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THE PRACTICE OF BANKRUPTCY

by MAX SCHWARTZ *

THE typical normal individual, whether in business or not, in entering into a business transaction, a contract, or incurring a debt, does not contemplate that the transactions will ever be involved in a bankruptcy proceeding. However, in view of the rising trend in the number of bankruptcies,—over 208,000 for the year ending June 30, 1967,¹ and increasing in the current fiscal year ending June 30, 1968—it is in order and in the exercise of prudent foresight to be acquainted and familiar with the practice and procedure of a bankruptcy proceeding.

The Bankruptcy Act is made up of 15 chapters. In addition, there are miscellaneous acts relating to crimes and offenses, as defined in Title 18 U.S. Code, §§ 152-154. The Act has also been supplemented by General Orders promulgated by the United States Supreme Court which have the force of law.² Insofar as they are not in conflict with the provisions of the Bankruptcy Act, the Federal Rules of Civil Procedure are applicable to a bankruptcy proceeding.³

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¹ Tables of Bankruptcy Statistics of the Administrative Office of the United States Courts for the year ending June 30, 1967.

² See 4A. W. COLLIER, BANKRUPTCY 1527 (14th ed. 1967).

³ The decisions appear to be uniform that the Federal Rules of Civil Procedure are applicable in bankruptcy proceedings, except where they are inconsistent with the Bankruptcy Act. *Solove v. Chase Manhattan Bank*, 388 F.2d 874 (5th Cir. 1968); General Order 37 provides that the Federal Rules of Civil Procedure are applicable to bankruptcy in so far as they are not inconsistent with the Act. 4A W. COLLIER, BANKRUPTCY 1542 (14th ed. 1967). *Abraham v. Boedeker*, 379 F.2d 741 (5th Cir. 1967), *cert. denied*, 389 U.S. 1006 (1968); *Bixby v. First Nat'l Bank*, 250 F.2d 713 (7th Cir.), *cert. denied*, 356 U.S. 958 (1958); *I. & I. Holding Corp. v. Greenberg*, 151 F.2d 570 (2d Cir.), *cert. denied*, 327 U.S. 781 (1945); *In re Miller*, 262 F. Supp. 295 (E.D. Ill. 1967); *In re Totem Lodge & Country Club*, 134 F. Supp. 158 (S.D.N.Y. 1955).

TYPES OF BANKRUPTCY PROCEEDINGS

Proceedings under Chapters I-VII are designated as straight bankruptcy proceedings. Of the filings during the year ending June 30, 1967, 173,884 were voluntary straight bankruptcies and 1,241 were involuntary straight bankruptcies.⁴ They are the usual type of proceedings, affecting both business and non-business bankrupts.

A Chapter X proceeding for corporation reorganization generally is applicable to a publicly owned corporation for the relief of debtors, involving a modification of the capital structure and the claims of secured and unsecured creditors.⁵

A Chapter XI proceeding is applicable to a business, whether a corporation, a partnership or an individual, and is limited to affecting the rights of unsecured creditors.⁶

⁴ *Supra* note 1.

⁵ In *In re Manufacturers' Credit Corp.*, 278 F. Supp. 384 (D.N.J. 1968), the court held that Chapter X was intended for the adjustment of publicly held debts in granting the motion of the S.E.C. to dismiss Chapter XI proceedings unless the debtors amended their petition or a creditors' petition be filed to conform the proceedings to Chapter X. On appeal, the distinction between Chapter X and Chapter XI proceedings was more clearly delineated. The court pointed out that a proceeding under Chapter X of the Bankruptcy Act is more appropriate than a proceeding under Chapter XI where the debt structure is complicated, the debtors are many and inter-related, the public investors are not few in number and are totally unfamiliar with the debtors' operations, and the payment of the debt owed cannot be effectuated by a relatively minor adjustment. Additional safeguards are provided for in a Chapter X proceeding for the benefit and protection of the creditors, stockholders and other interested parties by way of investigatory procedures, independent accountants, and the requirement of reports from the trustee as to his investigation to all creditors, stockholders and other interested parties. *In re Manufacturers' Credit Corp.*, 395 F.2d 833 (3rd Cir. 1968).

A Chapter X proceeding is designed to rehabilitate a financially embarrassed corporation and, when necessary, to recast its capital structure to eliminate financial problems which have caused it to become a "corporate cripple." *S.E.C. v. American Trailer Rentals Co.*, 379 U.S. 594 (1965); *General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956); *S.E.C. v. U.S. Realty & Improvement Co.*, 310 U.S. 434 (1940). See also 6 W. COLLIER, *BANKRUPTCY* §§ 0.08, 0.09, at 90-107 (14th ed. 1967).

⁶ See *General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956); *United States v. National Furniture Co.*, 348 F.2d 390 (8th Cir. 1963); *S.E.C. v. Canandaigua Enterprises Corp.*, 339 F.2d 14 (2d Cir. 1964). In *S.E.C. v. Crumpton Builders, Inc.*, 337 F.2d 907, 909 (5th Cir. 1964) the court pointed out that Chapter XI proceedings are subject to minimum controls by the court or their agents and are marked by speed and a minimum of expense, while Chapter X proceedings, involving publicly held debts, secured

Chapter XII is available to real property arrangements by persons other than corporations.

Chapter XIII is available solely to wage earners seeking an extension of time to pay their debts, which may affect both the secured and unsecured creditors.

The other chapters are rarely employed, being applicable to reorganization of public debtors such as municipalities and taxing agencies, and dealing with railroad adjustment and maritime commission liens.

The vast majority of all proceedings come within the provisions of Chapters I-VII, known as the straight bankruptcy proceedings.

VOLUNTARY BANKRUPTCY

There are two types of straight bankruptcy proceedings; one voluntary and the other involuntary. The voluntary petition is available to any person or corporation, except a municipal, railroad, insurance, banking corporation or building and loan association.⁷

There is no restriction or limitation upon a debtor in filing a voluntary petition in bankruptcy. It may be filed regardless of the liabilities or assets of the debtor, who may be either grossly insolvent or solvent.⁸

and unsecured obligations, and revision of capital structure, are slower and more expensive and have more safeguards to protect the public and parties. Chapter XI proceedings may also be directed to be converted into Chapter X proceedings, or else dismissed. *Grayson-Robinson Stores, Inc. v. S.E.C.*, 320 F.2d 940 (2d Cir. 1963); *William H. Wise & Co. v. Rand McNally & Co.*, 195 F. Supp. 621 (S.D.N.Y. 1961).

⁷ 11 U.S.C. § 22 (1964). This section of the Bankruptcy Act has been strictly construed as to the amenability of corporations to its provisions and is limited to the corporations specifically described. It has been held that the section does not apply to, nor include, any corporation not clearly within the enumerated classes. *Porterfield v. Gerstel*, 222 F.2d 137 (5th Cir. 1955); *In re New York & New Jersey Ice Lines*, 147 F. 214 (2d Cir. 1906); *In re Dairy Marketing Ass'n*, 8 F.2d 626 (D. Ind. 1925); *In re Michigan Sanitarium & Benevolent Ass'n*, 20 F. Supp. 979 (E.D. Mich.), *appeal dismissed*, 96 F.2d 1019 (6th Cir. 1937). Even as to wage earners, it has been held that this section should be strictly construed. *In re Bradford*, 268 F. Supp. 896 (N.D. Ala. 1967).

⁸ It is not essential that a voluntary bankrupt own any property or that the voluntary bankrupt be insolvent. *In re Hargardine-McKittrick Dry Goods Co.*, 239 F. 155 (E.D. Mo.), *rev'd on other grounds*, 244 F. 719 (8th Cir.), *cert. denied*, 245 U.S. 667 (1917). Likewise it

No creditor may oppose the filing of a voluntary petition in bankruptcy.⁹ The only remedy or right available to a creditor is to move to dismiss such voluntary petition on the ground that it was filed as a fraud upon the court and that the maintenance of the proceeding would be an abuse of the process of the court.¹⁰

A voluntary petition by a corporation can only be filed when authorized by the Board of Directors. No

has been held that a person who owes but one debt and has no assets, may, nevertheless, become a voluntary bankrupt. *In re Schwaninger*, 144 F. 555 (E.D. Wis. 1906).

A solvent person may voluntarily have his property distributed among his creditors under the Bankruptcy Act. *In re Fox West Coast Theatres*, 88 F.2d 212 (9th Cir.), cert. denied, 301 U.S. 710 (1937); *In re Townsend Builders Supply Co.*, 144 F. Supp. 717 (E.D.N.C. 1966); *In re Harriman*, 31 F. Supp. 50 (S.D.N.Y. 1939); *In re Yarbrough*, 18 F. Supp. 359 (M.D. Ga. 1937); *In re People's Warehouse Co.*, 273 F. 611 (S.D. Miss. 1929); *In re Pyatt*, 257 F. 362 (D. Nev. 1918).

⁹ *McClave & Co. v. Carden*, 118 F.2d 677 (2d Cir.), cert. denied, 314 U.S. 647 (1941); *In re Fike*, 117 F.2d 667 (7th Cir. 1941); *In re Spohn Motor Co.*, 158 F. Supp. 855 (W.D. Pa. 1958); *In Commercial Credit Corp. v. Skutt*, 341 F.2d 177 (8th Cir. 1965), the court reviewed the history of 11 U.S.C. §4 indicating that originally creditors could intervene under §41(b) and oppose a petition in involuntary bankruptcy, which right was given to creditors to protect their interests where affected by the adjudication. The Act was amended in 1938 by the Chandler Act which rewrote the section and limited the right to creditors to be heard in opposition to an adjudication on the ground that the motion of the creditor in opposing adjudication was to protect preferences or to retain some advantage at the expense of the other creditors, contrary to the fundamental purposes of the Bankruptcy Act, the equitable distribution of assets among all creditors.

¹⁰ *Porterfield v. Gerstel*, 222 F.2d 137 (5th Cir. 1953); *Struthers Furnace Co. v. Grant*, 30 F.2d 576 (6th Cir. 1929); *Zeitinger v. Hargardine-McKittrick Dry Goods Co.*, 244 F. 719 (8th Cir.), cert. denied, 245 U.S. 667 (1917); *In re Metal Extrusions, Inc.*, 145 F. Supp. 51 (S.D. Fla. 1956); *In re E. C. Denton Stores Co.*, 5 F. Supp. 307 (S.D. Ohio 1933). In *In re Joseph Feld & Co.*, 38 F. Supp. 506, 507 (D.N.J. 1941), the company under a resolution adopted by two of the three directors, filed a voluntary petition in bankruptcy and the third director challenged the jurisdiction of the court on the ground that the filing of the petition required the consent of stockholders, and upon the further ground that there was no proper meeting of the Board of Directors and the resolution adopted was invalid. The court held that "[t]he right of the board of directors to authorize the filing of a voluntary petition in bankruptcy . . . is dependent upon the laws of the State in which the corporation is organized. It appears to be well established that in the absence of any restriction, either under the charter or statute, a board of directors, without the consent of stockholders, may authorize the filing of a voluntary petition in bankruptcy." However, the court found that there was no lawful meeting of the directors and by reason thereof dismissed the proceeding, without prejudice to the bankrupt to avail itself of the Bankruptcy Act in a proper proceeding. The rule announced in this case has been universally followed.

action by the stockholders is required unless state law or the by-laws of the corporation provide otherwise.¹¹ Where the Board of Directors is equally divided, the courts have sustained a voluntary petition filed by the properly constituted officers of the corporation on a showing that the Board of Directors is in fact equally divided, and that the best interests of the creditors of the debtor would be served by invoking the protection of the Bankruptcy Court.¹²

The right to file a voluntary petition may not be limited or contracted away. Attempts to prohibit such filing of a voluntary petition, by providing in contracts and agreements that the debtor may not invoke bankruptcy proceedings, or that the obligation will not be affected by any subsequent bankruptcy proceeding, have been held to be void as against public policy.¹³

¹¹ In *In re Rajloed Realty Co.*, 277 F. Supp. 225 (S.D.N.Y. 1967), the court reiterated the rule that the operation of the corporation must be left to the Board of Directors and that it is only the board and not a stockholder that may authorize the filing of a petition in bankruptcy. See also *Royal Indemnity Co. v. American Bond & Mortgage Co.*, 239 U.S. 165 (1933); *In re Guancevi Tunnel Co.*, 201 F. 316 (2d Cir. 1912); *In re Jefferson Casket Co.*, 182 F. 689 (N.D.N.Y. 1910).

¹² In *In re Dressler Producing Corp.*, 262 F. 257 (2d Cir. 1919), the court, after indicating there was a hopeless diversion of views of stockholders of equal interests, denied the application to dismiss the proceedings in bankruptcy even though prior proceedings to dissolve the corporation had been instituted in the state courts. The court also held there was no fraud on the Bankruptcy Court in the filing of the petition and in choosing the Bankruptcy Court as a forum for the liquidation of the corporation, rather than the state courts. The court also stated that a solvent corporation may have its property distributed among its creditors in the manner provided by the Bankruptcy Act. See also *Regal Cleaners & Dyers, Inc. v. Merlis*, 274 F. 915 (2d Cir. 1921); *In re Louisiana Inv. & Loan Corp.*, 224 F. Supp. 274 (E.D. La. 1963).

¹³ State courts cannot by order or injunction prevent a debtor from becoming a bankrupt. In *In re Allied Const., Inc.*, 79 F. Supp. 141 (W.D. Pa. 1948), a proceeding was pending in the state court on an action brought by creditors, in which a receiver was appointed, when the voluntary petition in bankruptcy was filed. The creditors sought to question the right of the directors to authorize the filing of a voluntary petition in bankruptcy. The court, in denying the relief sought by the creditors, held that a corporation is not deprived of the right to file a petition in voluntary bankruptcy merely because its property is in the custody of a state court receiver, even if it was for the purpose of avoiding the jurisdiction of the state court in having the federal court take over jurisdiction of the assets of the corporation. The court further held a corporation is not estopped from filing a voluntary petition because it is a party to an equity proceeding in the state court, nor may a corporation be prevented by a state court injunction of availing itself of

The voluntary bankrupt falls into two classes: the business and non-business bankrupt.

As to the non-business bankrupt the problem of whether to file is far simpler. He is usually a wage-earner. The debtor may even be a housewife. These types of debtors have become indebted beyond their means as a result of consumer financing (purchasing on time of automobiles, household commodities and appliances, etc.), personal loans, automobile accidents, as well as endorsements and guarantees. The result is that the earnings of the debtor are insufficient to meet the installment payments, as well as his current living expenses. Here there is no problem as to the future course of the debtor. Threatened by suits, garnishees and loss of his job, the only relief open to such a debtor is voluntary bankruptcy.

