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REHABILITATION OF THE INSOLVENT WAGE EARNER UNDER THE BANKRUPTCY ACT: A CHALLENGE TO MINNESOTA

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The eminent English economist, Lasky, has often been quoted as pointing out that “there are statistics, more statistics, and damned lies.” What he probably referred to was not the figures themselves, but their interpretation. How, then, do the lawyers and the citizens of the State of Minnesota want to interpret the latest available statistics involving the rehabilitation device for financially embarrassed wage earners provided by Chapter XIII of the National Bankruptcy Act? These statistics show that in all of the 86 federal districts of the United States, there were 11,549 Chapter XIII cases filed during the fiscal year ending June 30, 1957. Only five such cases were filed throughout the State of Minnesota during that period, regressing from 21 filings in 1956 and 15 in 1955. Is this a measure of the comparative knowledge of the Minnesota lawyer and layman as to the beneficial values offered both the debtor and his creditors under Chapter XIII? These statistics also show a total of 700 filings in the Eighth Circuit during the same period of time, with such neighboring states as Iowa and Missouri contributing a total of 129 and 441 of these Wage Earners’ proceedings respectively. Does that mean that the economic and social conditions in Minnesota are that many times different (5:129 in Iowa and 5:441 in Missouri)? Finally, the wage earners in a half dozen of the states of the deep South filed 8,805 cases under Chapter XIII, as compared to the grand total of 11,549 filings in all of the 86 federal districts. Assuming, of course, that the War Between the States has become an historical fact, do these comparative statistics prove that the wage earners in the South are so different because they predominately preferred to use this device to aid them in the payment of their debts rather than resort to straight bankruptcy? Truly, there are “statistics, more statistics, and damned lies.”

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1. All statistics used in this article come from the monumental and informative "Tables of Bankruptcy Statistics" for the fiscal year ending June 30, 1957, prepared by Hon. Edwin L. Covey, Chief of The Division of Bankruptcy of the Administrative Office of the United States Courts, to whom go the author's deep appreciation and thanks.

2. See note 16 infra for cases defining "insolvent" in the bankruptcy and in the equity sense.

3. Alabama, Tennessee, Georgia, Arkansas, Kentucky, and Virginia.
Are the laws or the socio-economic conditions of the State of Minnesota such as to have no need for the rehabilitation provisions of Chapter XIII?

First, let us consider briefly the what-where-how provisions of the Wage Earners' Plan under Chapter XIII. Historically, the philosophy of these rehabilitation proceedings finds its genesis in the common law principles of extensions and compositions, and first made their appearance in American bankruptcy law as early as 1874, by an amendment of the Bankruptcy Act of 1867. Carried over into the subsequent Bankruptcy Act of 1898, it took the 1930 depression to point up the need to broaden the principles and refine the procedures of rehabilitation and reorganization. Accordingly, the act of 1898 was amended in 1933. Again, times and conditions demonstrated enough inadequacies and shortcomings to cause the complete overhauling of the entire act of 1898 by what is popularly known as the Chandler Act of 1938, which, with comparatively minor amendatory adjustments, is our present bankruptcy statute.

Chapter XIII, which deals with Wage Earners' Plans, is only one of a series of chapters in the act, each designed to help cure rather than bury a financially sick debtor. Each chapter is tailor-made to best serve both the type of debtor and the nature of his assets or liabilities. Chapter XIII is another version of the same theme, adjusted to the special status of a wage earner, setting forth both substantive and procedural provisions which when followed and consummated will result in the financial rehabilitation of the petitioner.

