Bankruptcy

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The Fifth Circuit decided relatively few cases of general interest in the field of bankruptcy law in 1981. Not surprisingly, most cases arose under the old Bankruptcy Act,[1] but there were two cases decided under the new Bankruptcy Code.[2]

In *Home Indemnity Co. v. Oesterle (In re Oesterle)*,[3] the court held that the bankruptcy judge did not abuse his discretion in finding that the bankrupt's failure to maintain financial records was justified. A creditor had objected to the bankrupt's discharge under section 14(c)(2) of the Act.[4] The bankruptcy court accepted the bankrupt's excuse that he had turned over certain records to trustees in corporate bankruptcies filed in another jurisdiction. The bankruptcy court held that the bankrupt was justified in not keeping certain of the records because of the small amount of money involved in his business as a tax consultant. The panel expressed some reservation regarding the failure of a tax consultant to maintain records, even when a relatively small income was involved, but concluded that the lower courts had not abused their discretion.

The primary issue in *Crist v. Crist (In re Crist)*[5] was whether section 17(a)(7) of the Act[6] is constitutional. The *Crist* case is a consolidation of

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1. 11 U.S.C. §§ 1-1255 (1976)(current version at 11 U.S.C. §§ 101-151326 (Supp. IV 1980)) [hereinafter referred to as the Bankruptcy Act or the Act].

2. 11 U.S.C. §§ 101-151326 (Supp. IV 1980) [hereinafter referred to as the Code or the Bankruptcy Code].

3. 651 F.2d 401 (5th Cir. 1981).

4. 11 U.S.C. § 32(c)(2) (1976).

5. 632 F.2d 1226 (5th Cir. 1980), *cert. denied*, 451 U.S. 986 (1981).

6. 11 U.S.C. § 35(a)(7) (1976).

appeals in two cases concerning judgments of the bankruptcy court that the debtors would not be discharged from alimony obligations.

Section 17(a)(7) provides in pertinent part that: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . (7) are for alimony due or to become due, or for maintenance or support of wife and child. . . ."[7]

In an exhaustive analysis, the Fifth Circuit considered the alternative interpretations of the statute that were suggested by the parties and courts below. Concerning the provision of the statute relating to alimony, the court stated that the "alimony clause portion of the foregoing excerpt contains no reference to either sex and it is forcefully argued that it is gender neutral and therefore constitutional."[8] Regarding the remaining words of the section that specifically refer to a wife, the court stated:

> We conclude that, by providing the benefit of non-dischargeability of debts for alimony and support owed to wives but not to husbands—or, to state it another way, by providing the benefit of dischargeability of such debts owed by wives but not those owed by husbands—§ 17(a)(7) violates the equal protection component of the due process clause of the Fifth Amendment.[9]

Rather than declare the statute void, however, the Fifth Circuit extended its benefits to men, following the lead of the United States Supreme Court in cases such as *Califano v. Westcott*.[10] This issue will not arise under the Code because the drafters were careful to use gender neutral terms in section 523(a)(5).[11]

In *Erspan v. Badgett*,[12] the court affirmed the district court's determination that the wife's share of the husband's United States Army retirement benefits was a nondischargeable obligation for alimony. This follows the rule in *In re Nunnally*.[13] In *Nunnally*, the court had held that regardless of how a state defines the term "alimony," a federal court, applying federal law, is not bound by the state determination. The court stated that "consistent with the objectives of federal bankruptcy policy, the substance of the award must govern."[14]

Columbus Bank & Trust Co. v. Cohn[15] dealt with the appeal of a

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7. *Id.*
8. 632 F.2d at 1233.
9. *Id.* at 1234.
10. 443 U.S. 76 (1979).
11. 11 U.S.C. § 523(a)(5) (Supp. IV 1980).
12. 647 F.2d 550 (5th Cir. 1981).
13. 506 F.2d 1024 (5th Cir. 1975).
14. 647 F.2d at 555.
15. 644 F.2d 1040 (5th Cir. 1981).

