STRAIGHT BANKRUPTCY

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Although there were no landmark cases reported on straight bankruptcy in the Fifth Circuit during 1969, in the past that circuit traditionally has made difficult and far-reaching decisions. This has undoubtedly resulted from the archaic laws of the states in the circuit which have not reflected the current changes in the attitude toward the debtor-creditor relationship as propounded by the bankruptcy law and courts.[1] As this situation continues, this circuit will in all probability be plagued from time to time with "hard cases" in the bankruptcy area.

During the year 1969 three cases are noted dealing with United States priority claims, two with voidable preferences or transfers, two with fraudulent conveyances, four with discharge, two with reasonableness of attorneys' fees, two with creditors' liens and one each with jurisdiction and exemptions. This sampling seems to reflect the usual volume of litigation in bankruptcy proceedings in which the United States' and attorneys' interests share a large part.

Jurisdiction

The question as to whether a referee in bankruptcy may, within his summary jurisdiction, issue an order directing property to be turned over to the trustee in bankruptcy, has been a troublesome one for many years. The key seems to be whether the bankrupt had actual or constructive possession of the property at the time of the petition in bankruptcy. The issue as to whether summary or plenary jurisdiction is applicable may be determined by the referee in a summary manner, but to make any such determination binding on one, he must be made a party to the summary proceeding, and it was so held. Thus a turnover order directed to a bank holding sums in escrow to which there was an adverse claimant not a party to the proceeding was vacated and remanded with the direction that the adverse claimant be made a party to the turnover proceeding.[2] It should be noted, however, that the issue to be determined is one of possession of the funds at the time of the petition. If the bank held the funds for the bankrupt at that time, there would be summary jurisdiction to issue the turnover order even though the third party did have an

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1. *See*, Georgia's Constitutional and Statutory Homestead laws. GA. CODE ANN., chs. 51-1 and 51-13.

2. South Side Atlanta Bank v. I. T. Thomasson, 406 F.2d 407 (5th Cir. 1969).

adverse claim. The adverse claim would then have to be asserted in the bankruptcy proceeding.

Creditors' Liens

As to liens in bankruptcy, it was held that under the controlling state law (Florida) an execution lien attached only to tangible property and not to choses in action and, therefore, the lien was good as against funds in the hands of the trustee which were proceeds from the sale of such tangible property, but no lien attached to other funds in the hands of the trustee.[3] This is the usual treatment of this problem. However, the laws of the states governing the creation of a judgment lien are very divergent and must be carefully observed for the beginning point of a problem such as this.

In another lien case,[4] pursuant to a security device (factoring) under Alabama law, a lien was given to secure "loans and advances" and "for all indebtedness and liabilities of every kind of the Borrower to Lender, hereinafter owing."[5] A few days thereafter a lease was executed between the same parties, in which they were designated lessor and lessee. Later the party who had given the lien became indebted under the lease and the question was whether this became secured by the security device. The court said that the parties did not relate the two transactions and that there was no nexus between them and therefore, the lease indebtedness was not secured by the former. This case could easily have gone either way. It may be that the court relfected an attitude restricting the use of the floating lien which is a commendable one. Certainly, the granting of a lien "for all indebtedness and liabilities of every kind"[6] could be interpreted to include later rent claims.

Discharge

As is the normal situation, the most numerous cases, dealt with the right to a discharge in bankruptcy. Since this is the most important element in a personal bankruptcy and an adverse decision is so devastating to the bankrupt and advantageous to the creditors, the issue is often hotly contested.

In *Leachman v. Mitchell*[7] the referee found that the bankrupt did not

3. Willard v. Petruska, 402 F.2d 756 (5th Cir. 1969).
4. National Acceptance Co. of America v. Blackford, 408 F.2d 20 (5th Cir. 1969).
5. *Id.* at 21.
6. *Id.*
7. 402 F.2d 765 (5th Cir. 1968).

make a fraudulent conveyance within twelve months, nor did he fail to keep required business records or fail to explain losses, as was affirmatively alleged as a basis for denying discharge. The court re-emphasized the express philosophy of discharge as contained in the Bankruptcy Act and reflected by court decision, construing the Act liberally in favor of the bankrupt. The extent of this philosophy is evidenced in a later case in which a discharge was directed even though the bankrupt made materially false statements in writing to obtain credit.[8] However, the facts in that case showed that the lender of the money, Robins Federal Credit Union, knew through Levins, its loan manager, that the statements were false and actually induced an affidavit swearing that all the debts were listed when Levins knew that such was not the case. The court, citing COLLIER ON BANKRUPTCY, stated however that § 14(c)(3) of the Bankruptcy Act " 'should be confined to cases where the decision to give credit was induced by the false statement, which must have been, if not the moving cause behind the . . . of credit, a contributing cause, *i.e.*: The lender . . . must to an extent at least have relied upon it.' "[9] The court aptly stated, "The affidavit being knowingly false was a trap which afforded a perfect paper record on which to circumvent discharge of the debtor defaulted," and such self-dealing would not be tolerated.[10]

Debts created by fraud, embezzlement, misappropriation or defalcation, while acting as an office or in a fiduciary capacity, are excepted from a discharge granted in bankruptcy. A payment of salary to a partner while a partnership was insolvent, being not unlawful under the applicable laws, therefore did not form the basis for a debt excepted from a discharge in bankruptcy and so was discharged.[11] It is suggested that the applicable law be carefully ascertained for that law may be very different in the several states.