The purpose and function of Wage Earners' Plans is to extend the helping hand of the federal courts to the honest but hard pressed "wage earner" who wants to extricate himself from the accumulation of debts incurred through over extension of credit buying or because of illness or other economic or unforeseen exigencies. Fashioning its provisions so as to extract any possible stigma of bankruptcy, the petitioning wage earner is designated a "debtor" and not a "bankrupt," and is given the opportunity, under

4. For a more detailed discussion of text, practice, procedure, forms, etc., see Nadler, The Law of Debtor Relief (1954), which source was chiefly used for this article, with the gracious consent of the publishers.
6. See, e.g., Commonwealth v. Thompson, 190 F.2d 10, 11 (1st Cir. 1951).
7. E.g., Chapter X (Corporate Reorganizations); Chapter XI (Arrangements); Chapter XII (Real Property Arrangements by Persons Other Than Corporations); Chapter XV (Railroad Adjustments).
to amortize his debts over a period of years. Thus, not only does the debtor immediately put a stop to never-ending creditor dunning, but upon successful consummation of the plan he has conserved his morale and self-respect, saying nothing of some of the legal benefits hereinafter noted. The relief thus provided is predicated upon the proposition that the future earnings of a debtor are made available for the payment or composition of his unsecured debts, and, if the several secured creditors are so willing, for the installment payment or composition of each claim. The only secured creditors who cannot participate in these proceedings are mortgagees of real property or of chattels real belonging to the wage earner.

The "wage earner" who may voluntarily invoke the benefits of Chapter XIII is expressly limited to an individual or natural person who owes at least one debt and who works for wages, salary, or hire at a rate of compensation which does not exceed $5,000 per year when added to his other income. Although "wage earner" as defined in Chapter XIII differs from the "wage earner" defined in other sections of the act, the general substantive bankruptcy law relating to wage earners is similarly applicable to that of the wage earner of Chapter XIII. In addition to the definitive character of a

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9. Only in that way can an unwilling minority in number and amount of his unsecured creditors be compelled to accept the wage earner’s plan of extension or composition. See Nadler, The Law of Debtor Relief § 560 (1954) and numerous cases there cited.

11. Id. at § 930, 11 U.S.C. at § 106.
12. No involuntary proceedings under Chapter XIII are permitted. See, e.g., In re Edwards, 73 F. Supp. 310 (S.D. Cal. 1941); Miller v. Woolley, 141 F.2d 837 (9th Cir. 1944). Note, however, that an involuntary petition in straight bankruptcy against a "wage earner" is prohibited where the wage earner's compensation does not exceed $1,500 a year. See 66 Stat. 420, 11 U.S.C. § 1(32) (1932). Thus, a wage earner whose compensation exceeds $1,500 a year may be subject to involuntary proceedings in straight bankruptcy, but cannot be forced into Chapter XIII proceedings involuntarily. See 52 Stat. 845 (1938), 11 U.S.C. § 22(b) (1952).
14. 64 Stat. 1134 (1950), 11 U.S.C. § 1006(8) (1952). It may be well to note that at the recent meeting of the National Bankruptcy Conference there was discussed the advisability of amending the present provision of Chapter XIII that limits an otherwise eligible wage earner to a rate of compensation which does not exceed $5,000 per year. The thinking there was that the total amount of $5,000 is unrealistic. Rather than manipulate with specific figures for example, increase the limit to $10,000, it would see more stabilizing to eliminate the limitation of amount altogether and make Chapter XIII available to any debtor who "works for wages, salary, or hire." There is much substantive law interpretative of who "works for wages, or hire" and that should be a sufficient definition of eligibility.
15. For detailed discussion, see Nadler, The Law of Debtor Relief § 397 (Determinative Factors); § 398 (Natural Person, Partnership, Corporation and Wage Earner); § 399 (Contractual Capacity of Wage Earner); § 400 (Infants; Married Woman; Insane Persons; Aliens) (1954).
Chapter XIII petitioner, the other basic requirement is that the wage earner be insolvent in either the bankruptcy or the equity sense of the word. In other words, in order for the wage earner to be an eligible petitioner, his liabilities must exceed his assets or he must be unable to satisfy his debts as they mature.

