STRAIGHT BANKRUPTCY

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Of the eighteen nominable straight bankruptcy cases to be reported from the United States Fifth Circuit Court of Appeals, the greatest number are concerned with matters of jurisdiction and procedure, and questions of discharge. Those dealing with discharge have an overriding concern for the dischargeability of tax claims, a relatively new problem, for only since 1966 have tax claims been dischargeable.[1] Other cases deal with the exemptions in bankruptcy, preferences, and the ubiquitous matter of attorneys' fees.

JURISDICTION

The question as to whether a Bankruptcy Court has summary jurisdiction over property may be easily determined as a matter of law. Upon the filing of the petition in bankruptcy, all the property in the actual or constructive possession of the bankrupt is subject to the summary jurisdiction of the Bankruptcy Court.[2] Property in the physical possession of a bankrupt's agent or bailee is in constructive possession of the bankrupt and so subject to the summary jurisdiction.[3] However, whether the facts establish actual or constructive possession is, many times, controversial and uncertain. The referee has the right and duty to make the initial determination of this issue upon the facts, subject to review and appeal.[4]

In *American Southern Publishing Co. v. Bailes*,[5] on a close question, the Fifth Circuit held that books owned by the bankrupt, in the actual possession of a warehouse but pledged for loans from a bank, were not in the constructive possession of the bankrupt and so not subject to the summary jurisdiction of the Bankruptcy Court. The court said:

> The warehouse, under the agreements, could surrender possession to the bankrupt only with the approval of the bank. The books were being held by the bailee subject to the order of the bank.
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> . . . .
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> Here the bankrupt did not have unconditional control over the books

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1. Bankruptcy Act § 17(1), 11 U.S.C. § 35(1) (1964), *as amended* 11 U.S.C. § 35(1) (1966).
2. Am. S. Publishing Co. v. Bailes, 426 F.2d 160 (5th Cir. 1970).
3. *Id.*
4. *Id. See also* Abraham v. Rochelle, 421 F.2d 226 (5th Cir. 1970).
5. 426 F.2d 160 (5th Cir. 1970).

> in the hands of the warehouse. Indeed, the evidence indicates that the bankrupt had little control if any at all. . . . All actions relating to the books were subject to the bank's approval. The relationship between the bankrupt and the warehouse cannot support a finding of constructive possession.[6]

In *Bass v. Hutchins*,[7] the question was whether the Bankruptcy Court had summary jurisdiction to issue a turnover order against the president of a bankrupt corporation for funds withdrawn from the corporation. The president had withdrawn over $250,000 from the corporation's bank accounts within a period of less than a year before bankruptcy, and refused to explain, asserting a fifth amendment silence. The court applied the inference of the continued possession theory and held there was summary jurisdiction. The court said:

> The burden is on the trustee to show that the corporate funds were misappropriated, but the alleged corporate plunderer must assume an explanatory role or subject himself to reasonable inferences or circumstantial evidence. The truth can free him.[8]

If the Bankruptcy Court does have summary jurisdiction over property, that court may enjoin any proceeding in a state court in which the property is involved. Thus, in *Abraham v. Rochelle*[9] the Bankruptcy Court, having summary jurisdiction over real estate, was entitled to enjoin a foreclosure proceeding in a state court.

In *Haber v. Commissioner of Internal Revenue*[10] the Fifth Circuit held that although a Bankruptcy Court may characterize a relationship as one of lending money, the Tax Court is not precluded from determining that relationship to be one of compensation for tax purposes, where the United States is not a party to the bankruptcy proceedings. In the instant case, the Bankruptcy Court had ordered the taxpayer to turn over to the trustee certain funds representing loans. The Tax Court held these "loans" to be compensation for tax purposes.[11]

PROCEDURE

A referee's conclusion on the facts, subsequently the district court's conclusions, will be sustained by the circuit court of appeals unless

6. *Id.* at 163-64.
7. 417 F.2d 692 (5th Cir. 1969).
8. *Id.* at 698.
9. 421 F.2d 226 (5th Cir. 1970).
10. 422 F.2d 198 (5th Cir. 1970).
11. *Id.*

"clearly erroneous." The "clearly erroneous" doctrine is especially cogent when the district court has approved the referee's determination.[12]

An order made by the referee, of course, may be reviewed by the district judge,[13] and reversed by him.[14] A person aggrieved by an order of the referee may within ten days file a petition for review with the referee.[15] Although the ten day period is inelastic and the petition for review must be filed within the ten day period to prevent finality of the referee's order, where the party is fairly and in fact prevented from complying by circumstances completely beyond his control, the time limitation may be tolled. In *Mutual Leasing Corp. v. Miami National Bank*,[16] the last day for filing was Monday, July 14, 1969. On Saturday, July 12, 1969, a fire occurred in the building in which the referee's office was located. The public was immediately barred from the building. The petition for review was received on July 16 and filed July 17, three days late. In sustaining the late filing the court said:

> In the present cases there is sufficient evidence from which the trial court could conclude that the fire prevented the Bank's meeting the statutory filing deadline, and further that the filing was made as soon as was reasonably possible after the event.[17]

Petitioning creditors may be granted leave by the referee to amend an involuntary petition and such should be liberally granted. Only where there has been abuse of discretion will the appellate court exercise its powers of review, and in *Blankenship v. Citizens National Bank*[18] no abuse of discretion was evident.

The Bankruptcy Act provides in substance that courts of bankruptcy are invested with jurisdiction in proceedings under the Act to adjudge a corporation bankrupt which has had its principal place of business within their territorial jurisdiction for the preceding six months, or for a longer portion of the preceding six months than in any other jurisdiction,[19] and further provides that where venue is laid in the wrong court of bankruptcy, the judge may in the interest of justice, upon timely

12. Panama Airways, Inc. v. Gilbert, 429 F.2d 646 (5th Cir. 1970). *See also* Mt. Vernon Restaurants, Inc. v. Merritt, 426 F.2d 280, 281 (5th Cir. 1970).

13. Bankruptcy Act § 39(c), 11 U.S.C. § 67(c) (1964).

14. Johnson v. United States, 429 F.2d 579 (5th Cir. 1970).

15. Bankruptcy Act § 39(c), 11 U.S.C. § 67(c) (1964).

16. 424 F.2d 999 (5th Cir. 1970).

17. *Id.* at 1000.

18. 431 F.2d 569 (5th Cir. 1970).

19. Bankruptcy Act § 2(a)(1), 11 U.S.C. § 11 (a)(1) (1964); Bankruptcy Act § 1(23), 11 U.S.C. § 1 (23) (1964).

and sufficient objection, transfer the case to any other court of bankruptcy.[20] In interpreting the interrelationship of these two provisions the court in *Bass v. Hutchins*[21] held that they were true venue provisions and that the judge could, in his discretion, transfer the case to another district or retain the proceeding in the district where the petition was filed if timely request for change of venue was not made.

The trend in treatment of this problem may be illustrated by the following: "The effect of the statute, . . . is that it is absolutely jurisdictional with no play for the venue concept whatsoever. This argument is an old wives' tale. . . ."[22] It "is a true venue provision and is not jurisdiction confining or defining."[23] "[W]e are and ought to be reluctant to find a vise-like jurisdictional grip by a single judicial distrust over enterprises that may be nation-wide and that may need to be placed under the shelter of the Bankruptcy Act."[24]

PROPERTY PASSING TO TRUSTEE

It is elementary that title to virtually all non-exempt property of a bankrupt passes to the trustee.[25] However, in *Mt. Vernon Restaurants, Inc. v. Merritt*[26] a right to use a state liquor license granted to the bankrupt lessee was held not to be a part of the estate of the bankrupt, but if the estate did have some interest it was disclaimed. It seems that a right to use a liquor license if transferable or subject to creditors' claims should be property of the bankrupt.[27] However, under the trustee's obligation to assume or reject executory contracts,[28] it seems clear that here this right was lost.

In *Bass v. Hutchins* it was held that funds in the amount of $250,000 of a bankrupt corporation appropriated by its president a short time before its bankruptcy are property of the corporation and may be subject to a turnover order.[29] The language of the court is interesting and portentous. "During June, July, August and September, 1966, funds of Miracle Marine, aggregating in excess of $250,000 were appropriated by

20. Bankruptcy Act § 32(b), 11 U.S.C. § 55(b) (1964).
21. 417 F.2d 692.
22. *Id.* at 694.
23. *Id.*
24. *Id.* at 695.
25. Bankruptcy Act § 70(a), 11 U.S.C. § 110(a) (1964).
26. 426 F.2d 280 (5th Cir. 1970).
27. Bankruptcy Act § 70(a), 11 U.S.C. § 110(a) (1964).
28. *Id.* at § 70(b), 11 U.S.C. § 110(b) (1964).
29. 417 F.2d 692.