United States Priority Claims

In any year there will be a spate of cases dealing with the government or a governmental agency and its claim against a bankrupt's estate. This is true of the Fifth Circuit cases for the past year. Three of these deal with the priority claim of the Small Business Administration[12] (hereafter

8. Swint v. Robins Federal Credit Union, 415 F.2d 179 (5th Cir. 1969).
9. *Id.* at 182.
10. *Id.* at 184.
11. Wilson v. Button, 404 F.2d 309 (5th Cir. 1968).
12. Tampa Wholesale Electric, Inc. v. Fonte, 409 F.2d 501 (5th Cir. 1969); United States v. Brocato, 403 F.2d 105 (5th Cir. 1968).

referred to as SBA) and one involves tax claims by the Commissioner of Internal Revenue.[13]

In *United States v. Brocato*[14] the court held that under the particular arrangement between the SBA and the lending bank whereby the SBA guaranteed bankrupt's repayment of the loan in case of bankruptcy, no debt was owed to the SBA prior to bankruptcy, nor did the SBA have beneficial ownership of the debts prior to the bankruptcy. As this prior obligation or ownership is required for the assertion of a priority claim it was disallowed as such. A later case,[15] on casual reading, seems to go contrary to the *Brocato* case, but it does not, as the question of the priority of the SBA claim was not raised and was treated as entitled to priority. A later assignment was held to carry the priority with it.

Fraudulent Conveyances

Shortly before bankruptcy, there is a tendency for some to forestall its effects upon them by transfers of property. These transfers are subject to circumspection of the Bankruptcy Act and many are designated as fraudulent and voidable by the trustee.[16] A very common type of voidable transfer is one made by a husband to a wife. A variation of this occurred in *Seaton v. Sills*.[17] In this case the bankrupt was a corporation wholly owned by the husband and the transfer held to be fraudulent and void was a transfer by the corporation to a former wife. Payments shortly before bankruptcy by a corporation to one indirectly in control of the corporation are also subject to the watchful eye of the Act, as illustrated by *Tinney Produce Co. v. Phillips*[18] in which it was held that payments by a corporation to the advantage of one who had an option to acquire all the stock of the company, and had the officers under his power to displace them, was a fraudulent transfer voidable by the trustee.

Voidable Preferences of Transfers

A second type of transfer frowned upon in bankruptcy is a payment made to favored creditors shortly before bankruptcy. These transfers to creditors made shortly before bankruptcy are designated preferences

13. Moore v. United States, 412 F.2d 974 (5th Cir. 1969).
14. 403 F.2d 501 (5th Cir. 1969).
15. Tampa Wholesale Electric, Inc. v. Fonte, 409 F.2d 501 (5th Cir. 1969).
16. Bankruptcy Act, § 67(d)(2)(a), 11 U.S.C. § 107(d)(2)(a) (1964).
17. 403 F.2d 710 (5th Cir. 1968).
18. 415 F.2d 511 (5th Cir. 1969).

and, if made under certain circumstances, are voidable by the trustee in bankruptcy. In *Electric Constructors, Inc. v. Azar*,[18] it was held that payments made to Constructors Inc. for merchandise purchased earlier was a voidable preference under Section 60 of the Bankruptcy Act,[20] and in *Mobilift Equipment of Florida, Inc. v. Bryan*,[21] it was held that a transfer preferential under Florida law[22] was voidable by the trustee under § 70(e) of the Bankruptcy Act,[23] which authorizes the trustee to avoid any transfer which under any federal or state law is voidable for any reason by a creditor of the bankrupt. The unusual aspect of this case is that a state's definition of a voidable preference is used rather than the Bankruptcy Act's definition.

Exemptions

Probably the most important feature of an individual's bankruptcy, after his discharge right, is the right to claim the exemptions granted him by State and United States laws.[24] In *Thompson v. Powell*,[25] it was held that an amendment to exemption claims should be liberally allowed, and reiterated that a bankrupt should not be deprived of his exemptions by a narrow or strict interpretation of laws which were passed for his benefit and prompted by a humane public policy. This case is a current example of the general attitude of the courts in bankruptcy policy. Again, this amending policy is illustrated in *Sturdevant v. Maley*,[26] where it was held that amendment of specifications of objections to discharge after the last day for filing objections to discharge should be permitted and should be freely granted when justice is served.

19. 405 F.2d 475 (5th Cir. 1968).
20. 11 U.S.C. § 96 (1964).
21. 415 F.2d 841 (5th Cir. 1969).
22. FLA. STAT. ANN. § 608.55 (1956).
23. 11 U.S.C. § 110(a) (1964).
24. Bankruptcy Act, § 6, 11 U.S.C. § 24, and Bankruptcy Act, § 7; 11 U.S.C. § 25(a)(8) (1964).
25. 413 F.2d 276 (5th Cir. 1969).
26. 415 F.2d 465 (5th Cir. 1969).