The benefits of the Bankruptcy Act may be invoked not only by those presently in debt beyond their capacity to pay on their present or future earnings, but even by those whose earnings in the future may have a very high potential.¹⁴ The granting of a discharge to the voluntary bankrupt relieves him of any charge upon his future earnings.

Bankruptcy also grants the debtor relief from wage assignments, garnishments and all his debts upon the grant-

the Bankruptcy Act. *Boyce v. Chemical Plastics, Inc.*, 175 F.2d 839 (8th Cir.), *cert. denied*, 338 U.S. 828 (1949); *In re Dressler Producing Corp.*, 262 F. 257 (2d Cir. 1919); *In re Yaryan Naval Stores Co.*, 214 F. 563 (6th Cir. 1914); *In re Denton & Haskins Music Pub. Co.*, 10 F. Supp. 802 (S.D.N.Y. 1935); *In re Hicks*, 133 F. 739 (N.D.N.Y. 1905); *May v. Merchants & Mechanics Bank*, 109 Pa. 145 (1885); *Thompson v. Samson United Corp.*, 203 Misc. 38, 113 N.Y.S.2d 607 (Sup. Ct. 1952).

¹⁴ 11 U.S.C. § 22 (1964); 1 W. COLLIER, BANKRUPTCY ¶ 4.03, at 578-84 (14th ed. 1967); *In Bank of Elberton v. Swift*, 268 F. 305 (5th Cir. 1920), it was charged that the petition was filed to perpetrate a fraud on the court. This was based on the fact that "[i]t was not denied that a party might take advantage of a voluntary proceeding in bankruptcy for the very purpose of having any property he might accumulate thereafter relieved from his debts. . . ." *Id.* at 307. Here the bankrupt acquired property shortly after the filing of the petition. The court held that the law authorizes the petition to be filed, adjudication to be made and a discharge granted; that the Bankruptcy Act fixes the rights of the parties. *In re Automatic Typewriter & Serv. Co.*, 271 F. 1 (2d Cir. 1921); *Hindman v. Owl Drug*, 33 P.2d 1023 (1934), *aff'd on rehearing*, 4 Cal. 2d 451, 50 P.2d 438 (1935).

ing of a discharge.¹⁵ However, it would be a mere futility to file a petition in bankruptcy if the debtor could not obtain the relief sought, to wit, a discharge. A debtor is entitled to a discharge if he has not committed any of the acts as set forth in § 32(c) of the U.S. Code,¹⁶ and if the debts incurred by him do not come within the definition of

¹⁵ *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934). In *In re Burgess*, F. Supp. (S.D.N.Y. 1968), the court held that a bankrupt was entitled to an order restraining the employer from making further deductions and directing the creditor to return all monies received from the employer since the date the bankruptcy petition was filed, upon an application for such relief, after the bankrupt had obtained his discharge. Further, wages earned and paid after the discharge are not leviable by creditors holding discharged debts even though suits are pending in the state court to adjudge the debt non-dischargeable. Until the state court declares the debts non-dischargeable, the debts are discharged for purposes of levy for payment of debts. *In re Cunningham*, 57 F. Supp. 668 (S.D.N.Y. 1944); *Brenen v. Dahlstrom Metallic Door Co.*, 189 App. Div. 685, 178 N.Y.S. 846 (1st Dep't 1919).

¹⁶ 11 U.S.C. § 32(c) provides that "the court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offence punishable by imprisonment as provided under section 152 of Title 18; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; or (3) while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation; or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay or defraud his creditors; or (5) in a proceeding under this title 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 Title; or (6) in the course of a proceeding under this Title refused to obey any lawful order of, or to answer any material question approved by, the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities; or (8) has failed to pay the filing fees required to be paid by this Title in full; Provided, That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this subdivision, would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt."

a non-dischargeable debt in accordance with the provisions of § 35 of the U.S. Code.¹⁷

A different problem presents itself as to one engaged in business. The voluntary business bankrupt encompasses the individual, partnership and corporation. For one engaged in business the question to be resolved is whether the reverses and losses, leading to the financial problems, are temporary, meriting efforts to continue in business, or whether the prospects are so bleak as to warrant resort to legal proceedings. Where there is no future prospect for recovery and profitable operations, a businessman, if an individual or a partnership, desiring to make a fresh start, perhaps would have to resort to bankruptcy.

A corporation which is faced with the prospect of being liquidated and going out of business has the option of being liquidated, either by an assignment for the benefit of creditors, under the Debtor and Creditor Law of the State, or resorting to voluntary bankruptcy. But, attention is called to the fact that an assignment for the benefit of creditors is in itself an act of bankruptcy.

In dealing with a business situation, whether individual, partnership or corporation, if there is a belief that it has favorable and profitable prospects for the future, and the debtor has the financial means of carrying on, there

¹⁷ 11 U.S.C. § 35 sets forth the provision with respect to debts excluded from the effect of a discharge. They include tax liens; liability for obtaining money or property on credit or obtaining an extension of renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published in any manner whatsoever with injuries to the person or property of another, or for alimony due and to become due, or for maintenance or support of a wife or child; debts that have not been scheduled in time for proof and allowance, unless the creditor had actual notice or knowledge of the proceeding; debts created by fraud or embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; debts for wages earned within three months of the commencement of the proceeding due to an employee and debts for money received as a security deposit from an employee to secure the faithful performance of the duties of the employee. This section was amended, effective October 3, 1966, so as to provide for the dischargeability of debts that were legally due and owing more than three years preceding the filing of the petition. Tax liens are not dischargeable, nor are taxes for withholding, nor are taxes due and owing by reason of the bankrupt's failure to file returns, or by reason of the bankrupt having filed a false or fraudulent return or where he had attempted to evade or defeat the Internal Revenue Law.

is an opportunity to affect a settlement either out of court, which will require the cooperation and consent of every creditor, or the option to resort to a Chapter XI proceeding, which requires the consent of 51% in amount and number of creditors filing claims. Discussion of Chapter XI proceedings is beyond the scope of this paper.

With respect to a voluntary bankruptcy, the amount of the indebtedness is immaterial.¹⁸ The voluntary non-business bankrupt must merely meet the jurisdictional requirements of the Act, which are that he shall have his residence or domicile in the district where the petition is being filed for the longer portion of the preceding six months than in any other district.¹⁹ As to the individual business bankrupt, his place of business is an additional jurisdictional alternative where the petition may be filed.²⁰

Where a petition has been filed, the subsequent death of the bankrupt, or his insanity, will not affect the conduct of the proceedings but they will go forward until fully administered.²¹

¹⁸ 11 U.S.C. § 11(a) (1964). See *supra* note 8.

¹⁹ 11 U.S.C. § 11(a)(1) (1964). See 11 U.S.C. § 55 (1964); *In re Fada Radio & Elec. Co.*, 132 F. Supp. 89 (S.D.N.Y. 1955); *Saper v. Long*, 131 F. Supp. 795 (S.D.N.Y. 1955). Section 11(a)(1), though phrased in terms of jurisdiction, defines proper venue for bankruptcy proceedings. Read together with the provisions of § 55, the provisions with respect to the place of filing of a petition, whether voluntary or involuntary, based on residence, domicile or having a principal place of business, have been held to constitute merely provisions as to venue, and it is not jurisdictionally defective if a petition is filed in the wrong district. Thus it has been held that the bankruptcy court has jurisdiction regardless of residence, or domicile and may retain or transfer the case according to "the interests of justice," or in the interest of the parties. See *Hawaiian Investors v. Thorndal*, 339 F.2d 807 (8th Cir. 1965); *In re S.O.S. Sheet Metal Co.*, 297 F.2d 32 (2d Cir. 1961); *In re Eatherton*, 271 F.2d 199 (8th Cir. 1959).

²⁰ 11 U.S.C. § 11(a)(1) (1964). See *Higgins v. State Loan Co.*, 114 F.2d 25 (D.C. Cir. 1940); *In re Evans*, 85 F.2d 92 (2d Cir. 1936).

²¹ Under the present provisions of the Bankruptcy Act the estate of a decedent is not entitled to file a voluntary petition in bankruptcy. *In re Hiller's Estate*, 240 F. Supp. 504 (N.D. Cal. 1965); *In re Mulero's Estate*, 143 F. Supp. 504 (D.P.R. 1956). In *Hull v. Dicks*, 235 U.S. 584 (1915), it was held the administration of the bankrupt estate is unaffected by the death of the bankrupt subsequent to the filing of the petition, subject, however, to his family being entitled to the exemptions granted by state law. See also 11 U.S.C. § 1(4) (1964); *In re Evanishyn*, 107 F.2d 742 (2d Cir. 1939); *Siegel v. Wells*, 55 F.2d 877 (6th Cir.), *cert. denied*, 286 U.S. 549 (1932); *In re Clinton*, 41 F.2d 749 (S.D. Cal. 1930).

INVOLUNTARY BANKRUPTCY

Any natural person, except a wage earner²² or farmer,²³ or any money business or commercial corporation, except a building and loan association, municipality, railroad, insurance or banking corporation, may be the subject of an involuntary petition in bankruptcy if said person, business or corporation owes debts in excess of \$1,000.00.²⁴ Other requirements are: that he is insolvent; that he has committed an act of bankruptcy within four months of the filing of the petition; and that he has resided or has his domicile or principal place of business for a longer portion of the six months immediately preceding the filing of the petition in the district where the petition is filed than in any other judicial district.²⁵

²² 11 U.S.C. § 1(32) (1964) defines "wage earner" as "an individual who works for wages, salary or hire, at a rate of compensation not exceeding \$1500 per year," *In re Shear*, 139 F. Supp. 217 (N.D. Cal. 1956).

²³ *In re Hinrichs*, 314 F.2d 384 (7th Cir. 1963); *In re White*, 238 F. Supp. 454 (D.D.C. 1965).

²⁴ 11 U.S.C. § 22 (1964); *In re Hare*, 205 F. Supp. 881 (D. Md. 1962); *In re Eastern Supply Co.*, 170 F. Supp. 246 (W.D. Pa. 1959); *In re Pauline's Fashion Salon*, 121 F. Supp. 845 (S.D. Cal. 1954).

²⁵ 11 U.S.C. § 22 (1964). The four-month period for the filing of a petition for involuntary bankruptcy does not, with respect to concealment or removal of property, expire until four months after the concealment, fraudulent transfer or removal is discovered by creditors. With respect to preferential transfers, the four-month period for filing of petition by creditors expires four months after the preferential transfer has been perfected within § 96(a) and (b). *Hotel Halcyon Corp. v. Acme Supply Co.*, 36 F.2d 353 (5th Cir. 1929); *In re Estate of Northwest Mills, Inc.*, 281 F. Supp. 976 (W.D. Ark. 1968). Debtor by settling with most of his creditors could not prevent dissenting creditors from filing involuntary petition by asserting his liabilities were less than \$1,000. Liabilities would be determined as of date of commission of act of bankruptcy within four months of filing of petition. *In re Jacobson*, 181 F. 870 (D. Mass. 1909). A person's status was to be determined as of the date of the act of bankruptcy. *Virginia-Carolina Chemical Co. v. Shelhorse*, 228 F. 493 (4th Cir. 1915); *In re Inman*, 57 F.2d 595 (D. Wyo. 1932).

In construing § 95b respecting the filing of the petition in bankruptcy by three or more creditors having provable claims, not contingent and in excess of \$500, the court, in reviewing the status of petitioning creditors based on a judgment under appeal, held the judgment creditors qualified to act as petitioning creditors. The court held the term "not contingent as to liability," as used in § 95b is different from and broader than the claims based on instruments in writing or judgments; that creditors whose claims are based on written agreements or other transactions, not yet reduced to judgment are qualified to act as petitioning creditors. However, the court found that the judgment creditors by failing to mention the security held by

It is important to stress that the mere fact that the debtor is insolvent, that his liabilities exceed the total of his assets, that he is unable to pay his debts as they mature in the regular course of conduct of business, does not give a creditor the right to file an involuntary petition in bankruptcy. In addition to being insolvent, the debtor must have committed an act of bankruptcy within four months of the filing of the petition. The acts of bankruptcy, as set forth in § 21 of the U.S. Code may be summarized as follows:

- (1) A fraudulent transfer or concealment of assets.
- (2) A preferential transfer of money or property.
- (3) Permitting, while insolvent, a creditor to obtain a lien on property through legal proceedings and not vacating or discharging the same within 30 days from the date the lien was obtained.
- (4) Permitting a creditor to obtain a lien on property through legal proceedings and failing to vacate or discharge the same within five days before the date set for the sale of the property.
- (5) The execution of an assignment for the benefit of creditors.
- (6) Permitting, either voluntarily or involuntarily, the appointment of a receiver or trustee of debtor's assets while insolvent and unable to pay his debts as they mature.
- (7) Admitting, *in writing*, his inability to pay his debts and willingness to be adjudged a bankrupt.

In preparing the involuntary petition in bankruptcy it should be noted that alleging an act of bankruptcy in the language of the Bankruptcy Act is insufficient. Failure to set forth facts and specific information with respect to the property conveyed or transferred, the name of the

them in filing the involuntary petition, were deemed to have waived the security and the judgment claims pending appeal. *In re Walton Plywood*, 227 F. Supp. 319 (W.D. Wash. 1964). In *In re Eastern Supply Co.*, 170 F. Supp. 246 (W.D. Pa. 1959), the court held an involuntary petition could be filed on behalf of petitioning creditors by an attorney duly authorized to execute and file the petition on their behalf. It also held that where the original petition was sufficient on its face it could be amended to correct any defects that were not jurisdictional.

party to whom the transfer was made, the amount involved, or the nature of the property transferred in connection with alleging a fraudulent transfer, concealment or preferential transfer is insufficient and has been held to be so defective as to warrant the dismissal of the petition.²⁶ The courts may grant leave to amend, but there is grave danger that the amendment may speak of the date of the filing of the original petition so that more than four months may have elapsed between the act complained of and the date of the amended petition, which will result in a dismissal of the proceedings.²⁷

Alleging the act by which the debtor is charged with permitting a lien to be obtained through legal proceedings

²⁶ *Dworsky v. Alanjay Bias Binding Corp.*, 182 F.2d 803 (2d Cir. 1950), wherein the court did not permit amendment of the petition and dismissed the same. In *In re R. V. Smith Co.*, 38 F. Supp. 57 (W.D. Okla. 1941), the court held that the transfer of assets to a creditor was not an act of bankruptcy nor a preference where the creditor paid back to the bankrupt cash, or made loans in excess of what he received from the bankrupt during the four-month period before the filing of the petition. In *Abramson v. Boedeker*, 379 F.2d 741 (5th Cir. 1967), the court, in granting leave to file an amended involuntary petition, held that the amendment should be read liberally, consistent with the Federal Rules of Civil Procedure, and held that the amendment related back to the date of the original filing of the petition, so as to bring the act of bankruptcy, as well as preferential acts, within the four-month period of the filing of the petition. See also *Glint Factors, Inc. v. Schnapp*, 126 F.2d 207 (2d Cir. 1942); *In re Gaynore Homes*, 65 F.2d 378 (2d Cir. 1933); *In re Fuller*, 15 F.2d 294 (2d Cir. 1926); *In re Ideal Mercantile Corp.*, 143 F. Supp. 810 (S.D.N.Y. 1956), *aff'd*, 244 F.2d 828 (2d Cir.), *cert. denied*, 355 U.S. 856 (1957); *In re Heltman-Thompson Co.*, 83 F. Supp. 156 (W.D. Mich. 1949). Under § 95, notice must be given to all creditors before a petition may be dismissed by consent for want of prosecution or upon the application of the bankrupt and this applies in both involuntary and voluntary proceedings. Upon this application, creditors may intervene to oppose the dismissal and to join additional petitioning creditors in the involuntary petition.

