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FREQUENCY OF RELIEF UNDER THE BANKRUPTCY ACT—THE SIX YEAR RULE OF SECTION 14(c) (5)

I. INTRODUCTION

A debtor in financial difficulty has a choice of relief under the Bankruptcy Act. He may seek relief in a straight bankruptcy proceeding under chapters I through VII of the Act.¹ However, in many cases, straight bankruptcy would provide an unsatisfactory solution to the insolvency involved, because the creditors would receive only a fraction of their claims, and because the debtor would receive very little instruction as to how to live within his means.² However, a debtor choosing to seek relief under chapters XI and XIII of the Act is budgeted under the supervision of the court, and his use of credit is curtailed.³ He is allowed to continue his work or business and the creditors are paid from that part of his earnings which is not budgeted to his use. This will ordinarily enable the debtor to learn to live within his means, and it enables the creditors to recover a greater percentage of their claims than they would recover in straight bankruptcy.⁴

One of the problems under the Bankruptcy Act is determining how often a debtor may seek relief under the various provisions of the Act. A debtor's estate may be liquidated in straight bankruptcy as often as the debtor or his creditors duly invoke the bankruptcy court's jurisdiction. However, relief in the form of a discharge of the debtor's obligations in straight bankruptcy, or in the form of a chapter XI or XIII proceeding, may be barred by the recency of prior relief sought under the Act.

In order to receive a discharge from his debts in straight bankruptcy, the debtor must fulfill the requirements of section 14 of the Act.⁵ Section 14(c) (5) provides that the debtor cannot receive a discharge if in a proceeding under the Act commenced within six years prior to the date of the filing of the petition in bankruptcy the debtor has been granted a discharge, or has received confirmation of a composition.⁶ To get relief under chapter XI or chapter XIII, the debtor

1. Bankruptcy Act §§ 1-72, 11 U.S.C. §§ 1-112 (1964).

2. Allgood, *Operation of the Wage Earner's Plan in the Northern District of Alabama*, 14 *RUTGERS L. REV.* 578 (1960); Chandler, *The Wage Earner's Plan: Its Purpose*, 15 *VAND. L. REV.* 173 (1961); Nadler, *Rehabilitation of the Insolvent Wage Earner Under the Bankruptcy Act: A Challenge to Minnesota*, 42 *MINN. L. REV.* 377 (1958).

3. Bankruptcy Act §§ 301-99, 52 Stat. 905-916 (1938), 11 U.S.C. §§ 701-99 (1964); Bankruptcy Act §§ 601-86, 52 Stat. 930-38 (1938), 11 U.S.C. §§ 1001-86 (1964).

4. *Supra* note 2.

5. Bankruptcy Act § 14, 74 Stat. 408 (1960), 11 U.S.C. § 32 (1964).

6. "The court shall grant the discharge unless satisfied that the bankrupt has . . . (5) in a proceeding under this Act commenced within six years prior to the date of the filing of the petition in bankruptcy had been granted a discharge, or had a composition or an arrangement by way of composition or a wage earner's plan by way of composition confirmed under this Act. . . ." Bankruptcy Act § 14(c) (5), 74 Stat. 408(c) (5) (1960), 11 U.S.C. § 32(c) (5) (1964).

must receive confirmation of his plan for payment of debts from the bankruptcy court.⁷ In order to receive this confirmation, the debtor must comply with the requirements of section 366 of chapter XI, or with the requirements of section 656 of chapter XIII.⁸ Both sections provide that before a plan can be confirmed, the court must be satisfied that the debtor "shall not have been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of the bankrupt."⁹ This language incorporates section 14(c)(5) into chapters XI and XIII.¹⁰ The problem is to determine the relationship between chapters XI and XIII, and section 14(c)(5).

II. DEFINING THE PROBLEM

Chapters XI and XIII each provide two plans for the payment of creditors. Under either chapter, the debtor may choose a plan of composition or a plan of extension. Under a composition plan, the debtor can be discharged from his obligations for less than full payment; under an extension plan, he will receive additional time within which to pay his debts in full. In applying section 14(c)(5), the courts have recognized distinctions between chapter XI plans and chapter XIII plans, and between plans of extension and plans of composition. In order to study the application of section 14(c)(5), it is necessary to study its application in connection with five basic types of relief: Chapter XI plans of composition and extension; chapter XIII plans of composition and extension; and discharges in straight bankruptcy. The problem is to determine the effect of the five types of relief upon a subsequent proceeding which seeks any one of the five types of relief. In order to fully study this problem it is necessary to look at twenty-five situations, for a debtor may receive relief of any one of the five types, and then seek subsequent relief of any one of the five types. However, study of all twenty-five situations would be repetitious, because the courts treat many of them similarly.

