was not impaired and the creditor's acceptance was not necessary for confirmation. *Id.* at 69.

In *In re Pizzolato,* 268 F. Supp. 353 (W.D. Ark. 1967), the court held that the delay of a baloon payment was not sufficient to upset the entire Wage Earner Plan and possibly force the debtor into straight bankruptcy. *Id.* at 357-58. *See also In re* Teegarden, 330 F. Supp. 1113 (E.D. Ky. 1971).

26. *See In re* Thompson, 475 F.2d 1217, 1219 (5th Cir. 1973).

27. 11 U.S.C. § 1007 (1970).

28. *Id.*

29. *Id.*

installment contract.[30]

The rationale of this line of cases was that a secured creditor was not "dealt with" by the plan unless it either limited the total amount a secured creditor may recover or impaired his security interest.[31] The cases stressed that equitable considerations should control when a creditor is technically, but not substantially, "dealt with."[32] Furthermore, these considerations could dictate that the secured creditor be enjoined from enforcing his security interest if reclamation of the collateral would destroy the Wage Earner Plan.[33]

By enjoining reclamation and by slightly modifying the timing of the contract payments, this line of cases made the Chapter XIII plan a viable device, and also maintained a reasonable position towards the secured creditor. These equitable considerations stressed in the "liberal" cases added another dimension to the judicial interpretations of the statutory provisions of Chapter XIII. Yet, even this line of cases did not make Wage Earner Plans feasible when a plan "affected" a partially secured creditor, who by his veto could destroy the viability of a plan. While the decisions were authority for enjoining reclamation, they still required that an "affected" creditor receive full payment in accordance with the contract.[34] Thus, for a Wage Earner Plan which involved a partially secured creditor to be successful some other solution had to be provided; new Bankruptcy Rule 13-307(d) attempted to provide such a solution.

IV. Chapter XIII Rules

Due to the increasing number of bankruptcy cases filed in federal court each year,[35] and the lack of uniform rules governing procedures under the Act, a commission was established in 1970[36] to make recommendations regarding rules and procedures in bankruptcy

30. *In re* Duncan, 33 F. Supp. 997 (E.D. Va. 1940).

31. *See In re* Thompson, 475 F.2d 1217, 1218 (5th Cir. 1973); In re Teegarden, 330 F. Supp. 1113, 1114 (E.D. Ky. 1971); In re Pizzolato, 268 F. Supp. 353, 355 (W.D. Ark. 1967).

32. *See* 475 F.2d at 1218-19; 330 F. Supp. at 1115; 268 F. Supp. at 356.

33. *See* In re Thompson, 475 F.2d 1217 (5th Cir. 1973). Again, the premise that it is more equitable to subject the creditor to delay than to destroy the plan came into play. *Id.* at 1218-19.

34. *See* notes 19-30 *supra* and accompanying text.

35. *See* Note, *Debtors' Dilemma: Status of the Secured Creditor Under Chapter XIII of the Bankruptcy Act*, 4 U.Cal.D.L. Rev. 277, 278 (1971).

36. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

cases.[37] On July 30, 1973 the Commission sent its report and recommendations to Congress.[38] The Supreme Court, pursuant to enabling legislation,[39] promulgated the new bankruptcy rules in October, 1973.[40] These rules deal with practice and procedure alone, and they may not enlarge, abridge or modify any substantive right.[41] To the extent that practice or procedural provisions of the Act conflict with the rules, the rules supersede the Act[42] and all of the general orders in bankruptcy.[43]

The Chapter XIII rules require the valuation of security interests. The need to codify this area of bankruptcy was imperative since no reported Chapter XIII case ever differentiated between secured and partially secured creditors.[44] Both enjoyed the same rights. Courts often referred to creditors as secured creditors regardless of the value of the security held. As pre-rule cases demonstrated, the courts permitted a partially secured creditor to prevent adoption of a proposed plan by a single dissent.[45] Threatening to exercise his veto power, the partially secured creditor could demand that the plan provide for his payment in full, according to the terms of his contract. This approach, which gave the partially secured creditor much greater control over the debtor's property than his security interest warranted,[46] was inconsistent with the Act's underlying

37. The Rules of Bankruptcy Procedure are the result of the same kind of process that produced the Federal Rules of Civil Procedure, the Federal Rules of Criminal Procedure and other rules of procedure prescribed for the federal judiciary. 403 F. Supp. 357, 359 (E.D. Ark. 1975).