In *In re Adams*, 53 F. Supp. 982 (D. Pa. 1944), the court held that the involuntary petition must set forth sufficient facts as to the need for the act of bankruptcy so as to apprise the alleged bankrupt of what he will be required to meet, otherwise the petition would be defective.

²⁷ *South Suburban Safeway Lines v. Carcards, Inc.*, 256 F.2d 934 (2d Cir. 1958); *In re Oster*, 216 F. Supp. 133 (E.D.N.Y. 1963); *In re Thomas*, 211 F. Supp. 187 (D. Col. 1962). In *Abramson v. Boedeker*, 379 F.2d 741 (5th Cir. 1967), the court not only permitted the involuntary petition to be amended, but held that it was effective as of the date of the original filing of the petition with respect to the act of bankruptcy and preferential transfers.

Where the amendment to the involuntary petition alleges a new act of bankruptcy, the adjudication dates from the date of the filing of the amendment and not from the date of the filing of the original petition. *Wynne v. Rochelle*, 385 F.2d 789 (5th Cir. 1967).

is insufficient and defective unless the data with respect to the recovery of the judgment, the court wherein recovered, and the property upon which it became a lien are set forth, even though in very general terms.²⁸

The mere fact that a judgment has been recovered is not sufficient to create a lien or an act of bankruptcy, unless the debtor owns real estate. Neither will the issuance of execution under a judgment to a marshal or sheriff constitute an act of bankruptcy, unless the execution or levy becomes a lien on property, personal or real.²⁹

Stress is placed upon the need to set forth facts and not rely on mere statutory language in alleging acts of bankruptcy. Laymen as well as many lawyers labor under a misapprehension that creditors have the right, as a matter of course, to file an involuntary petition where the debtor is insolvent and unable to pay his debts as they mature. They also make the mistake of assuming that the recovery of a judgment in and of itself constitutes an act of bankruptcy.

If the debtor has over 12 creditors the petition must be joined in by at least 3 creditors with provable claims, fixed as to liability and liquidated as to amount, aggregating over \$500.00.³⁰ If there are less than 12 creditors then

²⁸ *Hamilton Steel Prods. Co. v. Yorke*, 376 F.2d 463 (7th Cir. 1967); *In re Ideal Mercantile Corp.*, 143 F. Supp. 810 (S.D.N.Y. 1956), *aff'd*, 244 F.2d 828 (2d Cir.), *cert. denied*, 355 U.S. 856 (1967). A judgment does not become a lien until recorded and if recorded after bankruptcy, it is void as a lien against the trustee. *Allen v. Camp Ganeden*, 214 F.2d 467 (2d Cir. 1954); *In re Flushing-Queensboro Laundry, Inc.*, 90 F.2d 601 (2d Cir. 1937); *Weitzel Flooring Corp. v. Getz*, 31 F.2d 930 (3rd Cir. 1929); *In re New Lots Sash & Door*, 3 F. Supp. 570 (E.D.N.Y. 1933).

²⁹ *In re Ideal Mercantile Corp.*, 244 F.2d 828 (2d Cir.), *aff'g*, 143 F. Supp. 810 (S.D.N.Y. 1956), *cert. denied*, 355 U.S. 856 (1957). A judgment does not become a lien until recorded and if recorded after bankruptcy, it is void as a lien against the trustee. *Hamilton Steel Prods. Co. v. Yorke*, 376 F.2d 463 (7th Cir. 1967).

³⁰ 11 U.S.C. § 95(b) (1964); *Syracuse Eng'g. Co. v. Haight*, 110 F.2d 468 (2d Cir. 1940); *In re Blount*, 142 F. 263 (E.D. Ark. 1906); *Leighton v. Kennedy*, 129 F. 737 (1st Cir. 1904) (petition filed by one creditor dismissed where it was established there were more than 12 creditors and three or more creditors failed to join in petition). *Theis v. Luther*, 151 F.2d 397 (8th Cir.), *cert. denied*, 327 U.S. 781 (1945). While some courts have held that small current claims should not be taken into account in determining the number of creditors of an alleged bankrupt, *In re Blount*, 142 F. 263 (E.D. Ark. 1906), other jurisdictions have held that

an involuntary petition may be filed by one creditor.³¹ The petition must be executed in triplicate and verified under oath by general unsecured creditors. A secured creditor may act as a petitioning creditor only to the extent of the unsecured portion of his claim, which should be specifically indicated in the petition as otherwise there may be a claim asserted later that by joining in the involuntary petition as an unsecured creditor he waived his security.³²

A bankruptcy proceeding upon an involuntary petition is initiated by the filing of an original and two duplicate petitions with the clerk of the court. The clerk then issues subpoenas which, together with the duplicate petitions, are delivered to the United States Marshal for service upon the alleged bankrupt. The attorney should be armed with the information as to the names and addresses, both business and home, of the officers of the alleged bankrupt corporation, or the partners of a partnership or of the individual bankrupt. The subpoena is returnable within 10 days and the bankrupt has 5 days after the return date to answer or otherwise plead to the involuntary petition.³³ Where the subpoena cannot be served by the United States Marshal, he makes a return of non-service and the attorneys can then proceed to serve the alleged bankrupt by publication. Where the bankrupt is a corporation, either domestic or foreign, service of the subpoena may be made upon the Secretary of State.

creditors holding bona fide claims for small personal expenses should be counted in determining whether an involuntary bankruptcy could be filed by one creditor, or whether three creditors were required. *Theis v. Luther*, 151 F.2d 397 (8th Cir. 1945). See also 3 W. COLLIER, BANKRUPTCY ¶ 59.20, at 626-29 (14th ed. 1968); *In re Branche*, 275 F. 555 (N.D.N.Y. 1921); *Grigsby-Grunow Co. v. Hieb Radio Supply Co.*, 71 F.2d 113 (8th Cir. 1934); *In re Kirk*, 198 F. Supp. 771 (D. Pa. 1961).

³¹ *Northeastern Real Estate Sec. Corp. v. Goldstein*, 163 F.2d 963 (2d Cir. 1947); *In re Garrett & Co.*, 134 F.2d 227 (7th Cir. 1943).

³² *U.S. Nat'l Bank v. Chase Nat'l Bank*, 331 U.S. 28 (1947); *Mt. Vernon Hotel Co. v. Block*, 157 F.2d 637 (9th Cir. 1946); *In re Central Ill. Oil & Refining Co.*, 133 F.2d 657 (7th Cir. 1943); *In re Hayes*, 127 F. Supp. 514 (D. Ala. 1955); *In re Mann*, 117 F. Supp. 511 (D. Md. 1952); *In re Silver*, 109 F. Supp. 200 (E.D. Ill. 1952), *aff'd*, 204 F.2d 259 (7th Cir. 1953); *In re Lawton*, 119 F. Supp. 724 (S.D. W.Va. 1954).

³³ 11 U.S.C. § 41 (1964).

The unwarranted filing of an involuntary petition in bankruptcy can have serious repercussions, particularly if the petition is opposed and dismissed. Where the debtor is successful in having the petition dismissed he has the right to recover costs, expenses and damages and may also have the right to institute an action for malicious prosecution.³⁴

The order adjudicating a debtor a bankrupt may not be collaterally attacked nor may the adjudication be vacated in a collateral attack.³⁵ Instead, the order of the referee may be appealed by way of a petition for review, which must be filed within 10 days from the entry of the order of the referee, unless for cause shown the period is extended, and an application for such extension must be filed within the 10 day period.³⁶ Appeals from the orders of the District Court may be taken to the United States Court of Appeals. The appeal is perfected by the filing of a notice of appeal within 30 days from the service of the order of the court, where served with notice of entry within 5 days of its entry, or 40 days where there is service of the order with notice of entry. In effect, the maximum period for filing an appeal is 40 days, whether or not served with any notice as to the entry of the order.³⁷

Creditors do not have the right to oppose the filing of an involuntary petition in bankruptcy. This is limited

³⁴ 11 U.S.C. §§ 109(b), 78(n) (1964); *In re Joslyn's Estate*, 171 F.2d 159 (7th Cir. 1949); *In re Swofford*, 112 F. Supp. 893 (D. Minn. 1952); *In re Childs Co.*, 52 F. Supp. 89 (S.D.N.Y. 1943); *In re Sabul*, 36 F. Supp. 95 (D. N.J. 1940); *In re Summit, Inc.*, 10 F. Supp. 495 (W.D.N.Y. 1935).

³⁵ *Cornwell Press, Inc. v. Ray Long & Richard R. Smith, Inc.*, 75 F.2d 276 (2d Cir. 1935). The orders entered in the bankruptcy proceeding are res judicata of the subject matter before the court as between the parties and those standing in privity thereto. *Myers v. International Trust Co.*, 263 U.S. 64 (1923); *In re Imperial "400" Nat'l Inc.*, 391 F.2d 163 (3rd Cir. 1968); *Hummel v. Equitable Life Assur. Soc.*, 151 F.2d 994 (7th Cir. 1945); *In re Tele-Tone Radio Corp.*, 133 F. Supp. 739 (D.N.J. 1955).

³⁶ 11 U.S.C. § 67 (c) (1964); *In re Imperial "400" Nat'l Inc.*, 391 F.2d 163 (3rd Cir. 1968); *St. Regis Paper Co. v. Jackson*, 369 F.2d 136 (5th Cir. 1966); *In re Beverly Hills Security Investments*, 233 F. Supp. 737 (D. Ariz. 1964).

³⁷ 11 U.S.C. § 48 (1964); FED. R. CIV. PROC. §§ 73-76. The provisions of § 48 with respect to filing a notice of appeal within 40 days after the entry of the order of the district court is mandatory and jurisdictional. If the appeal is not taken within 40 days the court has no jurisdiction and must dismiss the appeal. *Hart v. Hedrick*, 390 F.2d 10 (5th Cir. 1968).

solely to the debtor.³⁸ However, an involuntary petition, as well as a voluntary petition, cannot be dismissed upon the application of either the bankrupt or the petitioning creditors, except upon notice to all of the creditors of the bankrupt.³⁹ In order to proceed with an application to dismiss a bankruptcy proceeding the bankrupt must file a list, under oath, of all of his creditors setting forth their addresses, and notice of this application must be given to all creditors, as set forth in said list or schedule. While the time for the hearing may be fixed by the court in an order to show cause, if the application is by way of notice of motion it should be on 10 days notice to the creditors. However, if the bankrupt can obtain the consent of all creditors, the petition may be dismissed upon consent.⁴⁰

PROCEDURE UPON THE FILING OF PETITION

Similar to the requirements with respect to the filing of an involuntary petition, the filing of a voluntary petition and the schedules and statement of affairs that must accompany same should be prepared and executed in triplicate, under oath, and then filed in triplicate with the clerk of the court, paying the filing fee of \$50.00. It is a rare situation where the court will permit the filing of

³⁸ 11 U.S.C. § 41 (1964); *In re Carden*, 118 F.2d 677 (2d Cir.), cert. denied, 314 U.S. 647 (1941); *In re T. J. Ronan Co.*, 114 F. Supp. 299 (S.D.N.Y. 1953). Creditors cannot oppose a petition in involuntary bankruptcy either directly or through collateral attack. *Wynne v. Rochelle*, 385 F.2d 789 (5th Cir. 1967). 11 U.S.C. § 41 (1964).

³⁹ 11 U.S.C. § 95(g) (1964).

⁴⁰ *In re Riordan*, 95 F.2d 454 (7th Cir. 1938); *In re Thorpe*, 12 F.2d 775 (7th Cir. 1926); *In re Burns*, 36 F. Supp. 469 (S.D.N.Y. 1942). See *In re Sig. H. Rosenblatt & Co.*, 193 F. 638 (2d Cir. 1912) where the bankrupt filed an answer to an involuntary petition and neither the petitioning creditors nor the bankrupt put up the deposit required by the referee as indemnity, and nothing further was done. The court denied the subsequent motion of the bankrupt to dismiss the proceeding for lack of prosecution and also denied the counterclaim of the petitioning creditors to strike out the answer, and entered an order of adjudication. The court further held that as the bankrupt had failed to file the verified list of creditors, and had failed to give notice as required under § 109(g) to the creditors, his motion to dismiss was denied.

a voluntary petition without schedules and statement of affairs.

After the filing of the petition the next step to be taken is to protect the assets of the estate and creditor interests. If there are perishable or movable assets an application should be made to the court for the appointment of a receiver. The receiver is a temporary court officer functioning until the first meeting of creditors and the election of a trustee, who is the permanent officer in charge of the administration and liquidation of the estate.⁴¹ The court will grant such an application where it finds it is necessary and requisite to protect the assets of the estate.⁴² If a voluntary petition has been filed, the application for the appointment of a receiver may be made by any creditor, without any bond being required.⁴³ Where an involuntary petition has been filed not only may one of the petitioning creditors, but *any* creditor may apply for the appointment of a receiver, furnishing, however, a bond for costs to the court. The application for the appointment of a receiver may be made either simultaneously with the filing of the involuntary petition or at any time thereafter.⁴⁴ It may be made before the entry of the order of adjudication.⁴⁵

The provisions of the Bankruptcy Act require the scheduling of every liability and every asset belonging to or in which the bankrupt has an interest.⁴⁶

⁴¹ 11 U.S.C. § 11(a) (3) (1964); *In re F. P. Newport Corp.*, 216 F.2d 344 (9th Cir. 1954), *aff'd* 123 F. Supp. 95 (S.D. Cal.), *cert. denied*, 348 U.S. 972 (1955); *In re F.P. Newport Corp.*, 137 F. Supp. 58 (S.D. Cal. 1955); *Levin v. Barker*, 122 F.2d 969 (8th Cir. 1941), *cert. denied*, 315 U.S. 813 (1942); *In re Olsen*, 70 F.2d 253 (2d Cir. 1934).

⁴² *Harris v. Capehart-Farnsworth Corp.*, 207 F.2d 512 (8th Cir. 1953); *In re National Republic Co.*, 109 F.2d 167 (7th Cir. 1940).