Courts have treated a confirmation of a composition under either chapter XI or XIII as the equivalent of a discharge in straight bankruptcy, because under each the debtor is allowed to escape his obligations for less than full payment.¹¹

7. Bankruptcy Act § 362, 52 Stat. 911 (1938), 11 U.S.C. § 762 (1964); Bankruptcy Act § 652, 52 Stat. 931 (1938), 11 U.S.C. § 1051 (1964).

8. Bankruptcy Act § 366, 66 Stat. 433 (1952), as amended, 11 U.S.C. § 766 (1964); Bankruptcy Act § 656, 66 Stat. 437 (1952), as amended, 11 U.S.C. § 1056 (1964).

9. "The court shall confirm a plan if satisfied that— . . . (3) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of the bankrupt. . . ." Statute cited, *supra* note 8.

10. Bankruptcy Act § 14(c)(5), *supra* note 6.

11. *Perry v. Commerce Loan Co.*, 383 U.S. 392, 403 (1966); *In re Jensen*, 200 F.2d 58 (7th Cir. 1952), *cert. denied*, 345 U.S. 926 (1953); *In re Edwards*, 73 F.Supp. 312, 315 (S.D. Cal. 1942); *In re Weintraub*, 240 Fed. 552, 556 (E.D.N.C. 1917); *In re Comstock*, 154 Fed. 747, 748 (D. R.I. 1907); *But see In re Goldberg*, 53 F.2d 454 (1931). For some textual material see 8 COLLIER, BANKRUPTCY, ¶ 2.20, at 103 (14th ed. 1963); Kennedy, *Hospitality For Repeaters Under the Bankruptcy Act*, 68 COMM. L. J. 117, 118-20 (1965).

The courts have also found that relief under a chapter XI extension plan will have the same effect upon subsequent proceedings as relief in the form of a chapter XIII extension plan.¹² However, the two types of extension plans will not be affected in the same way by prior relief.¹³ While the effects of the two types of extension plan as prior relief can be equated, their effects as subsequent relief cannot be equated. Applying the mentioned equivalencies, the twenty-five situations are reduced to four: A straight bankruptcy discharge or a composition plan followed by a straight bankruptcy discharge or a composition plan; a chapter XI or chapter XIII extension followed by any type of relief under the Act; a straight bankruptcy discharge or a composition plan followed by a chapter XIII extension; and a straight bankruptcy discharge or a composition plan followed by a chapter XI extension. These four situations will be discussed in order.

III. FOUR QUESTIONS

A) What is the effect of a discharge in straight bankruptcy or of a chapter XI or chapter XIII composition plan upon a subsequent discharge in straight bankruptcy, or upon subsequent chapter XI or XIII composition plans?

As previously mentioned, courts treat the confirmation of a plan of composition as the equivalent of a discharge in straight bankruptcy.¹⁴ The courts have concluded that under a composition, as under a discharge in straight bankruptcy, the debtor escapes from his debts for less than full payment, and therefore, they have held that both are subject to the six-year rule of section 14(c)(5).¹⁵ For this reason, a debtor cannot receive a discharge in straight bankruptcy or a confirmation of a plan of composition, if, in a proceeding commenced within the previous six years, he has received a discharge in straight bankruptcy or a confirmation of a plan of composition.

B) What is the effect of a chapter XI or chapter XIII extension plan upon subsequent bankruptcy proceedings of all kinds?

The confirmation of plans of extension is not specifically set out in section 14(c)(5) as a bar to subsequent discharges or proceedings under the Act.¹⁶ However, section 14(c)(5) does provide that the granting of a discharge shall be barred by discharges granted in proceedings commenced within the previous six years. So the question becomes whether the confirmation of a plan of extension operates as a discharge. Confirmation of a chapter XIII plan does not operate as a discharge, and should not bar any subsequent discharges or proceedings under the Act.¹⁷ However, confirmation of a chapter XI plan does provide a discharge,¹⁸

12. *In re Jensen*, *supra* note 11; *In re Verlin*, 148 F. Supp. 661 (E.D.N.Y. 1951), *aff'd sub nom.*, *Fishman v. Verlin* 225 F.2d 58 (7th Cir. 1955); *Kennedy*, *supra* note 11 at 118-19.

13. *Perry v. Commerce Loan Co.*, *supra* note 11, at 403.

14. Cases cited note 11 *supra*.

15. *Ibid.*; Bankruptcy Act § 14(c)(5), *supra* note 6.