United States District Court judgment. The judgment was based upon a jury verdict that certain liabilities of Cohn and his wife to the bank were not dischargeable under section 17(a)(2) of the Act.[16] The Fifth Circuit found that there was adequate evidence to support the verdict. In particular, the bankrupts had delivered to the bank a financial statement that listed real estate assets without disclosing liabilities against those assets. In addition, the bankrupts stated on the financial statement that their shares of a closely held corporation were valued at $200,000; however, two days after the loan, they participated in the issuance of new shares that reduced their interest in the corporation from sixty-five percent to about five percent.[17]

In *Abramson v. Lakewood Bank & Trust Co.*,[18] the Fifth Circuit reaffirmed the holding in *Durrett v. Washington National Insurance Co.*[19] that a regularly conducted nonjudicial foreclosure may constitute a fraudulent transfer under section 67(d) of the Act.[20] In *Abramson*, the bank bid $65,000 at the foreclosure sale for property that secured indebtedness of the bankrupts totalling $75,000. Within one year, the debtors filed bankruptcy petitions, and the trustee brought an action against the bank to declare the transfer fraudulent under section 67(d) of the Act for lack of adequate consideration. The district court held that the transfer occurred at the time that the deed of trust was filed rather than at the time of the sale. Following the rule in *Durrett*, the majority of the panel decided that the transfer for section 67(d) purposes occurred at the time of the sale. Judge Clark, dissenting, stated that the holding in *Durrett* was "simply wrong."[21] He argued that a foreclosure sale is not a transfer by the debtor since the debtor does not voluntarily participate in the transaction but merely fails to make the payment, thereby entitling the creditor to conduct the sale in the debtor's name. The authors concur with Judge Clark and in particular with the following observation:

> The cloud created over mortgages and trusts deeds by making foreclosure sales subject to being voided by a bankruptcy trustee will naturally inhibit a purchaser other than the mortgagee from buying at foreclosure. This tends to depress further the prices of foreclosure sales and thus increase the potential size of the deficiency in each foreclosure in all six states comprising this circuit.[22]

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16. 11 U.S.C. § 35(a)(2) (1976).
17. 644 F.2d at 1042-43.
18. 647 F.2d 547 (5th Cir. 1981).
19. 621 F.2d 201 (5th Cir. 1980).
20. 11 U.S.C. § 107(d) (1976).
21. 647 F.2d at 549 (Clark, J., dissenting).
22. *Id.* at 550.

Though section 548 of the Code,[23] which deals with fraudulent transfers is based largely on section 67 of the Act, the adoption of the Code give the next panel that considers the issue an opportunity to reexamine th rationale of *Durrett*.

In *Turpin v. Wente (In re Turpin)*[24] the trustee sought to recove funds held for the benefit of the debtor in certain pension and profi sharing trusts. The issue was whether the funds passed to the truste under section 70(a)(5) of the Act.[25] The lower courts held that the fund did pass to the trustee, but the Fifth Circuit reversed and followed it decision in *In re Nunnally*.[26] The court reviewed the competing policie of marshaling assets for the benefit of creditors and the giving of a fres start to the bankrupt. The court stated:

> In *Nunnally*, we concluded that retirement benefits were assets designed to provide the bankrupt with a substitute for wages at some point in the future and thus the bankruptcy trustee had no claim to them under § 70(a)(5). We reach the same conclusion with regard to the benefits at issue here.[27]

The trustee argued that retirement funds were unnecessary to insur the bankrupt a fresh start since the bankrupt would not receive thos benefits for several years. This reasoning, as the Fifth Circuit pointed out misses the point of the *Nunnally* case. The focal point is not the *immedi ate* need for funds to insure the fresh start. Rather, in the court's words "[To] recognize the trustee's claim against the funds would leave a clou of pre-bankruptcy debt hanging over the bankrupt's future. Providin the bankrupt with a 'fresh start' means assuring him that assets to whic he may become entitled *in the future* will be acquired free of any pre bankruptcy obligations."[28] It should be noted that under sectio 522(d)(10)(e) of the Code[29] a debtor may exempt pension benefits to th extent reasonably necessary for the support of the debtor and any depen dent of the debtor.

In *Boullion v. McClanahan*,[30] the Fifth Circuit upheld the holding o the lower courts that a bankruptcy trustee enjoys absolute immunit against tort claims when the trustee's actions are approved by the bank ruptcy court. No appeal had been taken from the orders in question tha

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23. 11 U.S.C. § 548 (Supp. IV 1980).
24. 644 F.2d 472 (5th Cir. 1981).
25. 11 U.S.C. § 110(a)(5) (1976).
26. 506 F.2d 1024 (5th Cir. 1975).
27. 644 F.2d at 474.
28. *Id.* at 475.
29. 11 U.S.C. § 522(d)(10)(e) (Supp. IV 1980).
30. 639 F.2d 213 (5th Cir. 1981).

authorized the trustee to take certain acts. The trustee was entitled to "derived immunity" since he was under the supervision and subject to the orders of the bankruptcy court.