⁴³ 11 U.S.C. § 109(a) (1964); *In re Ziegler Printing Co.*, 6 F. Supp. 840 (W.D. Pa. 1934).

⁴⁴ 11 U.S.C. § 109 (1964); *In re Oakland Popcorn Supply, Inc.*, 213 F. Supp. 665 (N.D. Cal. 1963); *In re Premier Floor Covering Co.*, 35 F. Supp. 901 (E.D.N.Y. 1940); *In re Zeigler Printing Co.*, 6 F. Supp. 840 (W.D. Pa. 1934); *In re D & E Dress Co.*, 244 F. 885 (S.D.N.Y. 1916).

⁴⁵ *In re Oakland Popcorn Supply, Inc.*, 213 F. Supp. 665, 669 (N.D. Cal. 1963); *In re Ziegler Printing Co.*, 6 F. Supp. 840 (W.D. Pa. 1934).

⁴⁶ 11 U.S.C. § 25 (1964).

The entry of the order of adjudication follows as a matter of course in connection with the filing of a voluntary petition.⁴⁷ With respect to the involuntary petition, if no answer is interposed within five days after the return date of the subpoena, then an order of adjudication in bankruptcy is entered upon the involuntary petition, and the proceedings referred to a referee.⁴⁸ If an answer is to be interposed, it should be filed within five days after the return date of the subpoena.⁴⁹

The right to a trial by jury is limited solely to the question of insolvency and the demand therefor must be made at or before the time of the filing of the answer. If the demand is not so made, the right to a trial by jury is deemed waived.⁵⁰ All other issues may be tried either by the court or referred to a referee to make the adjudication or dismiss the petition.⁵¹

Upon the entry of the order of adjudication, whether in a voluntary or involuntary proceeding, the referee sends out notices of a first meeting to be held not less than 10 days nor more than 30 days after the date of adjudication in bankruptcy.⁵²

The receiver, upon his appointment and pending the first meeting of creditors, takes charge of the property and assets for the purpose of protecting the interests of creditors until either the petition is dismissed (where he is appointed prior to the entry of an order of adjudication) or the trustee in bankruptcy qualifies.

⁴⁷ 11 U.S.C. § 41(g) (1964).

⁴⁸ 11 U.S.C. § 41 (1964).

⁴⁹ 11 U.S.C. § 41(b) (1964).

⁵⁰ 11 U.S.C. § 42(a) (1964). See *In re Maley Tire Co.*, 273 F. Supp. 369 (N.D.N.Y. 1967), where the demand for a jury trial was served after the answer to the involuntary petition had been filed. It was held that the demand was not timely made and the debtor not entitled to a jury trial. The written application for a jury trial must be filed at or before the time within which the answer must be filed.

A jury trial in bankruptcy is limited to the insolvency of the debtor and the commission of an act of bankruptcy. The demand for a jury trial must be in writing and filed either prior to or simultaneously with the answer to the involuntary petition. *Wynne v. Rochelle*, 385 F.2d 789 (5th Cir. 1967).

⁵¹ 11 U.S.C. § 41(d) (1964).

⁵² 11 U.S.C. § 91(a) (1964).

The receiver is authorized to prosecute or defend suits or proceedings by or against a bankrupt.⁵³ Since the receiver is a temporary court officer it is rare that he is ever authorized to institute any suit or proceeding other than in connection with the liquidation of the assets that have come into his possession.

The receiver is authorized and may immediately proceed upon his appointment to liquidate the assets of the estate. It is usually by a sale at public auction, but he also has the right to dispose of the same on offer heard before the referee, on due notice to all creditors.⁵⁴ Normally, neither the court nor the referee will authorize a sale of assets prior to the entry of an order of adjudication, except upon the consent of the alleged bankrupt.⁵⁵ While there is a right of private sale, it is rarely invoked and it is strictly limited to highly perishable merchandise.⁵⁶

If, at the time of the filing of the petition, the bankrupt is subject to law suits, as well as garnishments, an application may be made to the referee for an order to stay the further conduct of any suit or proceeding in the state court against the bankrupt, pending the granting or denial of a discharge to the bankrupt.⁵⁷

⁵³ 11 U.S.C. § 11(a) (3) (1964); *In re Rosenbaum Mirror Mfg. Co.*, 11 F. Supp. 314 (D.C.N.Y. 1935), *aff'd*, 86 F.2d 1011 (2d Cir. 1936); *In re Marcus*, 11 F.2d 513 (7th Cir. 1926); *Maynor v. Schaefer*, 244 Ala. 111, 11 So. 2d 846 (1943).

⁵⁴ 11 U.S.C. §§ 94, 110, 2(a) (3) (1964); *Bragg v. Gerstel*, 148 F.2d 757 (5th Cir. 1945), where the sale was conducted without notice to the creditors, the sale was set aside as improvident and as working a legal fraud on the creditors. Normally, a judicial sale will not be set aside for inadequacy of price unless other circumstances are present, indicating unfairness or impropriety. *Mason v. Ashback*, 383 F.2d 779 (10th Cir. 1967); *In re Little & Ives Co.*, 262 F. Supp. 719 (S.D.N.Y. 1966); *In re Solantikas*, 33 F.2d 200 (W.D. Pa. 1929).

⁵⁵ 11 U.S.C. § 110(f) (1964); 6 REMINGTON BANKRUPTCY § 2543 (5th ed. 1952); *In re Peerless Finishing Co.*, 199 F. 350 (S.D.N.Y. 1912); *In re Desrochers*, 183 F. 991 (N.D.N.Y. 1911); *In re T. C. Kelly Dry Goods Co.*, 102 F. 747 (E.D. Wis. 1900).

⁵⁶ 11 U.S.C. § 110(f) (1964); *Puerto Rico v. Shell Co.*, 302 U.S. 253 (1937); *In re Layton*, 221 F. Supp. 667 (D. Ariz. 1963); *In re Bernhard Altmann Int'l Corp.*, 226 F. Supp. 201 (S.D.N.Y. 1963); *In re Paper Corp. of America*, 138 F. Supp. 29 (S.D.N.Y. 1956), as to form of notice of sale—private or public; *In re Yalden*, 109 F. Supp. 603 (D. Mass. 1953).

⁵⁷ 11 U.S.C. § 29 (1964).

EXAMINATIONS

After the filing of the petition, the receiver, or if no receiver has been appointed, a creditor, has the right under § 44 of the U.S. Code to conduct examinations of the bankrupt and others with respect to the property, assets and effects of the bankrupt. Within the scope of these rights and the provisions of § 44, the examination includes not only the bankrupt and the officers of the bankrupt, but also witnesses, who may include employees, debtors, creditors, both secured and unsecured, and any other party regarding transactions with the bankrupt and its property, assets and effects. The examination has been described as a "fishing expedition" which indeed it is, being almost unlimited in scope and in time.⁵⁸

In conducting these examinations, the bankrupt and witnesses can be called upon to produce their books, records, original instruments, cancelled vouchers, financial statements and any and all documents in connection with all transactions had with the bankrupt. The scope of the examination is broad, general and unlimited as to time, in order to afford the creditors and the receiver the means and the opportunity of tracing and ascertaining the bankrupt's activities, assets, liabilities and transactions.

THE TRUSTEE

As indicated, upon the entry of the order of adjudication the proceedings are referred to a referee who sends out the notices for the first meeting of creditors, at which the creditors may elect a trustee.⁵⁹ The appointment of a trustee terminates the receivership.⁶⁰ The trustee is

⁵⁸ 11 U.S.C. § 44 (1964); *In re Prudence Co.*, 92 F.2d 424 (2d Cir. 1937); *In re Youroveta Home & Foreign Trade Co.*, 288 F. 507 (2d Cir. 1923); *In re Insull Utility Investments, Inc.*, 27 F. Supp. 887 (S.D.N.Y. 1934).

⁵⁹ 11 U.S.C. §§ 72(a), 91(a) (1964).

⁶⁰ *F.P. Newport Corp. v. Sampsell*, 216 F.2d 344 (9th Cir.), *aff'd* 123 F. Supp. 95 (S.D. Cal. 1954), *cert. denied*, 348 U.S. 972 (1955); *In re Olsen*, 70 F.2d 253 (2d Cir. 1934); *Stanton v. Busch*, 59 F.2d 668 (9th Cir. 1932).

elected by the vote of a majority in amount and number of the claims of general unsecured claims present and voting at the first meeting.⁶¹ Hence, it is requisite for those who desire to participate in the nomination and election of a trustee to have their claims in order, and be present at the meeting. If an attorney is to vote the claims, then a power of attorney should be executed by the creditors, which requires an acknowledgment. If more than one claim is being voted by a creditor, a committee of creditors or an attorney, then an affidavit must be submitted in accordance with the local rules of the court.⁶² The rules should be examined, for their requirements are different as to the creditor, committee and attorney. Otherwise, the attorney, the creditor and the committee will be limited to voting on proof of claim. Secured creditors are not entitled to vote except to the extent that their claims may be unsecured, which is measured by the excess of the indebtedness over the value of the security held by them.⁶³

The trustee is vested with the right and the duty of liquidating all of the assets of the estate into cash, conducting examinations into the affairs, acts, conduct and transactions of the bankrupt, instituting actions for the recovery of preferential and fraudulent transfers or for the recovery of assets belonging to the estate, and the enforcement of any claim or cause of action that may be an asset of the estate.⁶⁴ These assets will include inheritances and executory devises passing to an individual bankrupt within six months of the filing of the petition, judgment in negligence actions recovered prior to the filing of the petition, and all property that could have been

⁶¹ While a trustee is to be elected by a majority in amount and number of claims present and voting, if neither candidate has a majority, the referee may appoint. *In re Haupt & Co.*, 379 F.2d 884 (2d Cir. 1967). See *In re Eloise Curtis, Inc.*, 388 F.2d 416 (2d Cir. 1967), where the referee appointed the trustee after disapproving of the trustee nominated by the creditors.

⁶² U.S. DIST. CT. R. (bankruptcy) 15 (E.D. and S.D. of N.Y.).

⁶³ 11 U.S.C. § 92(b) (1964).

⁶⁴ 11 U.S.C. §§ 75(a), 96, 107, 110 (1964).

transferred by the debtor or levied upon, or sold under judicial process upon a claim of a creditor.⁶⁵

⁶⁵ The line of demarcation is the date of the filing of the bankruptcy petition. The trustee's title in and to all of the bankrupt's assets vests as of that date. The rights of all parties are to be determined as of the time the petition is filed. *In re Lustron Corp.*, 184 F.2d 789 (7th Cir. 1950), *cert. denied*, 340 U.S. 946 (1951); *Tuffy v. Nichols*, 120 F.2d 906 (2d Cir.), *cert. denied*, 314 U.S. 660 (1941); *City of Long Beach v. Metcalf*, 103 F.2d 483 (9th Cir.), *cert. denied*, 308 U.S. 602 (1939).

The test to be applied as to the property of a bankrupt passing to the trustee is two-fold; (1) could the property have been transferred by the bankrupt; or (2) levied upon and sold under judicial process against him, or otherwise seized, impounded or sequestered. If either condition can be met the property passes. *Young v. Handwork*, 179 F.2d 70 (7th Cir. 1949); *Adelman v. Centaur Corp.*, 145 F.2d 573 (6th Cir. 1944); *Gillaspay v. International Harvester Co.*, 109 Miss. 136, 67 So. 904 (1915). If neither one of the conditions can be met the property does not pass to the trustee. *In re Baxter*, 104 F.2d 318 (6th Cir. 1939); *Ruebush v. Funk*, 63 F.2d 170 (4th Cir. 1933).

A verdict was recovered by the bankrupt in a personal injury action prior to the filing of the petition but final judgment was not entered until after the filing of the petition. Under this situation the court held the recovery was not transferable nor leviable and did not pass to the trustee. *Ruebush v. Funk*, 63 F.2d 170 (4th Cir. 1933).

In *Allen v. Tate*, 6 F.2d 139 (8th Cir. 1925), a contingent interest under a will, which was not transferable nor leviable, was held not to pass.

Property not owned by the bankrupt but acquired subsequent to the filing of the petition does not pass to the trustee but is the property of the bankrupt, clear of all claims that are discharged by the bankruptcy proceeding. *Siegel v. Rochelle*, 382 U.S. 375 (1966); *Everett v. Judson*, 228 U.S. 474 (1913); *In re Scranton Knitting Mills*, 23 F. Supp. 803 (M.D. Pa. 1938); *In re Mitchell*, 42 Am. B.R. 658 (N.D.N.Y. 1919).

But, not coming within this rule and passing to the trustee are income taxes paid prior to the filing of the petition, *Siegel v. Rochelle*, 382 U.S. 375 (1966), as well as any property inherited within six months after the filing of the petition.

The bankrupt's interest in a tenancy by the entirety, tenancy in common or joint tenancy will pass to the trustee if the same was transferable or leviable within the test above stated. *Mangus v. Miller*, 317 U.S. 178 (1942); *Fetter v. U.S.*, 269 F.2d 467 (6th Cir. 1959); *Dioguardi v. Curran*, 35 F.2d 431 (4th Cir. 1929).

As to trustees' interest in spendthrift trusts see *Eaton v. Boston Safe Deposit & Trust Co.*, 240 U.S. 427 (1916); *In re Morris*, 204 F. 770 (2d Cir. 1913).

Passing to the trustee is the right to unpaid but earned wages and salary, at the time of the filing of the petition. *In re Cohen*, 276 F. Supp. 889 (N.D. Cal. 1967).

Separation pay due to the bankrupt at the time of the filing of the petition is property passing to the trustee. *In re Durham*, 272 F. Supp. 205 (S.D. Ill. 1967).

The trustee succeeds to the rights of the beneficiary bankrupt in a testamentary trust under which he has a present right to income and a contingency as to the corpus, subject, however, to the state laws as to exemptions. *In re Dollard*, 275 F. Supp. 1001 (C.D. Cal. 1967).

The trustee, upon his appointment, must qualify by filing his bond within five days of his appointment.⁶⁶ He should then procure a copy of the schedules filed by the bankrupt to ascertain the assets and liabilities that have been scheduled. This should be followed by a demand of all the assets of the bankrupt estate, together with the books and records of the bankrupt.

It is the trustee's duty to take possession of all of the assets of the estate and books and records of the bankrupt immediately upon his appointment.⁶⁷ However, exempt property does not pass to the trustee.⁶⁸ The Bankruptcy Act recognizes the allowance of exemptions granted a bankrupt in the state of his domicile by the laws of the United States as well as the laws of the state in force at the time of the filing of the petition.⁶⁹ The right to claim property exempt is limited to individuals and not to partnerships nor corporate property. No exemption will be allowed out of any property transferred or concealed in fraud of creditors and recovered by the trustee.⁷⁰ Exemptions vary from state to state, depending upon state law.⁷¹

Where the bankrupt was the beneficiary of an *inter vivos* trust created by his mother with the power of appointment, other than to himself, his creditors or his estate, the court held the bankrupt had only a special power of appointment, that he was not vested with ownership rights in the corpus of trust and the corpus did not pass to the trustee. The court held that as to the income of the trust, the trustee was vested with the interest the bankrupt could have transferred or the creditors could reach by legal process. *Drummond v. Cowles*, 278 F. Supp. 546 (D. Conn. 1968).

