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Commercial Law

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OVERVIEW

This section of the Tenth Circuit Survey provides a brief summary of the decisions rendered by the Tenth Circuit in the general area of commercial law during the 1977-78 survey period. Only those opinions which have been selected for official publication are reviewed herein.

The most noteworthy[1] cases involving commercial law this term arose out of bankruptcy proceedings. Thus, this section will be devoted entirely to decisions wich in some way had their origin in, or were directly affected by, a bankruptcy proceeding.

BANKRUPTCY

A. *Liability of a Trustee in Bankruptcy for F.I.C.A.[2] and F.U.T.A.[3] Taxes on Wages Paid Subsequent to Initiation of Bankruptcy Proceedings.*

In the case of *United States v. Ennis (In re* Armadillo Corp.)[4] the court approached some unsettled questions with regard to the liability of trustees in bankruptcy for wage claim related taxes. The taxes involved were: 1) F.I.C.A. and F.U.T.A. taxes on priority wage claims;[5] 2) F.I.C.A. and F.U.T.A. taxes on unsecured wage claims; and 3) employee portions of withheld income and F.I.C.A. taxes on general unsecured wage claims. The court approached the issues from the perspective of "the degree to which a trustee is required to function as an employer in paying and withholding wage claim related taxes."[6] Further, the court relied heavily on the Supreme Court decision in *Otte v. United States.*[7]

In its analysis of the issue, the court first noted that the applicable sections of the Internal Revenue Code make an "employer" liable for withholding and remitting the taxes in

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[1] Cases dealing with other topics within commercial law were decided but were not selected for official publication, and they are not treated herein.

[2] I.R.C. § 3101.

[3] I.R.C. § 3301.

[4] 561 F.2d 1382 (10th Cir. 1977).

[5] Priority wage claims in bankruptcy proceedings are wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding. *See* 11 U.S.C. § 104(a)(2) (1976) (amended 1978).

[6] 561 F.2d at 1385.

[7] 419 U.S. 43 (1974).

issue.[8] The *Otte* opinion restated the definitions of employer to include persons having "control of the payment of wages."[9] Based on an analogy to *Otte* and applying the guidelines set forth therein, the court concluded that the trustees were liable for all of those taxes as an employer would be.

The court then addressed the issue of whether the United States was required to file proof of claims[10] in order to collect such taxes. Once again relying on the reasoning from the *Otte* opinion, the court held that no proof of claim was necessary in order to preserve the United States' right to the taxes.

Finally, the United States asserted that all the wage claim related taxes were entitled to be considered first priority debts.[11] This issue had previously been addressed in the *Otte* case. In reliance thereon, the court concluded that wage claim related taxes were entitled only to the same priority as the wages from which they emerge, and not to the status of first priority treatment.

B. Power of the Bankruptcy Court to Enjoin a Civil Action Against the Guarantor of a Bankrupt.

Globe Construction Co. v. Oklahoma City Housing Authority[12] primarily addressed the issue of whether an order staying all proceedings against a bankrupt pending bankruptcy proceedings precluded a judgment being entered against a surety of the bankrupt during the effective period of the order.

The case arose out of a construction contract in which a surety provided a performance bond guaranteeing performance by the general contractor and its surety for failing to satisfactorily

[8] I.R.C. § 3402 and Treas. Reg. § 31.3402(a)1(b) (1960 as amended) require employers to withhold income taxes, and I.R.C. § 3403 along with Treas. Reg. § 31.3403(1) (1960) require employers to pay the withheld taxes to the United States; I.R.C. § 3102 requires employers to withhold employee F.I.C.A. taxes and Treas. Reg. § 31.3102-2 (1960 as amended) requires employers to pay these taxes to the United States; I.R.C. § 3101 and Treas. Reg. § 31.3111-4 (1960) impose liability on an employer for the employer's portion of F.I.C.A. taxes and Treas. Reg. § 31.3111-5 dictates the manner of payment; I.R.C. § 3301 and Treas. Reg. § 31.3301-1 (1960) impose liability upon the employer for the F.U.T.A. taxes.

[9] 419 U.S. at 49.

[10] A proof of claim is required to be filed in a bankruptcy proceeding as a condition precedent to a creditor receiving an apportionment of the debtor's assets for a debt.

[11] 561 F.2d at 1387.

[12] 571 F.2d 1140 (10th Cir. 1978).

complete the construction contract. Subsequently, the general contractor filed a petition in bankruptcy under Chapter XI of the Bankruptcy Act.[13] The bankruptcy judge immediately entered an order staying all proceedings against the bankrupt. In spite of the order, judgment was entered against both the general contractor and the surety.[14] On appeal from these judgments, the plaintiff conceded that the entry of judgment against the bankrupt was in error but sought enforcement of the judgment against the surety.