. . . [the president of the corporation]. Neither . . . [he] nor anyone representing the bankrupt offered any rhyme or reason for the withdrawal of the $250,000. . . .''[30] ''[He] stood mute before this proof, asserting a Fifth Amendment silence. . . .''[31]

When corporations are closely interrelated, the assets of one may be considered assets of the other if one is bankrupt. A corporate principal may have its assets treated as assets of the bankrupt agent. In *Panama Airways, Inc. v. Gilbert*,[32] it was held that assets of a corporate principal were the sole property and assets of the bankrupt agent corporation. Because of the consent and laches elements in this case, the inter-corporate arrangement was not developed in detail, but the case does indicate the willingness to permit such inter-corporate asset treatment.[33]

DISCHARGE

By far the greatest number of cases to be reported from the Fifth Circuit dealt with the problem of discharge of the bankrupt from his debts or certain of them. Of these, the question of discharge of tax claims predominates.

Section 14(c)(3) of the Bankruptcy Act provides in substance that a discharge shall not be granted if the bankrupt, while engaged in business, obtained money for such business by making a materially false statement in writing respecting his financial condition.[34] Under this a discharge was denied a bankrupt who obtained a loan from the Small Business Administration for failing to list among his liabilities a debt of $14,180 owed his brother.[35]

Section 14(c)(6) of the Bankruptcy Act provides the basis for denial of a discharge if the bankrupt refuses to obey an order of the court,[36] and in *Connelly v. Michael*[37] a denial of discharge was ordered because of the violation by the bankrupt of certain court orders. The court in the instant case stated:

> [T]he party objecting to a bankrupt's discharge has the burden to establish a reasonable basis for believing that the bankrupt has

30. *Id.* at 693.
31. *Id.* at 696.
32. 429 F.2d 646 (5th Cir. 1970).
33. *Id.*
34. 11 U.S.C. § 32(c)(3) (1964).
35. McCarty v. Small Business Administration, 420 F.2d 943 (5th Cir. 1970).
36. 11 U.S.C. § 32(c) (6) (1964).
37. 424 F.2d 387 (5th Cir. 1970).

> committed an act which would prevent a discharge in bankruptcy. . . . When the trustee has met this burden, the burden of going forward with the evidence is upon the bankrupt to demonstrate that the bankrupt has not committed any of the alleged acts.[38]

Unbeknown to many corporations' executives and officers is their special treatment in the Bankruptcy Act in regard to their right to discharge in bankruptcy.[39] The Act provides that debts created by fraud, embezzlement, misappropriation or defalcation, while acting as an officer or in any fiduciary capacity, are not discharged.[40] Under this section the court held in *Maguire v. Herzog*[41] that the managing officer of a corporation was not discharged from an obligation resulting from the misappropriation of funds. The transaction giving rise to the misappropriation was the application of proceeds received under a floor plan for payment of certain corporate creditors to whom he was secondarily liable.[42] The court said: "Hence it can be seen that Section 17(a)(4) has been applied when an officer of a corporation has misused his position to gain personal benefit at the expense of the corporate creditors."[43]

Before October of 1966, a bankrupt was not discharged from his tax liabilities, but since that date a discharge in bankruptcy releases the bankrupt from taxes which become legally due and owing more than three years before bankruptcy.[44] In *United States v. Winters*[45] it was contended by one who obtained a discharge in bankruptcy before the effective date of the amendment, that the amendment should apply to him, thus discharging taxes which became legally due and owing more than three years before bankruptcy. This contention was held without merit, the court saying:

> If we were to apply the 1966 amendment to Winters, then any taxpayer who had been granted a discharge before October 1966 who still has outstanding tax claims which became due and owing more than three

38. *Id.* at 389. The proviso in section 14(c)(8) of the Bankruptcy Act is similar. 11 U.S.C. § 32(c)(8) (1964).

39. Joslin, *Corporation Officers and Directors: Involvements in Bankruptcy*, 10 CORP. PRACTICE COMMENTATOR 141, 146 (1968).

40. Bankruptcy Act § 17(a)(4), 11 U.S.C. § 35(a)(4) (1964).

41. 421 F.2d 419 (5th Cir. 1970).

42. *Id.*

43. 421 F.2d at 422.

44. *See* Bankruptcy Act § 17(a)(1), 11 U.S.C. § 35(a)(1) (1964); United States v. Winters, 424 F.2d 113, 115 (5th Cir. 1970); Able Roofing & Sheet Metal Co. v. Gordon, 425 F.2d 699 (5th Cir. 1970).

45. 424 F.2d 113 (5th Cir. 1970). One should be careful of the headnotes in this case.