⁶⁶ 11 U.S.C. § 78(a) (1964).

⁶⁷ 11 U.S.C. §§ 25 & 75(a) (1964).

⁶⁸ 11 U.S.C. § 24 (1964). In *In re Ragozinno*, 38 F. Supp. 53 (E.D.N.Y. 1941), the bankrupt assigned a policy of insurance not scheduled by him, after the filing of the petition, to secure a loan. The trustee was successful in setting aside the transfer and sought to obtain the cash surrender value of the policy. By reason of the concealment of the policy and its recovery by the trustee, the court denied the bankrupt's claim of exemption as to the policy and its cash surrender value.

⁶⁹ *Phillips v. C. Palomo & Sons*, 270 F.2d 791 (5th Cir. 1959); *Seiden v. Southland Chenilles' Inc.*, 195 F.2d 899 (5th Cir. 1952); *Turner v. Bovee*, 92 F.2d 791 (9th Cir. 1937); *In re Reiter*, 58 F.2d 631 (2d Cir.), *cert. denied*, 287 U.S. 652 (1932); *In re Star Spring Bed Co.*, 243 F. 957 (D.N.J. 1917); *In re O'Hara*, 162 F. 325 (M.D. Pa. 1908).

⁷⁰ 11 U.S.C. § 24 (1964).

⁷¹ Homestead exemptions are granted but limited in value to \$1,000 in Maine, New York, North Carolina and Ohio. They are unlimited as to value in Florida. There are no homestead exemptions in Connecticut, Dela-

With respect to the administration of the estate, the trustee may retain counsel, who is entitled to compensation only if he has been retained pursuant to the order of the court.⁷²

The trustee and his attorney then should forthwith proceed to reduce the assets of the estate to cash. This entails the sale at public auction of the physical assets whether real or personal or both. In practically all instances the application for leave to sell should be on the petition of the trustee calling for the appointment of an appraiser and the designation of an auctioneer to conduct the public sale, on notice to all creditors.⁷³

The sale will be consummated if the gross proceeds of the assets realize at least 75% of the appraised value.⁷⁴ If less than 75% is realized, an application must be made to the referee to approve or disapprove of the sale, and good cause must be shown to have the sale approved, otherwise a resale will be ordered.

One of the prime duties of the trustee is to investigate into the conduct, property, assets and effects of the bankrupt. This will entail the examination of the bankrupt individually, or the officers of the bankrupt corporation, and witnesses. The examinations are usually commenced at the first meeting of creditors, and then adjourned for more extensive examinations. The purpose of the adjournment is to afford an opportunity to the trustee and his attorney to examine into the books and records of the bankrupt. Where the affairs of the bankrupt are com-

ware, District of Columbia, Indiana, Maryland, New Jersey, Pennsylvania and Rhode Island. Nevada has a \$10,000 homestead exemption. California may even have a higher value homestead exemption. As to recognition of State Homestead Law by the Bankruptcy Court, see *Elliott v. Ostman*, 340 F.2d 581 (9th Cir. 1965); *Esten v. Cheek*, 254 F.2d 667 (9th Cir. 1958).

⁷²U.S. DIST. CR. R. (Bankruptcy) 10 (S.D. & E.D. N.Y.); General Order 44, General Orders and Official Forms in Bankruptcy.

⁷³11 U.S.C. §§ 94, 110(f) (1964); *Bragg v. Gerstel*, 148 F.2d 757 (5th Cir. 1945); *In re Clark*, 257 F. Supp. 761 (E.D. Va. 1966); *In re Park Distributors, Inc.*, 176 F. Supp. 38 (S.D. Cal. 1959); *In re Winthrop Mills*, 106 F. Supp. 464 (D. Me. 1952).

⁷⁴11 U.S.C. § 110(f) (1964); *Frazier v. Ash*, 234 F.2d 320 (5th Cir. 1956); *Reid v. King*, 157 F.2d 868 (4th Cir. 1946); *In re Superior Mushroom Growers Corp.*, 228 F. Supp. 372 (E.D. Pa. 1964); *In re New Strand Theatre Inc.*, 109 F. Supp. 350 (S.D.N.Y. 1952).

plicated and require explanation, the trustee may be authorized to retain an accountant. Again, on the application of the trustee, in accordance with the local rules and General Orders,⁷⁵ an order of the referee must be procured in order to assure the accountant compensation for his services.

The examination of the bankrupt's officers and witnesses is without limit as to extent or time, in order to enable the trustee and his attorney to ascertain the nature and the scope of the business affairs of the bankrupt, transfers of property, loans and exchanges, purchases and sales, receipts and disbursements.

If, as a result of these examinations, it appears there have been preferential transfers within four months of the filing of the petition, then the trustee is under an obligation to institute suits for the recovery of the preferences, either in the state court or federal court, wherever jurisdiction over the prospective defendant may be obtained.⁷⁶

⁷⁵ U.S. Dist. Ct. R. (Bankruptcy) 11 (S.D. & E.D.N.Y.); General Order 44, Official Forms in Bankruptcy.

⁷⁶ 11 U.S.C. §§ 96(a), (b) (1964). No preference was found by the court where there was an exchange of security, and where there was no diminution of the estate as a result of the transaction. *First Nat'l Bank of Clinton v. Julian*, 383 F.2d 329, 336 (8th Cir. 1967).

The court permitted the transactions on a running account between the bankrupt and the bank to be set off against each other, even though within four months, and as a result of such set-offs found that there was no preference. *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967).

Where the right of set-off exists there is no preference or fraudulent transfer. *Rosof v. Roth*, 169 F. Supp. 707 (S.D.N.Y. 1957), *aff'd*, 262 F.2d 829 (2d Cir. 1959) (with court holding there is no preference where there is an exchange of mutual debits and credits). See *Mayo v. Pioneer Bank & Trust Co.*, 297 F.2d 392 (5th Cir. 1961), for an extended discussion as to the elements of a preference and the burden on the trustee to obtain a recovery.

Payments and transfers to officers and directors of the bankrupt, to a corporate creditor of the bankrupt in which these same men were officers and directors, or in favor of a group of employees, were held to constitute preferences recoverable by the trustee under section 96 of the U.S. Code. *Feldman v. Capitol Piece Dye Works*, 185 F. Supp. 426 (S.D.N.Y. 1960).

In *Ricotta v. Burns Coal & Bldg. Supply Co.*, 264 F.2d 749 (2d Cir. 1959), payments to a mechanic lienor, even upon an unfiled mechanics lien within four months of the filing of the petition were held not to be a preference, the court pointing out that the payments were made in lieu of the filing of the lien which would have been valid under 11 U.S.C. § 107(b) (1964).

A payment on account of a past indebtedness within four months of the filing of the petition, with knowledge or reasonable cause to believe on the part of the transferee that the transferor is insolvent, or his insolvency is imminent, and that the effect of the payment or transfer will enable him to receive a greater percentage upon his indebtedness than other creditors in the same class, constitutes a preference recoverable by the trustees.⁷⁷

If there has been a transfer of property while insolvent, within one year preceding the filing of the petition,

The trustee must establish and prove every element of a preference. If any one of the elements of a preference as set forth in 11 U.S.C. § 96(a) (1964) is wanting, the trustee has failed. *In re Steinberg*, 138 F. Supp. 462 (S.D. Cal. 1956).

⁷⁷ *Sloan v. Garrett*, 277 F. Supp. 235 (D.S.C. 1967). Where a preferential payment is returned or repaid by the creditor who is also an officer of the bankrupt corporation, within a few days after the taking or receipt of the payment, this creditor-officer would not be required to repay the same sum again to the trustee. *Hassen v. Jonas*, 373 F.2d 880 (9th Cir. 1967); *Kapelus v. Joint Venture*, 377 F.2d 815 (9th Cir. 1967).

In *Cooper Petroleum Co. v. Hart*, 379 F.2d 777 (5th Cir. 1967), the court held that payments on a running account, within four months of the filing of the petition, where not directed to be applied against current contract obligations, were preferential. Here the creditor had extended credit after the receipt of the payments. This decision appears to be contrary to the decisions in many other circuits, including the Second Circuit.

It is not a preference for a bank to set off the deposit or the balance to the credit of the bankrupt account at the time of the filing of the petition, in the absence of fraud or collusion between the bank and the bankrupt. Hence it is not a preference for the bank to set off the deposits against indebtedness owing by bankrupt. *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967).

In *In re R.V. Smith Co.*, 38 F. Supp. 57 (W.D. Okla. 1941), the court held that the transfer of assets to a creditor was not an act of bankruptcy, nor a preference where the creditor paid back to the bankrupt cash, or made loans in excess of what he received from the bankrupt, during the four-month period before the filing of the petition.

The law of the state where the transfer was made controls determination of when the transfer is perfected for the purpose of determining whether there has been a voidable preferential transfer under 11 U.S.C. § 96 (1964). *Holahan v. Gore*, 278 F. Supp. 899 (E.D. La. 1968).

Payment and discharge of a valid mechanic's lien within four months of the filing of the petition does not create or result in a voidable preference. *Sloan v. Garrett*, 277 F. Supp. 235 (D.S.C. 1967); *Ricotta v. Burns Coal & Bldg. Supply Co.*, 264 F.2d 749 (2d Cir. 1959).

The essence of a voidable preference is the depletion of the bankrupt's estate available to the remaining creditors, and a suit to recover a preference may be brought by the trustee, either in the federal court or state court. The element of reasonable cause to believe on the part of the transferee as to the bankrupt's insolvency is as of the time of the transfer. That is, the time of the delivery of the property. *Sloan v. Garrett*, 277 F. Supp. 235 (D.S.C. 1967).

for an inadequate consideration, then the trustee is authorized to institute a fraudulent transfer proceeding under the provisions of the Bankruptcy Act, as well as under state law for the recovery of such transfers.⁷⁸

The lien, levy or attachment, made or created within four months of the filing of the petition, regardless of the date of recovery of judgment upon which such lien, levy or attachment is based, while the debtor is insolvent, is void as against a trustee and may be set aside and the proceeds recovered by the trustee.⁷⁹

⁷⁸ Under 11 U.S.C. § 107(d)(2) (1964), a transfer without fair consideration while insolvent, made within one year of the filing of the petition, can be set aside and recovered by the trustee as a fraudulent transfer. *In re Southern Metal Products Corp.*, 26 F. Supp. 666 (N.D. Ala. 1939).

In *Segrest v. Hale*, 164 S.W.2d 793 (Tex. Civ. App. 1941), the transfer was initiated by letter in 1933, but not perfected by recordation until 1941, after the bankruptcy of the transferor. The court held the transfer came within § 107(d)(2), and was void as to the trustee.

Under 11 U.S.C. § 107(d)(2) (1964), a conveyance or obligation is fraudulent, without regard to actual intent, if not made for a fair consideration and the debtor is insolvent or rendered insolvent as a result thereof. The test, therefore, is fraud in law as distinguished from fraud in fact; constructive fraud a distinguished from actual fraud. If there is a lack of present fair consideration and insolvency, there is a conclusive presumption of fraud. *See also* *Dering v. Williams*, 378 F.2d 417 (9th Cir. 1967); *Marshall v. Showalter*, 375 F.2d 529 (10th Cir. 1967); *Epstein v. Goldstein*, 107 F.2d 755 (2d Cir. 1939); *Rudin v. Steinbugler*, 103 F.2d 323 (2d Cir. 1939); *Wilson v. Robinson*, 83 F.2d 397 (2d Cir. 1936); *In re Kayser*, 177 F. 383 (3d Cir. 1910).

In *Branch v. Steph*, 389 F.2d 233 (10th Cir. 1968), it was held that the trustee was entitled to recover from the seller of corporate stock of the bankrupt the amount received by the seller from corporate assets as payment for the purchase price. Such transaction was held to result in a transfer which was fraudulent as to corporate assets. Here the transaction took place within one year of the filing of the bankruptcy petition, and was found to be without fair consideration. It was held to be a fraudulent transfer voidable by the trustee under § 107(d)(2)(a). *See also* *Dwyer v. Tracey*, 118 F. Supp. 289 (N.D. Ill. 1954); *Caesar v. Bernard*, 156 App. Div. 724, 141 N.Y.S. 659 (1st Dep't 1913).

⁷⁹ 11 U.S.C. § 96 (1964). Set-offs or payments received within four months held to be a preference notwithstanding the running account between the parties. *Shaw v. Walter E. Heller & Co.*, 385 F.2d 353 (5th Cir. 1967); *In re Morasco*, 233 F.2d 11 (2d Cir. 1956); *Constance v. Harvey*, 215 F.2d 571 (2d Cir. 1954); *Zamore v. Goldblatt*, 194 F.2d 933 (2d Cir. 1952) (under §§ 110(c) and (e)); *Tyler State Bank & Trust Co. v. Bullington*, 179 F.2d 755 (5th Cir. 1950); *Gins v. Mauser Plumbing Supply Co.*, 148 F.2d 974 (2d Cir. 1945) (involving a pledge); *In re American Cork Industries*, 54 F.2d 740 (2d Cir. 1931); *In re Huston*, 143 F. Supp. 40 (N.D. Ohio 1956); *England v. Moore Equip. Co.*, 94 F. Supp. 532 (N.D. Cal. 1950); *In re Greenberg*, 48 F. Supp. 3 (D. Mass. 1942). *Contra*, *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S.

A transfer made or a debt incurred by a debtor while insolvent, within four months of the filing of the petition, is fraudulent if made or incurred in anticipation of the filing of the petition and with the intent to use the consideration obtained from such transfer or such debt to enable a creditor to obtain a greater percentage of his debt than other creditors of the same class, and if the transferee or obligee knew or believed the debtor intended to make such use of the consideration.⁸⁰ In effect, if the debtor borrows \$2,500.00 from his friend "A", secured by a security interest on his automobile, for the purpose of paying off the loan owed by the debtor to the bank, which is unsecured, such transaction and the security interest will be deemed to be fraudulent, if it takes place within four months of the bankruptcy of the debtor, and "A" has knowledge or reason to believe his loan will be so used.

It is important to note that while a trustee may move to set aside a lien, he is also given the right to reserve the same for the benefit of the estate as against subordinate or subsequent liens.⁸¹

1021 (1967); *Hartford Acc. & Indemn. Co. v. Coggin*, 78 F.2d 471 (4th Cir. 1935).