The court held that the "power of the bankruptcy court to enjoin *in personam* suits is confined to suits against the debtor, and there is no jurisdiction to enjoin a suit brought to enforce the liability of a guarantor of bonds secured by a mortgage upon property owned by the debtor."[15] The judgment against the surety was enforceable.

C. Preferential Transfers under Section 60(a) of the Bankruptcy Act.[16]

In *Furedy v. Appleman (In re* Vodco Volume Development Co.),[17] the court approached the issue of whether filing a continuation statement in accordance with Colorado law,[18] after a properly filed financing statement has lapsed, causes continuous perfection of the original security interest against a trustee in bankruptcy.

The issue arose when the trustee in bankruptcy asserted that a certain payment on a loan to a creditor, Appleman, (the appellee) was a preferential transfer[19] under the Bankruptcy Act and thus to be included in the bankrupt's assets for distribution to the general creditors. Appleman contended that because of Colorado's unique addition to the Uniform Commercial Code section

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[13] 11 U.S.C. §§ 701-66 (1976) (amended 1978).

[14] 571 F.2d at 1143.

[15] *Id.*

[16] 11 U.S.C. § 96(a) (1976) (amended 1978).

[17] 567 F.2d 967 (10th Cir. 1977).

[18] COLO. REV. STAT. § 4-9-403(3) (1973).

[19] A preferential transfer is defined as transfer "of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." 11 U.S.C. § 96(a)(1) (1976) (amended 1978).

dealing with continuation statements,[20] a late filing of a continuation statement relates back to the date of the original financing statement and causes continuous perfection of his security interest. Since the security interest would thus be continuously perfected, the antecedent debt requirement of a preferential transfer[21] would not be met.

The court rejected this argument, holding that the intent of the federal bankruptcy law took precedence over the state law in this situation.[22] In distinguishing a prior case,[23] the court stated that although the procedure to be followed in perfecting a security interest in the property of a bankrupt is determined by state law, the time at which perfection becomes effective against the trustee in bankruptcy is determined by federal law. This conclusion preserves the superiority of the federal bankruptcy law but at the same time does not override the use of the Colorado revision of the Uniform Commercial Code in all situations.[24]

D. Other Cases

1. In *Nitz v. Nitz*[25] the court considered the definition of alimony, child support, and maintenance under Utah law[26] to determine whether certain obligations of the bankrupt incurred at divorce were dischargeable in a bankruptcy proceeding.[27] The court held that the trial judge's determination that the petitioner

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[20] COLO. REV. STAT. § 4-9-403(3) (1973) initially follows the Uniform Commercial Code provision allowing a continuation statement to be filed within six months before and sixty days after a stated maturity date in the original financing statement but then adds:

> The failure to file a continuation statement within the time provided in this section shall not affect the validity of a secured party's security interest as against the debtor, and if a continuation statement is filed subsequent to the time provided for but in no event later than two years thereafter, then the late filing shall have the same effect as if it were filed within the time provided, except as to pesons who may have acquired rights subsequent to the time when the filing should have been made and prior to the late filing, and as to them only to the extent of the rights so acquired . . . .

[21] A condition to a finding of a preferential transfer is that the property be transferred for or on account of an antecedent debt. If this is not found, the trustee cannot successfully assert that a given transfer is a preference.

[22] 567 F.2d at 971.

[23] *See* E. F. Corp. v. Smith, 496 F.2d 826 (10th Cir. 1974).

[24] 567 F.2d at 971.

[25] 568 F.2d 148 (10th Cir. 1977).

[26] UTAH CODE ANN. § 30-3-5 (1953).

[27] Under the Bankruptcy Act, obligations for alimony and support for a wife and child are nondischageable. 11 U.S.C. § 35 (a)(7) (1976) (amended 1978).

had failed to meet her burden of proof with respect to showing the nature of the obligations to be nondischargeable, was not clearly erroneously and thus not reversible.[28]

2. The court in *Wellston, Oklahoma, Natural Gas Authority Bondholders v. Nesbitt (In re* Eufaula Enterprises, Inc.)[29] applied the "clearly erroneous" standard[30] to a bankruptcy judge's determination that a public trust was the mere instrumentality or alter ego of the bankrupt. The rule governing piercing the veil in the bankruptcy context was stated to be "[w]hen one legal entity is but an instrumentality of alter ego of another, by which it is dominated, a court may look beyond form to substance and may disregard the theory of distinct legal entities in determining ownership of assets in a bankruptcy proceeding."[31] The court also expressly found that even though the legal entity attacked was a public trust,[32] it could be validly brought within the ambit of the aforementioned rule.