Under the Code, a trustee in a Chapter 11 proceeding may operate the debtor's business unless the court orders otherwise.[31] The tendency will be for trustees not to seek approval of routine asset sales that might have been required under the Act. Perhaps trustees will wish to consider using the safe harbor of *Boullion* by obtaining court approval even if that approval is no longer required.

In *Neville v. Eufaula Bank & Trust Co. (In re U.S. Golf Corp.)*,[32] the court again addressed the legal framework within which attorneys' fees may be paid in bankruptcy proceedings. This case arose under the Act. The bankruptcy court had limited the attorney for the trustee to a maximum fee, commonly applied in that district, of thirty dollars per hour for out-of-court time. The Fifth Circuit, noting that many of the factors outlined in *Johnson v. Georgia Highway Express, Inc.*[33] were in the attorney's favor, set a higher fee of forty-five dollars per hour for out-of-court time.

In *Flournoy v. Trust Co. of Columbus (In re Weaver)*,[34] the Fifth Circuit held that a trustee in a Chapter XIII proceeding under the Act has standing to bring a truth-in-lending claim under the Truth-in-Lending Act[35] on behalf of the wage earner against the lender. The creditor urged that since the debtor was to pay his creditors out of future earnings and since the debtor would be revested with title to the debtor's property upon the consummation of the proceeding, the trustee ought to have no standing to bring such an action. The court disagreed, pointing out that the truth-in-lending claim was in the nature of a compulsory counterclaim that would have the effect of reducing the amount of indebtedness owed to the creditor. Under section 47(a)(8) of the Act[36] and Bankruptcy Rule 13-307(a),[37] a Chapter XIII trustee has the duty to examine claims and to object to invalid claims. Moreover, the court held that objections to claims under these circumstances might be made even after the confirmation of the debtor's plan.

The court addressed the issue of whether a truth-in-lending claim passes to a trustee in a straight bankruptcy under section 70(a) of the

31. 11 U.S.C. § 1108 (Supp. IV 1980).
32. 39 F.2d 1197 (5th Cir. 1981).
33. 488 F.2d 714 (5th Cir. 1974).
34. 632 F.2d 461 (5th Cir. 1980).
35. 15 U.S.C. §§ 1601-91f (Supp. IV 1980).
36. 11 U.S.C. § 75(a)(8) (1976).
37. FED. R. BANKR. PROC. 13-307(a).

Act[38] in *First National Bank & Trust Co. v. Flatau (In re Wood)*.[39] I this case, the bank filed a reclamation complaint to recover an automobil that secured indebtedness of the bankrupt to the bank. The trustee coun terclaimed under the Truth-in-Lending Act[40] to recover statutory dam ages. The bankruptcy judge permitted the bank to reclaim the automc bile and dismissed the trustee's counterclaim on the ground that th trustee had no standing to bring it.[41] The district court affirmed.[42] Th Fifth Circuit reversed and held that the debtor's claim under the truth in-lending statute is transferable to the trustee in bankruptcy under sec tion 70(a)(5) of the Act. The court reasoned that this claim would pass t the trustee as property if it were transferable, that transferability reste upon whether the cause of action would survive the death of the debto and that survival depended upon whether the Truth-in-Lending Act wa a penal act. The court decided that the Truth-in-Lending Act was no penal since it was primarily designed to liquidate damages, was remedia in nature, and was intended to right private as opposed to public wrong

The issue in *NLRB v. Evans Plumbing Co.*[43] was whether the auto matic stay provisions of section 362(a)(1) of the Code[44] applied to an or der of the NLRB that directed the debtor to reinstate two employee with back pay. The two employees had complained about mismanage ment of vacation funds by their employer, and their union lodged an un fair labor practice charge with the NLRB. Despite the filing of a Chapte 11 petition, an administrative law judge held a hearing as scheduled found that the debtor had committed unfair labor practice, and ordere the employees reinstated with back pay.