A judgment does not become a lien until recorded, and if recorded after bankruptcy, it is void as a lien against the trustee. *Hamilton Steel Prods. Co. v. Yorke*, 376 F.2d 463 (7th Cir. 1967); *In re Wilks*, 196 F. Supp. 640 (N.D. Cal. 1961).

⁸⁰ To void a transfer under § 107(d)(3) of the U.S. Code, the court must find that the transfer meets all of the requirements of the section. There must be an express finding that the transfer was made in contemplation of the filing of the petition under the Bankruptcy Act, and findings that the debtor intended to use the consideration to enable a creditor to obtain a preference, and that the transferee knew or had reason to believe that the consideration was to be so used. All of these conditions were found in *In re Cesari*, 217 F.2d 424 (7th Cir. 1954).

The distinction should be noted between the voidability as a preference of the transfer to the unsecured creditor, and the voidability under § 107(d)(7) of the transfer of assets to secure the creditor supplying the funds to make the payment. *Dean v. Davis*, 242 U.S. 438 (1917); *Dering v. Williams*, 378 F.2d 417 (9th Cir. 1967); *Marshall v. Showalter* 375 F.2d 529 (10th Cir. 1967); *In re Cesari*, 217 F.2d 424 (7th Cir. 1954); *Trautwein v. Mandel*, 127 F.2d 567 (8th Cir. 1942); *In re Atlas Foundry Co.*, 155 F. Supp. 615 (D.N.J. 1957).

⁸¹ *Connell v. Walker*, 291 U.S. 1 (1933).

If, as a result of the examinations, it appears that there is an unaccounted discrepancy between the liabilities and the assets, the trustee can call upon the bankrupt to account for the discrepancy. This proceeding is known as a "turnover proceeding." It is brought before the referee, usually by an order to show cause, but also may be by way of a petition and notice of motion. The application will call upon the bankrupt to account for the discrepancy between his assets and liabilities at a starting point, normally within a reasonable period of time prior to the filing of the petition, and the assets and liabilities of the bankrupt at the time of the filing of the petition. The proceeding is founded on the books and records of the bankrupt, financial statements issued by the bankrupt, assets and liabilities as of the starting date, and if, after giving due credit to all transactions from that date to the date of the filing of the petition, there is an unaccounted discrepancy of assets, then the bankrupt is called upon to either account for the discrepancy or to turn over the asset. This proceeding should be brought as promptly as possible after the filing of the petition.

While the courts have held there is a presumption of continued possession of assets, this presumption weakens and fades as time elapses. In addition, the burden is on the trustee to establish present liability of the debtor to comply with any turnover order. Before the court will grant a turnover order the trustee must establish his claim by a clear preponderance of evidence. Unless the trustee can show that the bankrupt has the ability to comply with the turnover order the court will be most reluctant to grant any such order.

The consequences of a turnover order are most severe. It cannot be collaterally attacked. Failure to comply with the order will result in contempt proceedings, for failure to comply with the order of the court. While contempt proceedings are civil in nature, the bankrupt may be imprisoned for an indefinite term and the time of his in-

carceration in a civil jail will rest in the discretion of the court.⁸²

The trustee can also question the validity of any lien or encumbrance affecting the property and assets of the bankrupt. If the property was in the possession of the bankrupt at the time of the filing of the petition, and hence came into the possession of the bankruptcy court, and the receiver-trustee, the court has "summary" jurisdiction. This is merely a designation given to a proceeding brought on before the referee, by way of motion or order to show cause to the secured creditor, for leave to sell the asset that may be encumbered, free and clear of the lien of the encumbrance, and to hold the proceeds in a special fund pending the determination of the validity of the lien

⁸² On the subject of turnover proceedings and contempt for failure to comply with the turnover order, see *Maggio v. Zeitz*, 333 U.S. 56 (1948); *Oriel v. Russell*, 278 U.S. 358, 362 (1929); *First National Bank of Clinton v. Julian*, 383 F.2d 329, 333 (8th Cir. 1967); *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir. 1967), *cert. denied*, 389 U.S. 1021 (1968); *In re Standard Coal Mining & Converters Corp.*, 178 F.2d 819 (7th Cir. 1950); *Seligson v. Goldsmith*, 128 F.2d 977 (2d Cir. 1942); *In re California Motors*, 122 F. Supp. 885 (E.D.N.Y. 1954); *In re Wire Corp. of America*, 131 F. Supp. 586 (D.N.J. 1955).

As to turnover against a third party for assets claimed to belong to the bankrupt estate, the prime question before the court will be whether there was actual or constructive possession in the court as to the property sought to be turned over and whether the respondent's adverse claim is bona fide or colorable. See *Schwartz, Turnover and Contempt Proceedings in the Light of the History of Maggio v. Zeitz*, U.C.L.A. INTRA. L. REV. 75 (1958); *Cline v. Kaplan*, 323 U.S. 97 (1944); *Sampson v. Imperial Paper Corp.*, 313 U.S. 215 (1941); *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940); *May v. Henderson*, 268 U.S. 111 (1925). In *Sahn v. Pagano*, 302 F.2d 629 (2d Cir.), *cert. denied*, 371 U.S. 819 (1962), the court held that where the officers of the bankrupt, on the eve of the filing of the petition, extracted \$700,000 in exchange for their personal notes upon which they put in an adverse claim in opposition to a turnover motion against them on the part of the trustee, it is not ousted of its jurisdiction by the mere assertion of an adverse claim. The court may enter upon a preliminary inquiry to determine whether the adverse claim is real and substantial, or merely colorable, and if merely colorable, proceed to adjudicate the merits summarily.

Here the court found the claim to be baseless in fact and in law, that it had jurisdiction to determine the matter summarily and directed a turnover against the bankrupt. Subsequently the bankrupt's officers were held in contempt for failure to comply with the turnover order and their applications for a release and for habeas corpus were denied on the ground of the gross looting of the bankrupt estate and the incredible explanation of the officers as to the disposal of the loot. See also *United States v. Fitzpatrick*, 330 F.2d 953 (2d Cir. 1964).

or encumbrance.⁸³ If the trustee can establish that there is an equity, or there is a valid doubt as to the validity of the lien or encumbrance, the referee may grant the application and direct the property to be sold free and clear of the lien, and that the proceeds be held in a special fund pending the determination of its validity.⁸⁴ The proceedings are thereafter conducted before the referee, who has the jurisdiction to determine not only the validity but the amount due upon the lien or encumbrance.⁸⁵

If the property was not in the possession of the bankrupt at the time of the filing of the petition, but in the possession of the secured creditor, then the court does not have summary jurisdiction and the trustee must resort to a "plenary" suit. This is a suit in the appropriate state or federal court having jurisdiction over the defendant to try out the issues with respect to the validity and the amount due upon the lien or encumbrance.⁸⁶

⁸³ If the foreclosure proceedings are instituted prior to bankruptcy, the state court retains jurisdiction and the proceedings may not be enjoined or restrained by the bankruptcy court. *Straton v. New*, 283 U.S. 318 (1931).

The proceedings may, however, be stayed to determine the validity of the lien. If bankruptcy precedes any action on the part of the secured creditors, then the secured creditor cannot proceed with the foreclosure of the security, whether real estate or personal property, without permission of the bankruptcy court. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931).

Where the mortgagee merely commences foreclosure proceedings by publication, without taking possession as authorized by state law, before the filing of the bankruptcy petition, the referee has jurisdiction to authorize the sale of the real estate free and clear of the lien of the mortgage. The court founded this decision upon the fact that the property had not come into the possession of the state court prior to the filing of the petition. *In re Bowden*, 274 F. Supp. 729 (D. Me. 1967).

⁸⁴ *In re Kaminsky*, 281 F. Supp. 676 (E.D. Wis. 1968). Where the trustee has shown that the property is in the possession of the court and that there is an equity, the court will order a sale free and clear of liens, the proceeds to be held to await the determination of the validity and amount due upon the lien. *See, e.g., Van Huffel v. Harkelrode*, 284 U.S. 225 (1931); *Seaboard Nat'l Bank v. Rogers Milk Prods. Co.*, 21 F.2d 414 (2d Cir. 1927); *In re Nat'l Grain Corp.*, 9 F.2d 802 (2d Cir. 1926); *In re George T. Bell & Co.*, 29 F. Supp. 989 (M.D. Pa. 1939).

⁸⁵ *In re Prindible*, 115 F.2d 21 (3d Cir. 1940); *Seaboard Nat'l Bank v. Rogers Milk Prods. Co.*, 21 F.2d 414 (2d Cir. 1927).

⁸⁶ Where the property was under the jurisdiction of the state court in a pending suit at the time of the filing of the petition, the bankruptcy court does not have summary jurisdiction but the trustee will be relegated to instituting a plenary suit. *Carney v. Sanders*, 381 F.2d 300 (5th Cir. 1967).

It should be noted that bankruptcy does not supersede nor oust a receiver in a pending foreclosure proceeding at the time of the filing of the petition in bankruptcy.⁸⁷ On the other hand, a foreclosure proceeding may not be instituted after the filing of the petition in bankruptcy without leave of the bankruptcy court.⁸⁸

Under these sections and the general provisions of the Bankruptcy Act, the trustee stands not only in the position of the bankrupt, but also in the shoes of the creditors, with the right to attack payments and transfers as preferences, or fraudulent as against the creditors under the provisions of both the Bankruptcy Act and State Law.⁸⁹

Suits under §§ 96, 107 and 110 of the U.S. Code, by the trustee, are plenary suits that can only be instituted in the appropriate federal or state courts within the statutory period of limitations as set forth in § 29 of the U.S. Code.⁹⁰

Where the foreclosure proceeding of a mortgage was instituted more than four months prior to the filing of the bankruptcy petition, the bankruptcy court does not have summary jurisdiction and will not enjoin nor restrain the foreclosure proceeding. The trustee will be relegated to the state court proceeding. *Schmitt v. Blackwelder*, 379 F.2d 278 (2d Cir. 1967).

On the subject of summary or plenary jurisdiction, see *Cline v. Kaplan*, 323 U.S. 97 (1944); *May v. Henderson*, 268 U.S. 111 (1925); *Schwartz v. Horowitz*, 131 F.2d 506 (2d Cir. 1942).

⁸⁷ *Emil v. Hanley*, 318 U.S. 515 (1943).

⁸⁸ *Straton v. New*, 283 U.S. 318 (1931); *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931).

⁸⁹ The trustee stands in the shoes of creditors in order to pierce the corporate veil and recover a fraudulent transfer. *Maley v. Carroll*, 381 F.2d 147 (5th Cir. 1967).

The trustee is vested with the rights of creditors in addition to those of the bankrupt. *Connell v. Walker*, 291 U.S. 1 (1934); *Benedict v. Ratner*, 268 U.S. 353 (1925); *Globe Bank & Trust Co. v. Martin*, 236 U.S. 288 (1915); *United Calif. Bank v. England*, 371 F.2d 669 (9th Cir. 1966); *Schneider v. O'Neal*, 243 F.2d 914 (8th Cir. 1957); *David v. Lawrence Cedarhurst Bank*, 204 F.2d 431 (2d Cir.), *cert. denied*, 346 U.S. 877 (1953); *City Nat'l Bank v. Phillips*, 190 F.2d 97 (5th Cir. 1951).

The trustee may assert the right of creditors existing prior to the date of bankruptcy only if such a creditor actually exists. *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961).

⁹⁰ *McDonald v. Plymouth County Trust Co.*, 286 U.S. 263 (1932); *Weidhorn v. Levy*, 253 U.S. 268 (1920); *Chatz v. Freeman*, 204 F.2d 764 (7th Cir. 1953); *Lowenstein v. Reikes*, 60 F.2d 933 (2d Cir.), *cert. denied*, 287 U.S. 669 (1933).

Illustrative of state laws vesting rights of action in the trustee under § 110 are Article 10 of the Debtor & Creditor Law of New York and the

The trustee must also proceed to collect the accounts receivable, and where there are any causes of action in favor of the bankrupt, institute or take the steps necessary to enforce collection and liquidation of the same.

The bankruptcy court will not grant any relief where the bankrupt is in default in a supplementary proceeding examination in the state court, or where he is fined for any default or contempt in such proceeding. The bankruptcy court does not have jurisdiction to relieve the bankrupt of his default, contempt, or any fine assessed in such proceeding.⁹¹

Reference has been made to the right of a bankrupt to obtain a stay of suits pending against him at the time of the filing of the petition.⁹² A stay is obtained on an

provisions of Article 9 of the Uniform Commercial Code, now in effect in every State and Territory other than Louisiana.

Under the provisions of the Uniform Commercial Code it has been held that the distinction between the various types of securities, such as chattel mortgages and conditional bills of sale, have been eliminated and are immaterial. *In re Yale Express Systems, Inc.*, 370 F.2d 433 (2d Cir. 1966).

A trustee in bankruptcy has the right to void any security interest not perfected so as to be valid as against subsequent security interests and lienors, in accordance with the provisions of the Uniform Commercial Code. The trustee has been successful in having the security interest declared void for improper filing. *In re Lux's Superette, Inc.*, 206 F. Supp. 368 (E.D. Pa. 1962); *In re Smith*, 205 F. Supp. 30 (E.D. Pa. 1962). But see *In re United Thrift Stores, Inc.*, 363 F.2d 11 (3d Cir. 1966), where the court found that the proper security agreement in the form of a trust receipt had been executed, sufficient to cover the inventory and proceeds; that it had been properly filed and, therefore, was valid as against the trustees. See also *In re Ferro Contracting Co.*, 380 F.2d 116 (3d Cir. 1967).

In *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D. Mass. 1967), and in *In re Portland Newspaper Publishing Co.*, 271 F. Supp. 395 (D. Ore. 1967), the courts held the after-acquired property clause in the Uniform Commercial Code would be recognized by the bankruptcy court. Where the security interest covers after-acquired property and was valid under state law, it would be enforced as against the trustee under the Bankruptcy Act. The court, in each instance, upheld the validity of the after-acquired property clause in each of the security agreements as against the trustee's contention that the same was invalid under the provisions of § 96 of the U.S. Code. Accord, *In re White*, 283 F. Supp. 208 (D. Ohio 1967).

⁹¹ 11 U.S.C. § 29 (1964); *Hill v. Harding*, 107 U.S. 631 (1882); *Donald F. Duncan, Inc. v. Royal Tops Mfg. Co.*, 381 F.2d 879 (7th Cir. 1967) (referee has jurisdiction to grant stay orders both prior to the adjudication as well as subsequent thereto); *In re Innis*, 140 F.2d 479 (7th Cir.), cert. denied, 322 U.S. 736 (1944); *In re Thomashefsky*, 51 F.2d 1040 (2d Cir. 1931); *In re Metz*, 6 F.2d 962 (2d Cir. 1925); *In re McRoberts*, 17 F. Supp. 82 (W.D.N.Y. 1936); *In re DeGraaf*, 22 F.2d 163 (W.D. Mich. 1927).