> years prior to bankruptcy could . . . now assert that these tax claims were discharged.[46]

Although a discharge in bankruptcy releases a bankrupt from taxes which become legally due more than three years preceding bankruptcy, yet even these are not discharged if not assessed because the bankrupt failed to make returns, or not assessed by reason of a prohibition on assessment pending the exhaustion of remedies available to the bankrupt.[47] In the case of *In re Indian Lakes Estates*[48] the Fifth Circuit reversed the referee and the district court and held that the assessment of taxes were prohibited pending exhaustion of remedies and that the taxes were not reported as required and, therefore, were not discharged although they had become legally due more than three years before the bankruptcy. In explaining the reason for the legislation, the court stated: "A taxpayer . . . can then institute lengthy defensive maneuvers, possibly taking years, during which period the taxpayer's financial conditions may so deteriorate that a jeopardy assessment could subsequently be gained."[49]

EXEMPTIONS

A bankrupt is allowed by sections 17(a) and (c) of the Bankruptcy Act the exemptions prescribed by the state laws of the state wherein he had his domicile for the longest portion of the preceding six months.[50] In *Williams v. Wirt*,[51] under this provision, the bankrupt claimed a $1,000 exemption under Florida law of certain shares of stock worth $2,250. The referee allowed the exemption and permitted the bankrupt to retain the stock upon payment to the trustee the value of the portion not exempt. This was held to be the correct and proper method of disposing of this problem. The court further added that an appraisal by independent appraisers was not required.[52]

PREFERENCES

Section 70(e) of the Bankruptcy Act provides that any transfer made by a debtor adjudged a bankrupt, which under any state law is voidable

46. *Id.* at 116.
47. Bankruptcy Act § 17 (a) & (c), 11 U.S.C. § 35 (a) & (c) (1964).
48. 428 F.2d 319 (5th Cir. 1970).
49. *Id.* at 324.
50. Bankruptcy Act § 6, 11 U.S.C. § 24 (1964).
51. 423 F.2d 761 (5th Cir. 1970).
52. *Id.* at 763.

for any reason by any creditor of the debtor, is null and void as against the trustee.[53] Florida law provides that no transfer by a corporation when it is insolvent or insolvency is imminent, with intent to give a preference, shall be valid.[54] In *Freeling v. Michigan Repacking and Produce Co.*[55] tomato shipments were made to a creditor while the transferor was insolvent and the trustee attempted to invalidate the transfer. The court held that whether this was a voidable preference was a question to be determined under Florida law and remanded the case for a determination as to whether there was sufficient intent to meet the requirements of the Florida law.[56] The court seems to suggest that the intent to prefer as a matter of proof may depend upon the imminence of liquidation of the corporation.[57] In the situation raised here it is important to keep in mind that this was not an application of the bankruptcy preference law but the preference law of Florida.

INCIDENTALS

A trustee in bankruptcy is charged with collecting the estate and utilizing rights and powers of the bankrupt for the benefit of the estate.[58] In *Mt. Vernon Restaurants, Inc. v. Merritt*[59] a trustee charged fraud by a former trustee in dealing with a liquor license belonging to the bankrupt. The court said:

> The trustee also makes wide-ranging and numerous charges of fraud, conspiracy and other improprieties directed against the predecessor trustee, . . . The answer to these charges is that, however keenly the trustee may feel that they have merit, nothing is presented to us to upset the finding of the referee that the charges are only accusations unsupported by either testimony or documentary evidence.[60]

Attorneys' fees for representing a trustee in bankruptcy may be based upon time spent, the intricacies of problems involved, the size of the estate, the opposition met, results achieved and contingency fees, but the over-all award must be reasonable.[61] In *Bemporod Carpet Mills, Inc. v.*

53. 11 U.S.C. § 110(e) (1964).
54. FLA. STAT. ANN. § 608.55 (Supp. 1970).
55. 426 F.2d 989 (5th Cir. 1970).
56. *Id.*
57. 426 F.2d at 990.
58. Bankruptcy Act § 47, 11 U.S.C. § 75 (1964); Bankruptcy Act § 70(a)(3), 11 U.S.C. § 110(a)(3) (1964); Bankruptcy Act § 70(b), 11 U.S.C. § 110(b) (1964).
59. 426 F.2d 280.
60. *Id.* at 281.
61. Bemporod Carpet Mills, Inc. v. Heller, __ F.2d __ (5th Cir. 1970).

Heller[62] an attorney's fee of $59,000 was allowed for a half million dollar estate. A contingent fee of $25,000 was awarded and $25 an hour for nonlitigation time and $30 an hour for litigation time.

SUMMARY

The Fifth Circuit cases for 1970 bring up the usual problems, except that more cases are appearing in connection with the 1966 change in the law permitting discharge of tax claims. It is probable that many problems will arise in this area in the future, and that the number of cases in general will be greater since the volume of bankruptcies has greatly increased in the last year.

62. *Id.*