38. H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973).

39. 28 U.S.C. § 2075 (1970).

40. The Rules for general bankruptcy (straight bankruptcy) and Chapter XIII (wage earner proceedings) were published by the Judicial Conference's Advisory Committee on Bankruptcy Rules in March and September 1971, with April 1, 1972 as the deadline for comments. The Rules were approved by the Conference's Committee on Rules of Practice and Procedure in October 1972 and by the Judicial Conference in November 1972. The Rules were approved and promulgated by the Supreme Court on April 24, 1973, and were reported to Congress on that date. The Rules became effective on October 1, 1973. 411 U.S. 989 (1973).

41. *Id.*

42. *Id.*

43. The order of the Supreme Court promulgating the new Rules, 411 U.S. 989 (1973), abrogated the general orders and official forms of bankruptcy that it had previously instituted for the governance of straight bankruptcies and Chapter XIII cases. *Id.* at 991.

44. *See generally* Comment, *The Partially Secured Creditor Under Chapter XIII of the Bankruptcy Act*, 3 Prospectus 285 (1970).

45. *See* notes 19-23 and accompanying text *supra.*

46. A partially secured creditor is a secured creditor who has a security interest in collat-

objectives of fairness and equity. This approach also defeated the specific objective of Chapter XIII—that of providing a means of relief and rehabilitation to the wage earner debtor.[47]

The 1973 Chapter XIII rules allegedly provided a solution to this problem. Rule 13-307(d) provides that the Bankruptcy Judge must value the creditor's collateral to determine the extent to which a creditor might be deemed secured.[48] The Advisory Committee's notes[49] point out that the rule is merely an application of the general bankruptcy requirement that in order to achieve a fair and equitable distribution of the bankrupt's assets, a secured creditor, after receiving full payment of the value of his security, can participate in the general distribution for any amount remaining on his claim.[50]

Under the new rules, any creditor whose claim exceeds the value of his security interest, as outlined by 13-307(d), is said to be partially secured.[51] The partially secured creditor is then considered to have two claims, one secured and the other unsecured.[52] Thus, the creditor should get exactly what he bargained for when he entered into a security agreement; he would be a secured creditor to the extent that he protected himself and an unsecured creditor for the remainder left on the contract.[53]

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eral which is worth less than the debt secured thereby. The partially secured creditor usually has his security interest in rapidly depreciating collateral such as an auto, home furnishings, or appliances which have a limited resale value. *See* 10 COLLIER, BANKRUPTCY 48-49 (14th ed. 1977).

47. H.R. REP. No. 193, 86th Cong., 1st Sess. 2 (1959).

48. Bankruptcy Rule 13-307(d) states:

> If a secured creditor files a claim, the value of the security interest held by him as collateral for his claim shall be determined by the court. The claim shall be allowed as a secured claim to the extent of the value so determined and as an unsecured claim to the extent it is enforceable for any excess of the claim over such value. For the purposes of this subdivision the court may appoint an appraiser in the manner specified by and subject to the limitations of Bankruptcy Rule 606.

11 U.S.C. Rule 13-307(d) (Supp. V 1975).

49. *Id.*

50. 11 U.S.C. § 93(h) (1970).

51. 11 U.S.C. Rule 13-307(d) (Supp. V 1975).

52. Bankruptcy Rule 13-202(c) provides:

> A creditor whose claim has been allowed in part as a secured claim and in part as an unsecured claim shall be entitled to accept or reject a plan in both capacities unless his secured claim is not dealt with by the plan, in which event he shall be entitled to accept or reject only as an unsecured creditor.

11 U.S.C. Rule 13-202(c) (Supp. V 1975).

53. United States Nat'l Bank v. Chase Nat'l Bank, 331 U.S. 28, 34 (1947).

V. Post-Rule Cases

There are few reported cases on the validity of the new bankruptcy rules and those that do exist have reached conflicting results.