⁹² See, e.g., *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934).

application to the referee to stay the further conduct of any suit or proceeding pending in the state court against the bankrupt. Where a garnishee is outstanding, the stay will enjoin further collection upon the garnishee by the creditor but the employer will be directed to deduct and hold the funds pending the hearing and granting or denial of a discharge to the bankrupt. The application for the stay, which may be ex parte, must indicate that the claim upon which the suit is pending in the state court is scheduled, that it is dischargeable and that there is no default nor fine levied in the state court proceedings. Upon the granting of the discharge, application should be made to the court for the purpose of having the referee direct the funds that have accumulated since the filing of the petition to be returned to the bankrupt.⁹³

The trustee, likewise, can apply for a stay with respect to any suit or proceeding pending, affecting the assets of the estate.⁹⁴

⁹³ *Middleton v. Cox*, 331 F.2d 741 (5th Cir. 1964); *In re Palter*, 151 F. Supp. 278 (E.D.N.Y. 1957); *In re Brecher*, 19 F. Supp. 283 (S.D.N.Y. 1937).

⁹⁴ 11 U.S.C. § 11(a)(15) (1964), which provides as follows: "Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title: *Provided, however*, That an injunction to restrain a court may be issued by the judge only."

It is well to note the differences in the application of 11 U.S.C. § 11(a)(15) and 11 U.S.C. § 29(a). Section 29(a) pertains to stays of "in personam" suits that are pending against the bankrupt at the time of the filing of the bankruptcy petition, and are based on claims which would be dischargeable. Section 11(a)(15), amongst other things, applies to suits instituted after the bankruptcy petition has been filed. *Donald F. Duncan, Inc. v. Royal Tops Mfg. Co.*, 381 F.2d 879 (7th Cir. 1967) (Referee has jurisdiction to grant stay orders both prior to adjudication as well as subsequent thereto); *Hisey v. Lewis-Gale Hospital*, 27 F. Supp. 20 (W.D. Va. 1939); *In re Hicks*, 133 F. 739 (N.D.N.Y. 1905); 1 W. COLLIER, BANKRUPTCY 301, 315, 1138-9 (14th ed. 1967).

Even a creditor has been permitted to apply for a stay, to wit, the stay of a discharge of the bankrupt to obtain a lien on exempt property. Yet, recently a court refused to stay a discharge of the bankrupt in order to allow the creditor time to obtain and perfect a lien in a state court proceeding against exempt property based upon the rule of *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903), which was the authority for such an action, holding that the *Lockwood* decision was intended to apply and authorize a stay only to enforce a lien theretofore existing, or where there had been a waiver of the exemption of the property upon which a lien was sought, and was not intended for the purpose of authorizing the creation of a lien on exempt property. *Harris v. Hoffman*, 379 F.2d 413 (8th Cir. 1967).

In connection with suits to be instituted by the trustee for the recovery of any assets, the trustee is bound by the statute of limitations of the state that would be applicable, except that he is granted a minimum of two years limitation from the date of adjudication.⁹⁵ This period of limitation may extend the time to bring a suit under state law, but is a bar to any suit on the part of the trustee founded solely upon §§ 96, 107 and any other bankruptcy section of the U.S. Code.⁹⁶

In short, it is the trustee's duty to liquidate into cash, as promptly as possible, all of the assets belonging to the bankrupt estate.

THE CREDITORS

In the administration of the estate, it is the obligation of the creditors to file claims, if they desire to participate in any distribution of the assets of the bankrupt. The time for the filing of claims is limited by statute to six months from the date of the first meeting.⁹⁷ Unfortunately, this is, a statute of limitations without any discretion vested in the referee or the court to extend the time for the filing of a claim. Where no claim is asserted either to the court, referee or the trustee, or his attorney, prior to the expiration of six months, any claim sought to be filed thereafter, will be treated as a "late claim" not entitled to participate in any dividend distribution until all timely filed claims have been paid in full. This bar applies alike to all creditors, unsecured as well as priority claimants, whether for wages

⁹⁵ 11 U.S.C. § 29(e) (1964). The two-year statute of limitations after adjudication applies to suits and proceedings by the trustee under §§ 96 and 107 of the U.S. Code and may also apply to summary proceedings on the part of the trustee. *Herget v. Central Nat'l Bank Co.*, 324 U.S. 4 (1945).

A suit for the turnover of assets, as well as to recover a preference, is subject to the two-year statute of limitations, as set forth in § 29 of the U.S. Code. *Dabney v. Levy*, 191 F.2d 201 (2d Cir.), *cert. denied*, 342 U.S. 887 (1951).

⁹⁶ *Dabney v. Levy*, 191 F.2d 201 (2d Cir.), *cert. denied*, 342 U.S. 887 (1951); *Halpert v. Engine Air Serv., Inc.*, 116 F. Supp. 113 (E.D.N.Y. 1953).

⁹⁷ 11 U.S.C. § 93(n) (1964).

or taxes. It also applies to creditors who have not been listed and have not received notice of the bankruptcy proceedings. While it is true that their claims will not be discharged, this is of very little comfort where the bankrupt is a corporation that has gone out of business.

The status of all claims with respect to their provability, allowability and amount, is within the exclusive jurisdiction of the Bankruptcy Court.⁹⁸ The trustee is obliged to examine the claims filed. If there is any question as to the validity or amount of the claim, objections should be filed and brought on for a hearing by the trustee as soon as is practicable.

If a claim has been filed by a creditor who is charged with having received a preferential payment or fraudulent transfer, the objection to the claim may be based on such grounds.⁹⁹ The decision of the referee with respect to the preference or transfer will be *res judicata* should any independent suit against the creditor be necessary.¹⁰⁰

The referee does not have jurisdiction to grant affirmative judgment where an offset or counterclaim does not arise out of the same transaction and situation upon which the claim filed is based. In such a situation, however, the referee's decision is *res judicata*. That is, a plenary suit must be brought upon this affirmative defense or counterclaim in a court having jurisdiction over defendant, in which proceeding a motion for summary judgment will lie by reason of the fact that the issues have already

⁹⁸ Referee has jurisdiction to pass upon not only the principal of the secured claim to determine its validity and the amount due, but also the interest and attorneys' fees that may be owing in connection with the enforcement thereof. Even if the terms are harsh but valid under state law the contract will be enforced. 11 U.S.C. §§ 93, 103, 104 (1964); *Kapelus v. Joint Venture*, 377 F.2d 815 (9th Cir. 1967); *Rutas Aereas Nacionales S.A. (Ransa) v. United States*, 373 F.2d 213 (5th Cir. 1967); *In re Advance Printing & Litho Co.*, 277 F. Supp. 101 (W.D. Pa.), *aff'd*, 387 F.2d 952 (3rd Cir. 1967).

⁹⁹ 11 U.S.C. § 93(g) (1964).

¹⁰⁰ The referee's determination of the counterclaim of the trustee on an objection filed to a claim filed in the bankruptcy proceeding by the creditor is *res judicata* in a plenary suit, warranting the granting of a motion for summary judgment against the defendant-creditor. *Katchen v. Landy*, 382 U.S. 323 (1966); *Giffin v. Vought*, 175 F.2d 186 (3rd Cir. 1940); *Schwartz v. Levine & Malin*, 111 F.2d 81 (2d Cir. 1940).

been determined and there is nothing to be tried. However, where the offset or counterclaim arises out of the same transaction or contract as the claim asserted, the referee has jurisdiction to grant affirmative relief and a judgment in favor of the trustee as against the claimant.¹⁰¹

CLOSING THE ESTATE

After the status of all claims has been fixed and all assets liquidated into cash, the estate is ready for closing and the trustee's final report and accounts must be prepared and filed with the referee. A hearing thereon will be had on notice to all creditors, with respect to the trustee's final report and accounts, applications for allowances to attorneys and accountants, and for a declaration of a final dividend to the creditors.

The distribution of the funds realized during the administration of the estate is regulated by § 104 of the U.S. Code. The order of priority runs as follows:

First is the payment of the commissions, allowances and reimbursement of expenses incurred by the receiver-trustee, attorney for the receiver, attorney for petitioning creditors, attorney for the trustee and accountants.

Second are wage claims which include wages and commissions earned within three months prior to the filing of the petition, not exceeding \$600.00.¹⁰²

Third is the reimbursement for costs and expenses to creditors in successfully opposing a bankrupt's discharge, or the confirmation of a plan of arrangement or revoking of the same.

¹⁰¹ *Katchen v. Landy*, 382 U.S. 323 (1966). The jurisdiction of the Bankruptcy Court is not only to pass upon the validity and the amount of the claims filed, but extends to any counterclaim or offset against the claim, even as to a tax refund as against the Director of Internal Revenue. *Rutas Aereas Nacionales, S.A. (Ransa) v. United States*, 373 F.2d 213 (5th Cir. 1967); *Giffin v. Vought*, 175 F.2d 186 (2d Cir. 1949); *Schwartz v. Levine & Malin*, 111 F.2d 81 (2d Cir. 1940).

¹⁰² Claims of employees for vacation pay and also for severance pay are part of wages entitled to priority. They have also been held to be expenses of administration. *Straus-DuParquet, Inc. v. Local 3, Int'l Bhd. of Elec. Wkrs.*, 386 F.2d 649 (2d Cir. 1967); *L. O. Koven & Bros Inc. v. Local 5767, United Steel Workers*, 381 F.2d 196 (3d Cir. 1967).

Fourth are taxes of the Director of Internal Revenue, state and municipality, all on an equal plane.

Fifth are debts, other than taxes owing to the United States or any governmental agency, such as to the Federal Housing Authority and the Small Business Administration, and rent owing to a landlord entitled to priority under applicable state law, limited, however, to three months rent prior to the filing of the petition.

Claims that are provable and entitled to participate in any dividend distribution include debts based on contracts or breach of contract and judgments. Likewise provable is a judgment founded upon a negligence claim in suit at the time of the filing of the petition in bankruptcy.¹⁰³

Contingent debts founded on contracts and claims for anticipatory breaches of contracts, including leases, are provable, limited, however, to the difference between the rent reserved in the lease and the reletting value, not exceeding one year.¹⁰⁴

DISCHARGE

Independent of the administration of the estate by the trustee, the matter of the discharge of the bankrupt will go forward before the referee. The notices usually sent out by the referee with respect to the first meeting also provide for a date for the filing of specifications of objections to the bankrupt's discharge.¹⁰⁵ Usually this date will be extended, upon application and written order, while the examinations of the bankrupt and witnesses are pending. Only after the examinations are concluded will the final date be set for the filing of specifications.

If specifications are filed, then the bankrupt may file exceptions to the sufficiency of the specifications. The referee has the right, in the exercise of his discretion, to permit amendments of the specifications filed, but not

¹⁰³ 11 U.S.C. § 103 (1964).

¹⁰⁴ *Id.*

¹⁰⁵ 11 U.S.C. § 94 (1964).

to add new grounds not theretofore alleged. Specifications of objections to the discharge will not be entertained, except for good cause shown, if sought to be filed after the expiration of the time fixed for their filing.¹⁰⁶

The trial of the specifications is had before the referee. In the first instance the burden is on the objecting creditor to go forward and to establish a prima

¹⁰⁶ 11 U.S.C. § 32(b) (1964); General Order 32, General Orders and Official Forms in Bankruptcy. In *Lerner v. First Wisconsin Nat'l Bank of Milwaukee*, 294 U.S. 116 (1934), the court in construing § 32(b) as amended and General Order 32, said: "The language of the amended Order is mandatory; it is controlling in circumstances like those here presented; strict compliance should be accorded. Under Order XXXVII, and permissive provisions of the Bankruptcy Act, we think the Courts may exercise discretion sufficient for the successful conduct of proceedings in varying circumstances." *Id.* at 119.

In *Northeastern Real Estate Securities Corp. v. Goldstein*, 91 F.2d 942 (2d Cir. 1937), the court held that while specifications could be amended after the expiration of the time fixed for filing of the same, a new ground of objection was not an amendment—even though of the same class as originally pleaded—but the court can extend the date for the filing of specifications.

In *In re Leach*, 197 F. Supp. 32 (W.D. Ark. 1960), the court, after indicating that the specifications must set forth facts and not be alleged in the language of the statute, held that while new grounds may not be added specifications could be amended to set forth the specific facts in support thereof, under the liberality amendments, provisions and Rule 15 of the Federal Rules of Civil Procedure applicable in bankruptcy. However, where the specification was barren of any facts, the court held the referee was warranted in dismissing the specifications.

In *Rameson Bros. v. Goggin*, 241 F.2d 271 (9th Cir. 1957), the court held "that a Referee has the power to permit specifications objecting to discharge to be filed late, where good reason appears and the delay is not for the purpose of putting improper pressure upon the bankrupt. Similarly, where the Referee accepted the specifications late and later held hearings on them, he was held to have deliberately extended the time for filing, even though no express order to that effect was entered." *Id.* at 273-74. See also *Paully v. Magnotti*, 182 F.2d 466 (2d Cir. 1950); *Richey v. Ashton*, 143 F.2d 442 (9th Cir. 1944); *In re Massa*, 133 F.2d 191 (2d Cir. 1943); *In re Brecher*, 4 F.2d 1001 (2d Cir. 1925).

General Order 32 provides that any person opposing a discharge shall at or before the time fixed for the filing of objections to the discharge file a specification, in writing, of the grounds of his opposition.

11 U.S.C. § 32(b) (1964) provides that the court shall make an order fixing the time for the filing of objections to the bankrupt's discharge. If the examination of the bankrupt has not or will not be completed within the time fixed for the filing of objections, the court on its own motion or on the motion of the receiver, trustee, a creditor or any other party in interest, or for other cause shown, may extend the time for the filing of such objection. If no objections are filed within the time fixed, the court shall grant the discharge. *In re Palestine*, 75 F.2d 500 (2d Cir. 1935); *United Wallpaper Factories, Inc. v. Hodges*, 70 F.2d 243 (2d Cir. 1934).

facie case with respect to his grounds of objections to the bankrupt's discharge.¹⁰⁷ If the creditor establishes a prima facie case, then it may be said that the burden shifts and the bankrupt is faced with the obligation of going forward to rebut the proof submitted by the objecting creditor.¹⁰⁸ If the court finds that any one of many specifications has been established, the bankrupt will be denied his discharge.¹⁰⁹

The grounds of specifications of objections have been set forth above.¹¹⁰ Attention is called to the fact that the

¹⁰⁷ 11 U.S.C. § 32(c) (1964); *Moffett v. Union Bank*, 378 F.2d 10 (9th Cir. 1957); *McMullin v. Todd*, 228 F.2d 139 (10th Cir. 1955); *In re Hale*, 274 F. Supp. 813 (W.D. Va. 1967).