16. Bankruptcy Act § 14(c)(5), *supra* note 6.

17. Bankruptcy Act § 660, 66 Stat. 437 (1952), 11 U.S.C. § 1060 (1964), and Bankruptcy Act § 661, 66 Stat. 437 (1952), 11 U.S.C. § 1061 (1964), provide that the debtor shall be discharged only after he has either successfully completed his

and under a literal reading of section 14(c)(5), should bar subsequent proceedings to the same extent as a discharge in straight bankruptcy. Nevertheless, courts, basing their holdings upon the difference between composition plans and extension plans, have generally declined to regard a confirmed chapter XI plan of extension as a basis for denying any subsequent proceedings within six years.¹⁹ A composition plan provides the same escape for less than full payment as does a discharge in straight bankruptcy, but an extension provides no such escape because the debts will eventually be paid in full. The courts have concluded that even though confirmation of a chapter XI plan of extension provides a technical discharge, there is in fact no need for a discharge, and therefore the confirmation of a plan of extension under chapter XI should not provide such a discharge as to bar subsequent proceedings under the Act. This view may be affected by the dictum in *Perry v. Commerce Loan Co.*²⁰ There, the Supreme Court emphasizes that its "construction of the Act does not preclude application of section 14(c)(5) to confirmations of general arrangements under chapter XI. . . ."²¹ This may be interpreted to mean that the discharge provided by the confirmation of a chapter XI extension will be treated as a discharge in straight bankruptcy. The more reasonable interpretation would be only that the confirmation of a chapter XI plan of extension may be subject to the six-year rule of section 14(c)(5), and not that the plan once confirmed should bar subsequent proceedings.

Since confirmation of a plan of extension is not generally regarded as the equivalent of a discharge in straight bankruptcy, the question arises whether a

plan or failed to complete it because of circumstances beyond his control. There is no discharge when the plan is confirmed. Therefore, the confirmation of a chapter XIII plan should not bar any subsequent proceedings. One recent case reached this result by a very circuitous route. In *Perry v. Commerce Loan Co.*, *supra* note 11, the Supreme Court held that confirmation of a Chapter XIII extension plan is not barred under section 14(c)(5) by a prior discharge in straight bankruptcy. In *Barnes v. Maley*, 360 F.2d 922 (7th Cir. 1966), the petitioner sought a discharge in straight bankruptcy. The referee denied the discharge upon the ground that it was barred under section 14(c)(5) by a prior discharge in relation to a chapter XIII extension plan commenced within six years of the date of the filing of the petition in bankruptcy. The district court upheld the referee's decision. The court of appeals reversed, holding by analogy to *Perry v. Commerce Loan Co.* that the discharge of a bankrupt in straight bankruptcy is not barred by a discharge in relation to a chapter XIII plan of extension commenced within six years prior to the date of the filing of the petition in bankruptcy. It is hard to see how the court found any analogy between the problem which it confronted and the problem which was confronted by the Court in *Perry*. The court could have reached the same result by relying upon *In re Thompson*, 51 F. Supp. 12 (W.D. Vir. 1943). There the court concluded that the language of section 14(c)(5) indicates that discharge in relation to a plan of extension should not bar a subsequent discharge in straight bankruptcy. The court concluded that the legislative history of section 14(c)(5) clearly indicated that Congress intended to distinguish between plans of extension and plans of composition, and that a plan of extension should not bar a subsequent discharge in straight bankruptcy.

18. Bankruptcy Act § 371, 52 Stat. 912 (1938), 11 U.S.C. § 771 (1964).

19. *Barnes v. Maley*, *supra* note 17; cases cited note 12 *supra*. *In re Thompson*, *supra* note 17.

20. 383 U.S. 392 (1966).

21. *Id.* at 402.

debtor can seek relief under the Act before he has completed a plan of extension which has previously been confirmed. *In re Webb* indicates that he may not do so.²² There the debtor secured confirmation of a chapter XIII extension plan; but, before completing his plan, he sought confirmation of another chapter XIII extension plan. The referee and the district court withheld confirmation of the second extension on the grounds that the court has the power to prevent abuse of the Act and that "successive use of chapter XIII proceedings where one such proceeding is already under the control of the court would constitute a clear abuse of the Act."²³ Courts will not readily allow relief under the Act when the debtor has not completed a prior plan under the Act.