The first reported case interpreting the rule was *In re Garcia.*[54] Here a secured creditor of an automobile rejected the Wage Earner Plan and filed a complaint for reclamation of the car and for relief from automatic stay of lien enforcement.[55] The plan provided that secured creditors should have priority over unsecured creditors up to the actual value of their security.[56]

The District Court for the Northern District of California valued the 1973 Chevrolet at $2,850.[57] The debtor owed a total of $4,372 on the contract for the car.[58] In accordance with Rule 13-307(d), the court allowed the claim of G.M.A.C. as a secured creditor in the amount of $2,850, and allowed the remaining amount ($1,522) as an unsecured claim.[59] The court stated that the rationale behind Rule 13-307(d) was common sense since: "[i]f GMAC were to have repossessed the automobile on the date of filing they could have realized $2,850.00 on a resale, and they would have a deficiency as to any excess, for which they would obviously be unsecured."[60] The court said that when contracts are entered into, parties are deemed to know that the Act may override some provisions in the contract.[61]

The court concluded that reclamation should be declined when: (1) equitable considerations including the debtor's good faith favor restraining foreclosure; (2) the injunction against foreclosure is necessary to carry out the plan; and (3) the injunction does not impair the security of the lien.[62] In upholding the Rule, Judge Harry Westover cited pre-rule cases[63] as authority for reaching the result codified by the rule.[64] The court felt that the trend in bankruptcy cases

54. 396 F. Supp. 518 (C.D. Cal. 1974).
55. *Id.* at 519.
56. *Id.*
57. *Id.* at 521.
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.* at 525.
62. *Id.* at 523.
63. *See* note 25 *supra.*
64. 396 F. Supp. at 523. The court also noted that considerations which make it appropriate to restrict the rights of a secured creditor to the economic depreciation of his collateral in a Chapter X case should apply in a Chapter XIII case. *Id.* at 524. The court referred to

is in the direction of restraining secured creditors if necessary to rehabilitate the debtor.[65]

One year later, the District Court for the Northern District of California again interpreted the new bankruptcy rule in *In re Moralez*.[66] The debtors at the time of filing had an automobile which was financed by the Wells Fargo Bank.[67] The agreed balance due was $5,267.[68] The car was valued under Rule 13-307(d) at $3,913. The trustee informed Wells Fargo that he would honor the bank's claim up to $3,913 and that the balance of $1,354 would be considered unsecured.[69] The bank sought an order requiring the trustee to maintain the contract payments until the $5,267 was paid. The Bankruptcy Court granted the bank's motion and found that Rule 13-307(d) constituted a substantive change in the law thus exceeding the Supreme Court's rule making power.[70]

The trustee in bankruptcy appealed, and the district court held that the Rule was invalid[71] since it modified a secured creditor's substantive right to full performance of a secured installment contract.[72] The court concluded that the rule was outside the rule making power granted the Supreme Court under 28 U.S.C. § 2075.[73]

The bankruptcy trustee claimed that, according to the Advisory Committee's Notes to Rule 13-307(d), the Rule is merely an adaptation of section 93(h),[74] which prescribes certain valuation procedures and thus is merely procedural.[75] He argued that the Rule did not

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Hallenbeck v. Penn Mutual Life Ins. Co., 323 F.2d 566, 571 (4th Cir. 1963) as authority for the premise that the parallel structure and common purposes of the Bankruptcy Chapters should not be ignored and that the statutes which relate to the same persons or things or same class may be regarded *in pari materia*.

65. 396 F. Supp. at 523.
66. 400 F. Supp. 1352 (N.D. Cal. 1975).
67. *Id.* at 1354.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* at 1355.
72. *Id.*
73. *Id.*
74. 11 U.S.C. § 93(h) (1970) reads as follows:

> The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors. . . . Such determination shall be under the supervision and control of the court.