If no objection is filed the bankrupt will be granted a discharge. 11 U.S.C. § 32(b) (1964). A debt not scheduled in a prior proceeding is discharged in a subsequent proceeding, filed six years after the granting of the discharge. *Gross v. Fidelity & Deposit Co.*, 302 F.2d 338 (8th Cir. 1962); *In re Tabibian*, 289 F.2d 793 (2d Cir. 1961); *In re Baker*, 275 F. 511 (S.D.N.Y. 1920).

¹⁰⁸ *Rogers v. Gardner*, 226 F.2d 864 (9th Cir. 1955).

¹⁰⁹ A discharge can only be denied on the grounds covered by the objections filed. *In re Little*, 65 F.2d 777 (2d Cir. 1933); *In re Feinsilver*, 24 F.2d 408 (2d Cir. 1928).

Additional grounds may not be added after the time fixed for the filing of specifications has expired, unless the bankrupt has fraudulently concealed facts. *Paully v. Magnotti*, 182 F.2d 466 (2d Cir. 1950); *Northeastern Real Estate Securities Corp. v. Goldstein*, 91 F.2d 942 (2d Cir. 1937); *In re Metcalf*, 48 F. Supp. 405 (N.D. Tex. 1942).

¹¹⁰ See *supra* note 16. As to the specifications alleging a false oath, see *In re Steiker*, 380 F.2d 765 (3rd Cir. 1967).

As to specifications charging false financial statement, see *In re Ostrer*, 393 F.2d 646 (2d Cir. 1968), as to the need of establishing intent to deceive.

As to specifications charging false oath which must be knowingly and fraudulently made, see *In re Hale*, 274 F. Supp. 813 (W.D. Va. 1967). In this case the court held the initial burden of proof is on the objecting creditor to make out a prima facie case; the grounds for objecting to the discharge set forth in section 32 of the U.S. Code are exclusive, and unless one of these grounds is proven his discharge must be granted. The court also held that the false oath must be knowingly and fraudulently made. *International Shoe Co. v. Kahn*, 22 F.2d 131 (4th Cir. 1927).

As to specifications charging failure to preserve books and records so that the financial condition could be ascertained, the applicability of this ground of objection is dependent upon the circumstances of the case, the business activities and nature of debts of the bankrupt, and the court held that where the debts were the results of endorsements and guarantees, the bankrupt was not under any obligation to preserve or keep books with respect to the obligations arising under the endorsement. *In re Halpern*, 387 F.2d 312 (2d Cir. 1968).

The objecting creditor must prove that the financial statement was false and issued with the intent to defraud. *In re Hippler*, 278 F. Supp. 753 (W.D. La. 1968).

objections should be alleged in detail, and not in the language of the statute, to avoid objections and the need for an amendment and amplification of the same.

The grounds set forth in § 32(c) of the U.S. Code are the only grounds of objections to a discharge.¹¹¹ It may be observed that the commission of a preference, or an act of bankruptcy, such as the execution of an assignment for the benefit of creditors, or permitting a creditor to obtain a lien and not repaying the same within 30 days, or permitting the levy to go to sale, is no ground for opposition to a bankrupt's discharge.¹¹²

In *In re Estate of Northwest Mills, Inc.*, 281 F. Supp. 976 (W.D. Ark. 1968), the court held that a written statement purporting to set forth the true value of a corporation's inventory is a statement respecting the financial condition of that corporation within the statute making the issuance of a false financial statement a ground for a denial of a discharge. To bar a discharge, the financial statement must not only be false but intentionally so. Intent so as to warrant denial of discharge can be inferred from the fact that the bankrupt caused to be published what he knew or should have known to be false. The right to object is not limited to the one who received the statement but any creditor. *Shainman v. Shear's of Affton, Inc.*, 387 F.2d 33 (8th Cir. 1967).

It has been held that the refusal to obey a lawful order of the court, or answer a material question, or refusal to appear after being subpoenaed, is grounds for the denial of a discharge. *Richardson v. United States*, 273 F.2d 144 (8th Cir. 1959); *Howard v. United States*, 182 F.2d 908 (8th Cir. 1950); *In re Simon*, 297 F. 942 (2d Cir. 1924).

But the court must affirmatively approve the questions put to the bankrupt, either by overruling the objection or directing the bankrupt to answer. *In re Kolb*, 151 F.2d 605 (2d Cir. 1946).

Refusal to answer a question on the ground that it might tend to incriminate is sufficient grounds for the denial of a discharge. *In re Harris*, 221 U.S. 274 (1911); *Kaufman v. Hurwitz*, 176 F.2d 210 (4th Cir. 1949).

The charge of failure of the bankrupt to satisfactorily explain the loss of assets or the deficiency to meet his liabilities, must allege the particulars. It is insufficient to allege this ground in the language of the statute. *In re Korman*, 172 F. Supp. 193 (E.D. Pa. 1959); *In re Goldstein*, 20 F. Supp. 403 (S.D.N.Y. 1937).

The discharge may be opposed by the trustee, creditors, or the U.S. Attorney. 11 U.S.C. § 32(d) (1964).

The referee may not interpose objection to the discharge. *In re Walsh*, 256 F. 653 (7th Cir. 1919).

But the court may take judicial notice of a prior proceeding and deny the discharge. *In re Hammond*, 9 F. Supp. 628 (D. Kan. 1934).

¹¹¹ *Bluthenthal v. Jones*, 208 U.S. 64 (1908); *International Shoe Co. v. Kahn*, 22 F.2d 131 (4th Cir. 1927).

¹¹² Conduct, no matter how reprehensible, if not embodied within the grounds set forth in § 32(c) is not a ground for denial of a discharge. 1 W. COLLIER, BANKRUPTCY 1291 (14th ed. 1967).

It is worthy to note that there is no obligation to oppose a discharge on the part of creditors holding a non-dischargeable debt. These debts are set forth in § 35 of the U.S. Code. Such a debt may be enforced in the state or appropriate court, notwithstanding the granting of the discharge.¹¹³

A discharge is effective only as to the creditors scheduled and those creditors who the bankrupt can prove had actual knowledge of the bankruptcy proceeding, within six months from the date of the first meeting of creditors and before the granting of a discharge.¹¹⁴

The bankruptcy court passes on the right to a discharge, not its effect. Whether a *particular* debt is dischargeable or not, whether it comes within the provisions of § 35 of the U.S. Code, is a matter for determination by the state court. Except in the most unusual circumstances, (and there is no such case in the second circuit) the court will refuse to pass upon the issue as to whether a specific claim is dischargeable or not. It will enjoin proceedings in the state court pending the granting of the discharge. It will not enjoin the conduct of state court proceedings *after* the granting of the discharge, instituted for the purpose of determining the non-dischargeability of the debt sought to be enforced.¹¹⁵

There have been many instances of suits being brought by creditors after the granting of a discharge. These suits must be defended by the bankrupt, and if the debt is one that is discharged, he must assert the defense of

¹¹³ A property settlement and the obligations thereunder have been held to be a contract obligation and dischargeable as distinguished from the obligation to pay alimony. *Adler v. Nicholas*, 381 F.2d 168 (5th Cir. 1967).

The bankruptcy court does not pass upon the dischargeability of a debt. This is a matter for the state court to determine. *In re Courbat*, 274 F. Supp. 1 (N.D.N.Y. 1967).

¹¹⁴ 11 U.S.C. § 35(a) (1964); *In re Lyons*, 287 F. 602 (E.D.N.Y. 1922); *Oliver v. Kroff*, 143 So. 2d 497 (Fla. 1962); *Cohen v. Levenstein*, 140 Ga. App. 410, 121 S.E.2d 836 (1961); *Application of Keilly*, 4 Misc. 2d 99, 262 N.Y.S.2d 310 (Sup. Ct. 1965).

¹¹⁵ *Fallick v. Kehr*, 369 F.2d 899 (2d Cir. 1966); *Hilton Credit Corp. v. Jaggli*, 366 F.2d 793 (9th Cir. 1966); *Ciavarella v. Salituri*, 153 F.2d 343 (2d Cir. 1946).

a discharge in bankruptcy. Otherwise he may be faced with the danger of the recovery of a judgment against him notwithstanding his discharge.¹¹⁶

Once a discharge is denied on the merits, the debts involved in that bankruptcy proceeding cannot thereafter be discharged, regardless of the number of bankruptcy proceedings that may thereafter ensue.¹¹⁷ On the other

¹¹⁶ Discharge in bankruptcy does not extinguish debt but only raises a bar and discharge must be pleaded. *Beneficial Fin. Co. v. Sidwell*, 382 F.2d 275 (10th Cir. 1967).

Debts coming within the provisions of § 35(a)(2) include those created in reliance upon a false financial statement. It is not uncommon for banks and financial institutions not to oppose a discharge but to bring a suit after the granting of the same, on the basis that their claims are non-dischargeable. For an extended discussion of this type of claim and the effect of the discharge thereon, see *First Nat'l Bank v. Haymes*, 49 Misc. 2d 939, 268 N.Y.S.2d 820 (N.Y.C. Civ. Ct. 1966) and cases therein cited.

¹¹⁷ In *In re Turner's Estate*, 268 F. Supp. 918 (D.C. Ore. 1967), the court held that where the bankrupt had received a discharge in 1958 and a second petition was filed in 1963 wherein his discharge had been denied because the proceeding was within six years of the prior petition, and in 1967 the bankrupt filed a third petition, the bankrupt would be denied a discharge of his debts listed in the schedules of the petition, on the ground that the denial of the discharge of the 1963 petition was *res judicata* of the debts scheduled in the second proceeding. The court pointed out the bankrupt could have had the second proceeding, in 1963, dismissed without prejudice, which would have entitled him to a discharge in the 1967 proceeding, but that he had failed to do so. The intent of Congress was that the bankrupt must wait six years before receiving a second discharge. *Accord*, *Chopnick v. Tokatyan*, 128 F.2d 521 (2d Cir. 1942); *Perlman v. 322 West 72nd St. Co.*, 127 F.2d 716 (2d Cir. 1942).

Contra, *Turner v. Boston*, 393 F.2d 683 (9th Cir. 1968). In reversing *In re Turner's Estate*, 268 F. Supp. 918 (D.C. Ore. 1967), the court held that under the provisions of 11 U.S.C. § 32(c)(5) the "words . . . appear to constitute no more than a simple direction that a discharge is not to be granted if the bankrupt has been discharged on a petition filed within the preceding six years. The language of clause (5) is not directed against the premature filing of the petition but at the too early grant of a discharge. Clause (5) applies only when the bankrupt 'has been granted a discharge' on the prior petition. . . . In all cases we believe that the bankrupt, voluntary and involuntary, ought to be discharged as often as he makes the showing required by the act. . . ."

The congressional purpose of avoiding too frequent use of the Act to avoid debt is completely satisfied by denying discharge on any petition filed within the six-year period. It contributes nothing to this purpose to deny discharge of the prematurely listed debt on a subsequent petition filed after the six-year period has elapsed.

"The purpose in adding the ground relating to a prior discharge within six years was not to punish, but only to postpone a second discharge within that period of time. . . ."

As noted above, clause (5) was directed against too frequent discharges, not against too frequent petitions and therefore applies only when a discharge has been granted on the first petition. . . ."

hand, if the bankrupt does obtain his discharge, the bankrupt in any subsequent proceeding cannot obtain a second discharge within six years of the first discharge. There is no limit to the number of discharges a debtor may obtain provided there is an interval of at least six years between discharges.¹¹⁸

A discharge may not be collaterally attacked, and where an issue has been actually litigated upon objections to a discharge, the determination is binding on the objecting creditor in subsequent litigation.¹¹⁹ Proceedings may be instituted in the court where the discharge was granted, limited to within one year of the granting of the same, and based upon the charges of fraud.¹²⁰ In the absence of fraud, or after the expiration of one year the discharge cannot be questioned.¹²¹

The court reversed the District Court and granted a discharge notwithstanding the fact that the bankrupt had filed a second bankruptcy petition within five years, eight months and three weeks after filing the first petition, in which proceeding his discharge was denied because the petition was prematurely filed, and filed the present petition three years thereafter, or nearly nine years after being discharged upon the first petition.

This decision represents a new trend or interpretation of the Bankruptcy Act and may open the doors in the discharge of debts heretofore considered non-dischargeable where scheduled in the second prematurely filed proceeding.

¹¹⁸ In *In re Hale*, 274 F. Supp. 813 (W.D. Va. 1967), objection was made to the bankrupt's discharge on the ground that he had been granted two previous discharges on voluntary petitions and that the third discharge was sought shortly after the expiration of the six-year period after the second discharge. The objection was on the ground it would be "highly inequitable" to allow the bankrupt to evade his just debts and pervert the purposes of the Bankruptcy Act. The court in answering this argument states: "One of the primary purposes of the bankruptcy statute is to give the honest debtor the opportunity to reinstate himself in the business world by relieving him of the payment of his dischargeable debts. . . . It is well established that a bankrupt is not to be denied a discharge on general equitable principles but only when one or more statutory grounds of objection are proven. *Johnson v. Bockman*, 282 F.2d 544 (10th Cir. 1960)."

¹¹⁹ *Meyers v. Int'l Trust Co.*, 263 U.S. 64 (1923); *Matawan Bank v. Feldman*, 12 N.J. Misc. 785, 174 A. 442 (1934).

¹²⁰ 11 U.S.C. § 33 (1964).

¹²¹ *Id.*

SUMMARY

A proceeding is initiated by the filing of a petition, whether voluntary or involuntary, with the clerk of the court. In due order the proceedings are referred to a referee who will remain in charge of the administration of the proceeding to its close. All obligations of whatever nature should be addressed to the referee in bankruptcy in charge of the proceeding.

The bankruptcy court has exclusive jurisdiction not only to determine the validity and the amount due upon all claims asserted against the assets of the bankrupt estate in the possession of the receiver-trustee, but also with respect to any and all claims filed in the proceeding seeking to participate in the distribution of the assets.

The bankruptcy court has jurisdiction to restrain the institution of foreclosure proceedings of any lien or encumbrance sought to be instituted after the filing of the petition. It has jurisdiction to grant affirmative relief as against creditors upon counterclaims and offsets arising out of the transactions for which a proof of claim has been filed.

The trustee is vested not only with the rights of the bankrupt but also with the rights of creditors under state law, as well as the additional rights granted under the provisions of the Bankruptcy Act.

The Bankruptcy Act is also an avenue of economic rehabilitation of the bankrupt. If he has not committed any act which would bar his discharge and if the debts are discharged, his discharge will have the effect of relieving him of all prior indebtedness, and he can go forward and establish himself, once again, economically free of debts.

This is a humane statute, intended not only for the benefit of the debtor, who has become involved beyond his ability to pay his obligations, but also for the benefit of the creditors to assure equitable and pro-rata distribution to all creditors alike.