There is one additional problem relating to the effects of an extension plan upon subsequent proceedings under the Act. As mentioned, confirmation of a chapter XIII extension does not provide a discharge.²⁴ The discharge is granted under two alternate provisions of chapter XIII. If the debtor complies with his plan and completes his payments, then he will be discharged from his obligations under section 660,²⁵ which will have no effect upon subsequent proceedings. If the debtor is unable to complete his plan within three years after confirmation, through no fault of his own, then he may receive a discharge from his obligations under section 661,²⁶ which is like a discharge in straight bankruptcy or a confirmation of a plan of composition in that the debtor is allowed to escape his obligation for less than full payment. In dictum in *Perry v. Commerce Loan Co.*,²⁷ the Supreme Court concluded that when a debtor seeks relief under section 661, his creditors may raise the six-year rule of section 14(c)(5) as a defense.²⁸ This indicates that a section 661 discharge is barred by a prior proceeding to the same extent as a discharge in straight bankruptcy. Logically, a section 661 discharge should also have the same effect upon subsequent proceedings as does a straight bankruptcy discharge.

C) What is the effect of a discharge in straight bankruptcy or of a plan of composition upon a subsequent chapter XIII plan of extension?

This question has given the courts considerable trouble, and was specifically dealt with in *Perry v. Commerce Loan Co.*²⁹ There, petitioner sought confirmation of his chapter XIII extension but the referee dismissed the plan on the grounds that petitioner's discharge in a previous straight bankruptcy proceeding barred confirmation under section 14(c)(5). The district court upheld the dismissal,

22. 253 F. Supp. 757 (S.D.N.Y. 1966).

23. *Id.* at 758. It should be noted that the decision in *Webb* relies upon dictum in *Perry v. Commerce Loan Co.*, *supra* note 20, at 403. There the Court indicated that courts have a duty to prevent abuses of the Act. If this dictum is followed to its logical extreme a court might deny a discharge or a confirmation if it finds that the Act is being abused through its repeated use. This would not seem to be limited to the case where a prior plan is still pending before the court.

24. Statutes cited, *supra* note 17.

25. Bankruptcy Act § 660, *supra* note 17.

26. Bankruptcy Act § 661, *supra* note 17.

27. *Supra* note 20.

28. *Supra* note 20, at 404.

29. *Supra* note 20.

and the court of appeals affirmed.³⁰ The Supreme Court reversed, holding that confirmation of a chapter XIII extension plan was not barred by a previous discharge in straight bankruptcy. The Court reasoned that the purpose of the six-year provision was to prevent a class of habitual bankrupts, and that this did not apply to a chapter XIII extension because such a plan provides no escape to a debtor as he must pay his debts in full. Therefore, the Court concluded that "the rationale of section 14(c)(5)—the prevention of recurrent avoidance of debts—is so inconsistent with the aims of extension plans as to fall squarely within the exception of section 602."³¹ Section 602 provides that the provisions for straight bankruptcy in chapters I through VII will be incorporated into chapter XIII, insofar as they are not in conflict with the provisions of that chapter.³²

The logic of this decision can be disputed. The Court acknowledged that the major issue of statutory construction was whether section 14(c)(5) is to be read into section 656(a)(3), to apply the six-year rule to the confirmation of a chapter XIII extension plan.³³ The Court then concluded that the six-year provision applied to the confirmation of a chapter XIII composition but that it did not apply to the confirmation of a chapter XIII extension. This result is based upon the difference between an extension and a composition. It can be argued that the Court did not confront the true impact of the language of section 656(a)(3), which makes no distinctions between extensions and compositions, but rather was willing to accept a sophisticated, non-literal reading of section 656(a)(3). Nevertheless, as the law now stands confirmation of a chapter XIII extension is not subject to the six-year rules of section 14(c)(5), and therefore will not be barred by prior discharges and confirmations. This result is qualified by *In re Webb*³⁴ to the extent that an extension plan

30. *Perry v. Commerce Loan Co.*, 340 F.2d 588 (6th Cir. 1965).

31. *Supra* note 20, at 402.

32. Bankruptcy Act § 602, 52 Stat. 930 (1938), 11 U.S.C. § 1002 (1964). Two other recent cases have dealt with the situation where the debtor follows a plan of composition with a plan of extension. *In re Bingham*, 190 F. Supp. 219 (D. Kan. 1960), announced that confirmation of the second plan was barred by the six-year rule of section 14(c)(5), *supra* note 6. This case was overruled by *In re Holmes*, 309 F.2d 748 (10th Cir. 1962). Three other recent cases have dealt with the situation in which a debtor follows a straight bankruptcy discharge with a chapter XIII extension plan. *In re Mahaley*, 187 F. Supp. 229 (S.D. Cal. 1960) concluded that the purposes underlying section 14(c)(5) are so inconsistent with the purposes of relief by extension plan under chapter XIII that said section is inapplicable to such proceedings. *Accord, In re Sharp*, 205 F. Supp. 786 (W.D. Mo. 1962), 15 Ala. L. Rev. 213, 15 Stan. L. Rev. 518. In *In re Schlagerter*, 319 F.2d 821 (3d Cir. 1963), the court determined that because the debtor could receive a discharge under Bankruptcy Act § 661, *supra* note 17, without having completed his extension plan, the six-year rule of section 14(c)(5) should operate to bar confirmation of that plan. There has been confusion among the courts. *Perry v. Commerce Loan Co.*, *supra* note 11 clears up this confusion. For an excellent discussion of the problem see Kennedy, *supra* note 11.