3. In *Coldwell Banker v. Godwin Bever Co.*,[33] the Tenth Circuit resolved the status of a claim by Coldwell Banker and Company, *i.e.*, whether it was a general, unsecured claim or an expense of administration.[34] The claimant had acted as an agent for sale of certain of the bankrupt's stores. Prior to the bankruptcy proceedings, the claimant had completed its entire obligation of procuring a willing buyer, but the sale was not completed until after the proceedings had begun. The claimant asseted that it was the third party beneficiary of the purchase and escrow agreement made by the bankrupt with the buyer, which was not consummated until after bankruptcy, and thus was entitled to recover its debt as an administrative expense.[35] The court rejected this argument and held that the debt was a general, unsecured debt.

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[28] 568 F.2d at 152.

[29] 565 F.2d 1157 (10th Cir. 1977).

[30] The ruling of the trial court as to factual matters will not be overruled unless it is "clearly erroneous."

[31] 565 F.2d at 1161.

[32] *Id.* at 1161-62.

[33] 575 F.2d 805 (10th Cir. 1978).

[34] An expense of administration has the highest priority for payment for the assets of a bankrupt whereas a general, unsecured claim has the lowest priority for payment.

[35] 575 F.2d at 807.

4. In *Zarate v. Baldwin*,[36] a bankrupt doctor sought discharge of an obligation incurred by reason of the settlement of a suit based on his allegedly negligent medical treatment. The judgment entered in the case, which incorporated the terms of the settlement agreement, provided that the debt was not "provable or dischargeable in bankruptcy."[37] After making payment for several years, the bankrupt filed a voluntary petition in bankruptcy and *inter alia* sought discharge of the debt.

In addressing the issue, the court first noted that liability for negligent medical malpractice is a dischargeable debt.[38] However, the court distinguished the case at bar by classifying the petitioner's claim as a claim "for the property she forwent by entering into the settlement agreement in reliance on Baldwin's [the bankrupt's] false representation."[39] Thus, the claim by petitioner was sustained based on the fraudulent representations of the bankrupt when he entered the settlement agreement.

5. In *Belcher v. Turner*,[40] the bankrupts filed a voluntary petition in bankruptcy in which they claimed a duplex as exempt property.[41] The duplex was occupied on one side by the bankrupts; the other side was leased and occupied by another family. The bankrupts claimed exemption for the entire duplex. In applying Kansas law,[42] the court held that the intent of the bankrupts was always to use the leased portion for the production of income and thus the property was non-exempt,[43] and further, that the purpose and intent of the Bankruptcy Act is to preserve and protect only the residence of the debtor and such purpose would be fulfilled by exempting only half of the duplex.

6. In *Kansas State Bank v. Vickers*,[44] the bankrupt sought discharge of approximately $249,000.00 in promissory notes payable to Kansas State Bank and Trust Company. The bank objected on the grounds that the bankrupt had obtained the loans

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[36] 578 F.2d 293 (10th Cir. 1978).

[37] *Id.* at 294.

[38] *Id.* at 295.

[39] *Id.*

[40] 579 F.2d 73 (10th Cir. 1978).

[41] *Id.* at 74.

[42] 11 U.S.C. § 24. The Bankruptcy Act makes available to bankrupts those exemptions prescribed by state law. Thus the court looked to the law of Kansas for guidance.

[43] 579 F.2d at 75.

[44] 577 F.2d 683 (10th Cir. 1978).

based on fraud[45] and that the bankrupt created the debts fraudulently while acting in a fiduciary capacity with the bank.[46]

In the course of business affairs with the bank, the petitioner filed periodic financial statements, including one on May 23, 1973, showing a net worth of $3,711,310.79 and on November 9, 1973, (approximately six months later) showing a net worth of only $32,386.15. The bank contended that it was fraudulently deceived in renewing the bankrupt's notes based on the inaccurate financial statements submitted.

The court, in upholding the bankruptcy court's findings of dischargeability stated that "[t]o be false or fraudulent within the meaning of the statute [the Bankruptcy Act] the statement [financial report] must be more than erroneous. It must have been false and intended to deceive, and relied upon by the creditor."[47] This is in accordance with the opinions of the majority of circuits addressing the issue.[48] The court held further that the bankrupt, while acting only as an outside director of the bank, was not acting in a fiduciary capacity with the bank and the debt was thus not nondischargeable.[49]

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[45] A debt incurred by fraud is not dischargeable in bankruptcy. 11 U.S.C. § 35(a)(2) (1976) (amended 1978).

[46] A debt created fraudulently while acting in a fiduciary capacity is not dischargeable in bankruptcy. 11 U.S.C. § 35(a)(4) (1976) (amended 1978).

[47] 577 F.2d at 687.

[48] *See, e.g., In re* Taylor, 514 F.2d 1370 (9th Cir. 1975).

[49] 577 F.2d at 687-88.