75. 400 F. Supp. at 1354.

modify the creditor's right to his security, but only adopted a procedure for valuing the security.[76] Judge Orrick rejected these arguments. He concluded that section 93(h) is inapplicable to Chapter XIII proceedings and thus Rule 13-307(d) does not incorporate the procedural elements of section 93(h).[77] He considered the Rule substantive and outside the Supreme Court's power.[78]

In *In re Wall*,[79] the District Court for the Eastern District of Arkansas also considered this substantive versus procedural issue. In *Wall* a creditor claimed to have a secured debt in the amount of $3,600 for a car.[80] The Bankruptcy Court, pursuant to Rule 13-307(d), valued the car at $2,600 and said that monthly payments under the contract would be reduced to pay the $2,600 over the remaining contract term.[81] The court concluded that the creditor would not be affected by the plan even though it was to receive less than the contract monthly payments.[82]

On appeal, the creditor urged that Rule 13-307(d) abridged a substantive right since it impaired contract rights.[83] Citing one line of pre-rule cases,[84] the creditor contended that a Chapter XIII plan cannot provide for less than full contract monthly payments to secured creditors.[85] The District Court for the Eastern District of Arkansas disagreed.

The court approached the challenge to the Bankruptcy Rule by considering the history of the Rules. Since the Supreme Court adopted the Rules after scrutiny by panels of outstanding experts and review by Congress, the court believed that a strong presumption exists that the Rules neither modified nor abridged any substantive rights.[86] Judge Oren Harris pointed out the additional strong presumption that had the Supreme Court "overstepped the authority delegated by the Congress, such transgression would have

76. *Id.*
77. *Id.* at 1355.
78. *Id.*
79. 403 F. Supp. 357 (E.D. Ark. 1975).
80. *Id.* at 358.
81. *Id.*
82. *Id.*
83. *Id.*
84. *See* text accompanying note 21 *supra.*
85. 403 F. Supp. at 358.
86. *Id.* at 360.

been noted and the offending rule modified or deleted upon review."[87]

The court also cited *HFG Co. v. Pioneer Pub. Co.*,[88] as laying down the following rule of construction to deal with Bankruptcy Rules:[89]

> [t]he rules having been prescribed by the Supreme Court, as rules of procedure under the limitation imposed by Congress that the substantive rights of any litigant should not be altered, it would appear that one who asserts that this rule (or any rule) deals with matters of substantive law rather than procedure carries a heavy burden.[90]

The court also concluded that, absent the Rule, it would have followed the "liberal" pre-rule decisions.[91] Thus, the result required by the Rule would have been reached; the secured creditor would have been enjoined from reclamation of the collateral, provided that (1) the security was not impaired, (2) the injunction was necessary to preserve the plan, and (3) equitable considerations favored the injunction.[92] The court believed that the creditor was not "adversely dealt with" by the plan since reclamation and sale would leave him with the same or greater unsecured debt.[93]

The most recent case dealing with the validity of Rule 13-307(d) is *In re McKee*.[94] The debtor there had a $5,800 balance due on a car contract. Pursuant to Rule 13-307(d) the Bankruptcy Court valued the car at $3,700.[95] The District Court for the Eastern District of Arkansas classified the creditor as a secured creditor to the extent of the value of the collateral ($3,700) and as an unsecured creditor for the balance.[96] The issue raised was whether Rule 13-307(d), "by restricting the secured creditor's right to either full contract payments or repossession of the collateral, falls outside the rulemaking power of the Supreme Court. . . ."[97] The creditor argued that a

87. *Id.*
88. 162 F.2d 536 (7th Cir. 1947).
89. 403 F. Supp. at 359.
90. 162 F.2d 539.
91. 403 F. Supp. at 360. *See* notes 25-33 and accompanying text *supra*.
92. *Id.*
93. *Id.*
94. 416 F. Supp. 652 (E.D. Ark. 1976).
95. *Id.* at 653.
96. *Id.*
97. *Id.* at 653-54.

substantive right was modified.[98] Without much analysis, the district court, citing *Wall*,[99] upheld the validity of the Rule.[100]