The initiation of a Chapter XIII proceeding is, generally speaking, similar to the filing of a voluntary petition in straight bankruptcy, including such matters as venue, jurisdiction, filing and contents of petition, schedules, statement of affairs, examination of the debtor, meeting of creditors, duties of administrative officers, and so forth. Where there are any variations or departures, Chapter XIII provisions relating thereto must, of course, take precedence and must be followed. Thus, for example, Chapter XIII contemplates two possible situations: (1) where no straight bankruptcy proceedings are pending, or (2) where there is still pending a straight bankruptcy, voluntary or involuntary. In the first situation, which most frequently occurs, the wage earner files an “original” petition, the form for which has been promulgated by the Supreme Court. In the second situation, the petition is called a “converter,” whose contents are the same as those of an “original” petition except that it must set forth all identifying data relating to the pending bankruptcy proceeding.

Where the “original” petition should be filed is determined by the same jurisdictional factors as in straight bankruptcy. In other words, a wage earner must be a resident or must be domiciled within the territorial limits of the judicial district “for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction.” It should be noted that since the residence and the domicile of the wage earner may be located in different judicial districts, he is given the choice of filing his original petition in either district. Where straight bankruptcy proceedings are pending, it goes without saying that the “converter” petition must be filed in the same court in which the bankruptcy proceedings are pending. Although there seems to be no question that the “original” petition must be filed with the clerk of the appropriate court, there is sound argument for the procedure followed in some jurisdictions

permitting the wage earner to file his "converter" petition directly with the referee who has been administering the pending bankruptcy case. Obviously, the "converter" petition will be deemed to have been properly filed if filed with the clerk of the court.

It must be emphasized that in addition to the traditional three copies of the petition, attached schedules and statement of affairs, the wage earner must also file a written statement of his executory contracts. The court is expressly endowed with jurisdiction to permit rejection of the executory contracts of the wage earner. Here is one of the therapeutic provisions of this rehabilitation device. Thus, the debt-ridden wage earner is given the opportunity to relieve himself of all burdensome executory contracts and thereby make possible the consummation of a plan of installment payment that is within his financial ability to perform. Not only are real estate leases included but also all types of installment contract purchases of autos, television sets, radios, jewelry, and so forth. Where such an executory contract is rejected and the creditor can prove damages, he is an "affected" creditor and will share proratably with the other general creditors on the basis of what the court shall determine to be reasonable damages. Note, however, that the damages resulting from a rejected lease on real estate is specifically limited "to an amount not to exceed the rent, without acceleration, reserved by such lease for the year next succeeding the date of the surrender of the premises to the landlord or the date of re-entry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid accrued rent, without acceleration, up to the date of surrender or re-entry..."

To further lighten the wage earner's burden, the required filing fee is only $15.00 for an "original" proceeding instead of the $45.00 that must be paid in a straight bankruptcy. Obviously, no filing fee need be paid where the petition is a "converter" if a filing fee has already been paid in the prior bankruptcy proceeding. It should be noted that the filing fee must accompany the petition but where the wage earner does not have the cash at that time, the court is empowered to arrange for installment payments. Pauper petitions are no longer acceptable. In addition to these filing fees, and regardless of whether the petition is an "original" or a "con-

19. Forms for each of these have been promulgated by the Supreme Court and must be substantially followed.
verter," Chapter XIII provides for the following additional costs and fees that must subsequently be paid out of the estate: (1) additional costs and expenses of the referee, (2) a five per cent commission to the trustee, computed upon and payable out of the payments actually made by or for the wage earner under his plan, and (3) a reasonable fee to the attorney for the wage earner for services actually rendered to the debtor in connection with the proceedings. Where these proceedings are a conversion from a prior pending straight bankruptcy proceeding, such of the costs, expenses and fees must be paid that have not been previously paid.23 It has been indicated that the Judicial Council and the Administrative Office of the United States Courts are giving current attention to the reduction of these costs.