The Fifth Circuit held that the automatic stay provisions of sectio 362(a) of the Code did not bar the exercise of police or regulatory power of the NLRB in conducting the hearing and entering the order requirin reinstatement of the employees with back pay. The court pointed to sec tion 362(b)(4),[45] which provides that a petition does not operate as a sta "of the commencement or continuation of an action or proceeding by governmental unit to enforce such governmental unit's police or regula tory power. . . ."[46] Nonetheless, the court declined to rule on whether a attempt to enforce a judgment for back pay would be exempt from th

38. 11 U.S.C. § 110(a) (1976).
39. 643 F.2d 188 (5th Cir. 1980).
40. *Id.* at 190.
41. *Id.*
42. 15 U.S.C. §§ 1601-91f (Supp. IV 1980).
43. 639 F.2d 291 (5th Cir. 1981).
44. 11 U.S.C. § 362(a)(1) (Supp. IV 1980).
45. 11 U.S.C. § 362(b)(4) (Supp. IV 1980).
46. *Id.*

stay. Bankruptcy practitioners should note also that the court declined to express an opinion whether a bankruptcy court would have the power under section 105(a) of the Code[47] to issue a discretionary stay notwithstanding the provisions of section 362(b)(4).

The extent of the automatic stay provisions of the Code was also the subject of *SEC v. First Financial Group.*[48] The SEC had commenced a civil enforcement action to enjoin alleged fraudulent manipulation of the securities market, and upon motion of the SEC, the district court appointed a temporary receiver for appellant. Five days prior to the appointment of the receiver, an involuntary petition had been filed against appellant. The Fifth Circuit held that the appointment of a receiver in an injunctive enforcement proceeding was allied closely with the SEC's interest in the civil enforcement action and therefore a valid exercise of its police power. Accordingly, the filing of the petition did not operate as a stay under the provisions of section 362(b)(4)-(5).[49] The appellant argued that the act of taking possession of the debtor's property violated the provisions of section 362(a)(3),[50] which enjoin any act to obtain possession of the property of the bankrupt. Acknowledging the lack of any stated exception to section 362(a)(3), the Fifth Circuit nonetheless rejected appellant's argument and pointed out that the purpose of section 362(a)(3) is to prevent the dissipation of the assets of the debtor and thereby insure orderly distribution of those assets. The court found that the appointment of a temporary receiver served that purpose and, hence, did not conflict with the policy embodied in the Code.

In *Stewart v. Kutner (In re Kutner),*[51] the Fifth Circuit addressed the question of whether an order denying the standing Chapter 13 trustee's request to convert the case to a proceeding under Chapter 7 is directly appealable. Section 109(e) of the Code[52] provides that only an individual with a regular income owing less than $100,000 in noncontingent, unsecured debt may file a Chapter 13 action. The schedules attached to the petition reflected an unsecured debt of over $3,500,000, but the petitioner contended in those schedules that the debt was contingent. The Chapter 13 trustee alleged that the debtor owed more than $100,000 in noncontingent unsecured debt and filed a request to convert the case to a Chapter 7 case on the ground that the debtor was ineligible to file a Chapter 13 petition. Section 1307 of the Code[53] provides that a case may be con-

47. 11 U.S.C. § 105(a) (Supp. IV 1980).
48. 645 F.2d 429 (5th Cir. 1981).
49. 11 U.S.C. § 362(b)(4)-(5) (Supp. IV 1980).
50. 11 U.S.C. § 362(a)(3) (Supp. IV 1980).
51. 656 F.2d 1107 (5th Cir. 1981).
52. 11 U.S.C. § 109(e) (Supp. IV 1980).
53. 11 U.S.C. § 1307 (Supp. IV 1980).

verted only upon the request of a party in interest. The debtor contended that the trustee was not a party in interest, and the bankruptcy judge agreed. A direct appeal was filed to the Fifth Circuit Court of Appeals pursuant to the provisions of 28 U.S.C. section 1293.[54] The Fifth Circuit raised its own motion on the issue of whether it had jurisdiction and determined that it did not. The order was interlocutory and "merely dispose[d] of an incidental procedural matter during the proceedings in the bankruptcy court, but [was] not an order or judgment that end[ed] the bankruptcy proceedings."[55] The court determined that 28 U.S.C. section 1293(b),[56] which conferred upon the court of appeals jurisdiction to hear an appeal "from a final judgment, order, or decree of a bankruptcy court,"[57] applies during the transition period that ends on April 1, 1984. Accordingly, the court dismissed the appeal.

54. 28 U.S.C. § 1293 (Supp. III 1979).
55. 656 F.2d at 1111.
56. 28 U.S.C. § 1293(b) (Supp. III 1979).
57. *Id.*