VI. Conclusion

The conflicting opinions concerning the rights of secured and partially secured creditors are indicative of the uncertainty which still prevails in many courts regarding the judicial function in Chapter XIII proceedings. There is a balancing problem between the rights of the creditors and the viability of the Wage Earner Plan. The courts must balance three principles: first, impairment of contract rights is the essence of our bankruptcy system;[101] second, the due process clause of the Constitution compels preservation of the secured and partially secured creditors' rights,[102] and thus, courts must guarantee such creditors payment to the value of their security; and third, the courts have an obligation to implement the congressional purpose that Wage Earner Plans should succeed whenever possible.[103]

In balancing these three principles, the courts should implement all Wage Earner Plans which properly preserve a secured and partially secured creditor's interest in his collateral. In granting the creditor the value of his security, the creditor is getting what he bargained for when the contract was made.[104]

Most, if not all, wage earners filing under Chapter XIII have one or more partially secured creditors. By ignoring the value of the security and by relying on strict compliance with the contract terms, courts seem to assume that, but for the Wage Earner Plan,

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98. *Id.* at 654.

99. 403 F. Supp. 357 (E.D. Ark. 1975). *See* text accompanying notes 74-87 *supra*.

100. 416 F. Supp. at 654.

101. Hanover Nat'l Bank v. Moyses, 186 U.S. 181 (1902).

102. U.S. CONST. amend V.

103. The court in *In re Teegarden*, 330 F. Supp. 1113 (E.D. Ky. 1971), discussed the constitutional problem as follows:

> Congress has the power to regulate property rights and has exercised that power in the form of the Bankruptcy Act. The Bankruptcy Act becomes a part of every contract made, whether or not expressly stated in the contract . . . a creditor should not have a veto power over a wage earner's plan unless it can be shown that the plan is violative of due process; that is to say constitutes a taking of property without due process.

Id. at 1115.

104. Collier suggests that if distribution in Chapter XIII is to be in the best interests of all creditors, creditors should expect to receive no more than they would on liquidation. 9 Collier, Bankruptcy § 9.17 (14th ed. 1976).

the contract payment would be forthcoming in the normal course of events.[105] The more realistic view adopted by other courts recognizes that the debtor's financial plight, and not the Wage Earner Plan, renders the creditor's legal right to payment unenforceable.[106] Thus, the rights to the security are the only rights of the secured creditor which could be harmed by the plan, and the economic worth of such rights depends on the value of the security. This is the view embodied by Rule 13-307(d).

Consumer bankruptcy has become a growing social and economic problem in the United States. The reasons for this are not obscure. The expansion and change in the consumer credit field since World War II has been revolutionary. The burgeoning growth of consumer credit has been matched by a corresponding rise in the number of consumer bankruptcies. Advertising has taught consumers that cash is old-fashioned and that bankruptcy need not be a deterrent to incurring a new debt. Thus, in an environment where credit is easily obtained, more consumers will overextend themselves and turn to Wage Earner Plans to salvage their finances.

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.[107] 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. The Chapter XIII Wage Earner Plan is one of the few methods currently available which envisions the payment of past obligations via promises to pay out of future earnings.[108] If the Wage Earner

105. As the court in *Teegarden* said:

> If creditors had an absolute right to receive payments in accordance with the terms of the contract . . . there would be no purpose served by wage earner's plans. If debtors could satisfy their debts according to the terms of the contracts creating them, then they would not need the benefits of a wage earner's plan.

330 F. Supp. 1113, 1115 (E.D. Ky. 1971).

106. *See* note 25 *supra*.

107. *See* King, *Some Thoughts on Article 9 of the Uniform Commercial Code and the Bankruptcy Act*, 72 Com. L. J. 203 (1967).

108. Alternative methods 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 a small loan. Chapter XIII has the advantages of 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).

Plan is to remain a viable alternative to straight bankruptcy, the courts must use Rule 13-307(d) in the spirit and for the purpose for which it was promulgated.

In light of the history of Chapter XIII, any judicial interpretation of Rule 13-307(d) which grants secured and partially secured creditors payment in accordance with contractual terms, regardless of the value of the security, is regressive and alien to the reasoning behind the rule and to the concept of equity which underlies the rehabilitative proceedings of Chapter XIII.

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