The practice and procedure under Chapter XIII, after the initiation of the proceedings, is much the same as in other rehabilitation proceedings24 in that the proceedings are referred to the referee who carries on from there by (1) setting the date of the meeting of creditors, (2) sending out the not-less-than-10-days notice to creditors and all parties in interest, (3) conducting the meeting of creditors, including the allowance of claims, examination of the wage earner and consideration of the wage earner's plan or arrangement. Acceptance must be by not less than the statutory majority in number and amount of those unsecured creditors whose claims have been proved, filed, and allowed at the creditors' meeting. It should be emphasized that only unsecured creditors have the right of this voting franchise and then only if their respective claims have been filed and allowed at the time the vote is taken. Upon acceptance the referee is empowered to confirm the plan provided that he is satisfied that (a) the debtor has complied with the provisions of the chapter, (b) it is for the best interests of the creditors, (c) it is fair, equitable and feasible, (d) the debtor has done nothing which would bar him from a discharge if these were straight bankruptcy proceedings, and, finally, (e) the proposal and acceptance are in good faith and have not been secured by forbidden means.25 Here, again, is a benefit made available to the wage earner that he does not have under the common law. Under Chapter XIII he does not need the acceptance by all his creditors of his plan of either composition or extension. On the other hand, any one creditor can

24. See Nadler, The Law of Debtor Relief (1954) for detailed presentation of rehabilitation proceedings under Chapters X, XI and XII, as well as XIII.
prevent the confirmation of the plan if he can establish that the wage earner is chargeable with the commission of any of the seven grounds listed in the Bankruptcy Act justifying his discharge, or if he can establish that the wage earner has made some private deal with one or more of his unsecured creditors.

The plan that the wage earner may offer his unsecured creditors is allowed great flexibility by Chapter XIII. Some of the provisions are mandatory and some optional. Always to be remembered is the fact that only the future earnings of the wage earner can be made the basis of these proceedings and that they are primarily aimed at an adjustment of unsecured creditors. Secured creditors, however, may or may not be included in the plan. While unsecured creditors must all be treated alike, secured creditors may be treated separately, each upon separate terms. By reason of the fact that the Chapter XIII court is endowed with exclusive and paramount jurisdiction of the wage earner "and his property, wherever located, and of his earnings and wages during the period of consummation of the plan," the court has jurisdiction of secured creditors insofar as the wage earner's property or future wages may be involved. Further, the court is empowered to permit the wage earner to modify his plan before or after confirmation, if satisfied that the interests of all concerned would thus best be served.

When the plan is confirmed, its provisions are binding upon the debtor insofar as his future earnings are concerned, and upon all his unsecured creditors who were listed in the bankruptcy schedules. This includes not only the creditors whose claims have been filed and allowed and have accepted the plan, but also binds those who have not filed or proved their claims or otherwise participated in the proceedings. Secured creditors are not prevented from looking to their securities, but only to the extent of the balances, with interest, due each of them. Nor may a secured creditor do anything concerning the debtor's wages or earnings that will interfere with the operation of the plan. To implement the jurisdiction of the court, it has the power of injunction, and referees generally issue a temporary injunction at the time of the commencement of the proceedings as a matter of form. Should the plan be successfully consummated, it has the same effect as a discharge in straight bankruptcy. Even where the wage earner, through no chargeable fault

28. E.g., City Nat'l Bank and Trust Co. v. Oliver, 230 F.2d 686 (10th Cir. 1956) (where an unrecorded chattel mortgage was invalidated).
of his own, has been unable to successfully consummate his plan within three years, upon good cause shown the court may nonetheless grant the wage earner his discharge. Where, on the other hand, the wage earner fails to carry out the terms of the plan, the court has broad discretionary powers to dismiss the proceedings completely or to adjudge the wage earner a bankrupt. Obviously, if these proceedings were originated by a "converter" petition, the court may reconvert back to the original bankruptcy proceedings.