33. Bankruptcy Act § 14(c)(5), *supra* note 6; Bankruptcy Act § 656(a)(3), 66 Stat. 437 (1952), as amended, 11 U.S.C. 1056 (1964).

34. *Supra* note 22.

will not be readily confirmed when another plan is under the control of the court.³⁵

D) What is the effect of a discharge in straight bankruptcy or of a plan of composition upon a subsequent chapter XI plan of extension?

Dictum in *Perry v. Commerce Loan Co.* announced that the six-year provision of section 14(c)(5) would apply to the confirmation of a chapter XI extension.³⁶ This means that although sections 366(3) and 656(a)(3) are identical, they must be applied differently.³⁷ Section 366(3) applies the six-year rule of section 14(c)(5) to a chapter XI extension plan, but section 656(a)(3) does not apply the rule to a chapter XIII extension. The Court concluded that this result was required by a difference in statutory schemes between a chapter XI plan and a chapter XIII plan.³⁸ However, the court failed to indicate what this difference was. One difference in the two chapters is that confirmation of a chapter XI plan operates as a discharge from unsecured debts,³⁹ while confirmation of a chapter XIII plan provides no discharge.⁴⁰ It is submitted that this difference is one of form only. It may be that even though confirmation of a chapter XI plan theoretically discharges the debtor from his obligations, the debtor is in no better position than he would be under chapter XIII, where his discharge is not granted until he has either completed his plan or failed to complete it through no fault of his own. Possibly the discharge resulting from confirmation of a chapter XI plan can be effectively revoked by a court, because section 377 provides that if the debtor defaults upon his chapter XI plan, an order may be entered either dismissing the proceedings or adjudging the debtor a bankrupt.⁴¹ Once adjudged a bankrupt, the debtor may have to satisfy the six-year rule of section 14(c)(5) before he can be discharged.⁴² If the Court concluded that confirmation of a chapter XI extension should be subject to the six-year provision of section 14(c)(5) because such confirmation provides the debtor with a discharge from his obligations, it may have used an improper basis for distinguishing a chapter XI extension from a chapter XIII extension.

35. See discussion at note 23 *supra*.

36. *Supra* note 20, at 402-3.

37. See Bankruptcy Act § 366(3), 66 Stat. 433, as amended, 11 U.S.C. § 766 (1964); and Bankruptcy Act § 656(a)(3), 66 Stat. 437 (1952), as amended, 11 U.S.C. 1056 (1964); both providing that "The court shall confirm a plan if satisfied that . . . (3) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of the bankrupt. . . ."

38. *Supra* note 20, at 403.

39. Bankruptcy Act § 371, *supra* note 18.

40. Bankruptcy Act §§ 660 and 661, *supra* note 17.

41. Bankruptcy Act § 377, 52 Stat. 913 (1964), 11 U.S.C. 777 (1964).

42. Bankruptcy Act § 14(c)(5), *supra* note 6. No authority which sheds any light upon this problem can be found. However, the author believes that it logically follows that if the debtor is placed in straight bankruptcy he must fulfill the requirements of section 14 before he can obtain a discharge. However, no section of the Act specifically provides that the discharge granted by confirmation of the chapter XI plan is revoked when the court enters an order converting the proceeding to one in straight bankruptcy.

IV. SUMMARY

As the law now stands, there are two rules which must be followed in applying the six-year rule of section 14(c)(5) to discharges in straight bankruptcy, and to confirmations of plans under chapters XI and XIII.

A) Discharges in straight bankruptcy, confirmations of composition plans under chapters XI and XIII, confirmations of extensions under chapter XI, and discharges under section 661 of chapter XIII will be barred if, in a prior proceeding under the Act commenced within six years of the date of the filing of the petition, the debtor has received a discharge in straight bankruptcy, a confirmation of a composition plan under chapter XI or chapter XIII, or a discharge under section 661 of chapter XIII.

B) Confirmation of a chapter XIII extension plan will not be barred by any prior proceedings under the Act, unless such proceedings are still under the control of the bankruptcy court, or confirmation would constitute an abuse of the Act.

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