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Recent Case: Bankruptcy - Wage Earner Plans - Effect on Cosigners [*Schraer v. G.A.C. Finance Corp.*, 408 F.2d 891 (6th Cir. 1969)]

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to cope with the problem of bad faith bargaining remains an unanswered question.

BANKRUPTCY — WAGE EARNER PLANS — EFFECT ON COSIGNERS

Schraer v. G.A.C. Finance Corp.,
408 F.2d 891 (6th Cir. 1969)

Appellants filed a wage earner plan pursuant to Chapter XIII of the Federal Bankruptcy Act.[1] A wage earner plan is a proposal by the debtor in which he subjects his future earnings to the bankruptcy court's control to satisfy his outstanding debts. It is a voluntary extension of the debtor's obligations as opposed to a straight bankruptcy proceeding in which the debtor's obligations are discharged. Appellants' plan contained a provision that prohibited any creditor who accepted the plan from pursuing any cosigner of the listed debt unless the plan was in default. The appellee was a creditor who held appellants' note cosigned by one Ervin. The plan was accepted by a majority of the creditors, including the appellee, and confirmed by the bankruptcy court. After several installments had been remitted pursuant to the plan and while no payments were in default, appellee demanded payment from Ervin. Appellants filed a motion directed to the referee in bankruptcy requesting that appellee be restrained from proceeding against the cosigner. The referee denied the motion and the district court affirmed. In *Schraer v. G.A.C. Finance Corp.*,[2] the Court of Appeals for the Sixth Circuit reversed, holding that the creditor was bound by his acceptance of the plan's provision releasing the cosigner until default.

Prior to *Schraer*, the general rule followed by the courts concerning the effect of wage earner plans on cosigners was found in the case of *In re Lancaster*.[3] The court in *Lancaster* confirmed a referee's dissolution of an injunction restraining a creditor from proceeding against a surety, holding that the liability of a codebtor or guarantor should not be affected by a Chapter XIII proceeding. The *Lancaster* court referred to section 602 of Chapter XIII,[4] which pro-

[1] Bankruptcy Act §§ 601-86, 11 U.S.C. §§ 1001-86 (1964).
[2] 408 F.2d 891 (6th Cir. 1969).
[3] 38 F. Supp. 318 (W.D. Mo. 1941).
[4] 11 U.S.C. § 1002 (1964).

vides that all provisions of Chapters I to VII, insofar as they are not inconsistent or in conflict with the provisions of Chapter XIII, shall apply in proceedings under that Chapter. Section 16 of the Act,[5] found in Chapter III, specifically states that the liability of any party in a surety relationship with a bankrupt shall not be altered by the bankrupt's discharge. Since this provision is not inconsistent with any provisions of Chapter XIII, the *Lancaster* court found it applicable to Chapter XIII proceedings.

In finding section 16 applicable to wage earner plans, the *Lancaster* court equated an extension under Chapter XIII with a discharge. Although technically an extension is not the same as a discharge, there is no reason to treat the two differently for purposes of section 16. As the *Schraer* court recognized, they merely offer alternative routes to the same objective, economic rehabilitation of the debtor.[6] Section 602 provides that for purposes of applying Chapters I to VII to Chapter XIII proceedings, "provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors,' and 'bankruptcy proceedings' . . . shall be deemed to include proceedings under [Chapter XIII]."[7] This demonstrates the drafters' intention to equate Chapter XIII proceedings with ordinary discharges in bankruptcy.

The *Schraer* court acknowledged that confirmation of a wage earner plan does not automatically extend the time before which a creditor can pursue a cosigner. It distinguished *Lancaster*, however, on the grounds that the appellee in *Schraer*, by accepting a plan containing a provision releasing all cosigners until default, had voluntarily relinquished his right to pursue the cosigner. But in so reasoning, the *Schraer* court failed to recognize that this was not an isolated voluntary agreement; it was in the context of a bankruptcy court proceeding. The accepted plan had to be confirmed by the bankruptcy court before it would have binding effect,[8] and that court was required to adhere to bankruptcy principles.[9] Section 16

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[5] *Id.* § 34.

[6] 408 F.2d at 894.

[7] 11 U.S.C. § 1002 (1964).

[8] Bankruptcy Act § 657, 11 U.S.C. § 1057 (1964).

[9] *Id.* § 656, 11 U.S.C. § 1056, which provides in part: "The court shall confirm a plan if satisfied that — (1) the provisions of this chapter have been complied with." Section 602 provides that the provisions of Chapters I to VII shall apply to Chapter XIII proceedings insofar as they are not inconsistent with that chapter. Thus, the bankruptcy court cannot confirm a plan that violates any bankruptcy principle contained in the first seven chapters, unless that principle is inconsistent with a provision of Chapter XIII.

embodies a general bankruptcy principle that a bankruptcy proceeding exists to provide relief solely to the bankrupt debtor who applies for relief.[10] In confirming a plan containing a provision giving relief to a third party, the bankruptcy court had disregarded this principle, and for that reason the *Schraer* court should not have upheld the provision releasing the cosigner.

The *Schraer* court attempted to further justify its holding by stating that the inclusion of the provision would not alter the rights of creditors not accepting the plan. Section 657 of the Act,[11] however, provides that, upon confirmation, the wage earner plan and its provisions shall be binding on all creditors regardless of whether they have accepted the plan. This provision expresses the policy that all creditors under a wage earner plan should be treated similarly. A distinction should only be made between creditors if it helps to protect the rights of all the creditors. Acceptance or nonacceptance of a plan by creditors is not a valid reason for discriminating among them or adjusting their rights.

The wage earner plan has been a widely successful procedure for many debtors who, for moral and social reasons, prefer extending their debts to having them discharged. The *Schraer* decision follows the policy of the courts to encourage its use.[12] Judicial enforcement of provisions in wage earner plans releasing cosigners until default will, as a practical matter, encourage creditors to carefully read the provisions of such plans and weigh the consequences of acceptance. But a debtor faced with nonacceptance of a plan because of such a provision will probably choose to delete it rather than abandon an otherwise feasible plan. It is unlikely therefore that *Schraer* will have any noticeable effect on the use of wage earner plans.

Regardless of its practical effects, however, *Schraer* is noteworthy because it makes an inroad into the generally accepted bankruptcy principle that federal bankruptcy proceedings are intended to grant relief only to the debtor who applies to the bankruptcy court for relief. The primary question posed by the decision is to what extent will bankruptcy courts, whose jurisdiction has traditionally been confined to the bankrupt debtor and his creditors, adjust obligations between creditors of the bankrupt and third parties in the future.

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[10] *Cf.* W. COLLIER, BANKRUPTCY ¶ 16.05, at 1531 (14th ed. 1964).

[11] 11 U.S.C. § 1057 (1964).

[12] *See, e.g.*, Perry v. Commerce Loan Co., 386 U.S. 392 (1966). *See also* Chandler, *The Wage Earner Plan: Its Purpose*, 15 VAND. L. REV. 169 (1969).