Furthermore, another important variation from straight bankruptcy procedure relates to the trustee who is selected by the court rather than by the creditors, and who becomes, in effect, an official trustee. The court usually appoints the same person, who acts in substantially all administrative capacities, and receives an unvariable percentage of the funds he administers as his compensation. In actual practice, the trustee is virtually the right hand of the referee in seeing that the debtor follows the plan and that the creditors receive dividends.

Finally to be noted is that Chapter XIII expressly incorporates all those provisions of straight bankruptcy that "are not inconsistent or in conflict with [its] provisions...." Within these restrictions, the general substantive law of bankruptcy is applicable. Those provisions that are inconsistent or in conflict with straight bankruptcy make Chapter XIII the appropriate vehicle for the relief of the honest but harassed wage earner. Thus, the Chapter XIII court not only has "exclusive jurisdiction of the debtor and his property, wherever located" but this jurisdiction is expressly extended to include "his [future] earnings and wages during the period of consummation of the plan." Furthermore, the court is empowered to grant the debtor a discharge not only "upon compliance by the debtor with the provisions of the plan and completion of all payments to be made thereunder," but also, in its discretion, may grant the discharge "if at the expiration of three years after the confirmation of a plan the debtor has not completed his payments hereunder... upon the application of the debtor and after hearing upon notice, if satisfied that the failure of the debtor to complete his payments was due to circumstances for which he could

32. For detailed discussion, see Nadler, The Law of Debtor Relief 497-99 (1954).
34. City Nat'l Bank and Trust Co. v. Oliver, 230 F.2d 686 (10th Cir. 1956); In re Lancaster, 38 F. Supp. 318 (W.D. Mo. 1941).
Accordingly, the improvident and the unfortunate, as well as the wage earner who cannot say "no" to modern pressure-selling and free and easy credit, is given three years to amortize and pay his debts under the protection and guidance of the court. Rigidity of performance of the original or confirmed plan or arrangement is relieved by the provision authorizing the court to allow amendments after as well as before confirmation, decreasing or increasing the required installment payments "where it shall be made to appear, after hearing upon such notice as the court may designate, that the circumstances of the debtor so warrant or require." Furthermore, the debtor's executory contracts, may be rejected.

In addition to the economic benefits thus made available to the honest debtor, the spiritual and the social values of his rehabilitation must not be overlooked. "A debtor is not congenitally dishonest. He prefers to maintain his dignity and retain his self-respect. He would rather pay his honest debts if permitted within his financial limitations. He may have been weak or thoughtless or improvident but if given another chance he could and would right himself."

That this belief of Congress as the raison d'être for the enactment of Chapter XIII has justified itself is demonstrated by the fact that in the fiscal year ending June 30, 1956, in the Chapter XIII cases successfully concluded, $3,047,933 was paid out to creditors with claims totaling $3,098,289. Had these Chapter XIII cases been filed as straight bankruptcies, they would undoubtedly have been no-assets cases in which the secured creditors would have had to repossess their security and unsecured creditors would have received nothing.

Minnesota is not the only state which has failed to fully avail itself of the benefits of Chapter XIII. As of June 30, 1957, out of a total of 73,761 straight bankruptcies filed in all of the 86 Federal districts, 59,053 cases were by employees and 4,564 were by those "not in business," with more than 86% of them either no-asset cases or nominal asset cases. Of these "employee-not-in-business" cases only 11,549 were filed under Chapter XIII during the fiscal year ending June 30, 1957.

Why, then, were there so comparatively few cases filed under Chapter XIII not only in Minnesota but also throughout the nation?

A more or less cursory investigation could reasonably explain the causes as being (1) state garnishment and exemption statutes that greatly favor the wage earner, and (2) lack of knowledge on the part of attorneys, employers, credit associations and, particularly, eligible wage earners, of the true nature and beneficial features of Chapter XIII.

Minnesota, as well as its sister states, has consistently deemed it sound public policy to protect and to prefer the wage earner. Although Minnesota had been somewhat less paternal towards its wage earners than such states as Florida, the 1955 legislature liberalized the wage earners' exemptions from garnishment. The exemption now is fifty per cent of the net wages which would be paid at the end of the pay period during which the garnishment is served, with a maximum exemption of $75.00 per week. This is an improvement over the earlier law which provided a fixed exemption of up to $100.00 per month and did not prohibit taking the entire non-exempt amount out of one paycheck. The present law assures the wage earner of receiving a paycheck for at least half his earnings every pay period. Further, the percentage basis allows a desirable flexibility not found in the earlier statutes.

However, since the referee in a wage earner proceeding can order installment payments of an amount within the paying ability of the debtor, such payments may be lower than the garnishment statute grants to creditors. Obviously, the garnishment laws of Minnesota should be an incentive rather than a deterrent to the harassed wage earner to take advantage of a Chapter XIII proceeding. Moreover, where the wage earner finds himself enmeshed in usurious types of debts, a Chapter XIII proceeding makes available to him a further special relief. Not only is the referee empowered to suspend interest charges on all claims as of the date of the filing of the petition, but he is also mandated to “require proof from each creditor filing a claim that such claim is free from usury as defined by the laws of the place where the debt was contracted.”

41. For detailed discussion, with selected cases and practice and procedure, relating to the general subject of “exemptions,” see Nadler, Creditor and Debtor Relations 110-20 (1956).
42. Fla. Stat. Ann. § 222.11 (1943) provides: “No writ of attachment or garnishment or other process shall issue from any of the courts of this state to attach or delay the payment of any money or other thing due to any person who is the head of a family residing in this state, when the money or other thing is due for personal labor or services of such person.”
44. Hon. E. P. Johnston, Referee in Bankruptcy, Macon, Georgia. “The average payments may well be about $15 per month although I can recall payments which have ranged from as low as $5 a month up to as high as $150 a month.”
Nor should lack of knowledge on the part of attorneys, employers and eligible wage earners of the beneficial factors of Chapter XIII form an insurmountable barrier. In other jurisdictions, lawyers have found this area of law financially fruitful as well as socially satisfying. The procedures under Chapter XIII lend themselves to the following comparatively simple systemization: (1) a form of questionnaire filled out by the debtor setting forth such vital statistics as total income from all sources including present and reasonably anticipated wages; family status including description, and number and age of dependents; amount of rent, food, utilities, and other current and necessary expenses; as well as the amounts due and due dates of several secured creditors, (2) a simple petition with accompanying schedules, (3) statement of affairs, and, usually (4) one short appearance in court. Employers, when briefed on the purpose and procedure, have gladly cooperated knowing that an employee with a clear mind is a business asset.

Last, but not least, Minnesota wage earners are no different than wage earners the country over who have a real desire to pay their debts even at necessary sacrifices in order to retain their self respect and moral standing in the community. Undoubtedly many wage earners choose straight bankruptcy only because they are not familiar with the beneficial provisions of Chapter XIII. On the other hand, even if the debtor is bankruptcy-minded, he may have obtained a discharge in a prior bankruptcy proceeding less than six years before, so that a present bankruptcy would leave him with his present debts undischarged. Again, it may be that in the course of obtaining credit, he may have given a written financial statement, the correctness of which may be difficult or impossible for him to sustain, so that he may be barred from a discharge in straight bankruptcy. So, too, his thoughtful attorney, to whom he comes with his financial problems, may conclude that even though his client could take bankruptcy and get his discharge, the next six years are not too certain and may bring financial straits where a future discharge will be much more valuable. He would be servicing his client more effectually by now advising a Chapter XIII, thus leaving the more drastic remedy of straight bankruptcy available, if it becomes necessary, for the ensuing years.

All in all, here is an area of law where the impact of social conditions is as important as the economic problems and should, therefore, challenge the alerted attorney to broaden his interests by serving also as a social engineer, to the material and spiritual benefit of his fellow beings.