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PRACTICAL SUGGESTIONS TO THE LAWYER HANDLING A BANKRUPTCY CASE

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I HAVE a recollection of someone (I think it was a law book agent) saying it was more important to know where to find the law than to know the law; but I state, with all seriousness to the lawyers here present, that it is equally important to know the law and to know where to find it.

The lawyer must know the law for his own purpose, but he must know where to find it for the benefit of his opponent and the Court. For these reasons, the first concern of a lawyer entering into the field of Bankruptcy practice is to know where to find the law, even though he may not know what it is before he finds it.

The Bankruptcy Law is in the nature of a specialty, covering the subject of business failures, and the Courts of Bankruptcy are Courts having jurisdiction *in rem* and *in personam,* without limit as to the amount involved and without restrictions as to territorial limits as to situs of the property.

The present Bankruptcy Act, which is known as the Act of 1898, was adopted by the Congress of the United States under the power given it by Section 8 of Article I of the Constitution of the United States, reading as follows:

"Congress shall have power to establish uniform laws on the subject of bankruptcy throughout the United States and becomes a part of the supreme law of the land and is paramount in authority."

Its purpose is defined in *Wilson vs. City Bank,* 17 Wallace U. S. 473, to be as follows:

"The primary object of a bankruptcy law is to secure a just distribution of the bankrupt's property among his creditors; the secondary object is the release of the bankrupt from the obligation to pay his debts."

The *laws,* or *rules* having the effect of laws relating to bankruptcy are the following:

First: The Bankruptcy Act of 1898, with its amendments of 1903, 1910, 1926 and 1933, comprising 77 sections. These sections, in the ordinary copies of the law used by text

writers and others, and even by the Congress of the United States, are numbered from one to seventy-seven, inclusive, and embody all of the substantive law on the subject.

Those of you who are familiar with the United States Code will know that in 1926 the Congress made a compilation called "The Code of the Laws of the United States of America," ordinarily known as the "U. S. Code," or "U. S. C."; and in this Code, title "Eleven" is the one containing the Bankruptcy Act in full, with annotations; but you will also find upon examination that the Sections in the Bankruptcy Act, after the first section, do not conform to the numbering in the U. S. Code, due to the fact that the Code sections are not consecutively numbered—the object, as stated, being to allow amendments to be inserted. For instance, Section 14 of the Act of 1898, relating to discharges of bankrupts, is Section 32 of the U. S. Code—and so on. The U. S. Code as now constituted, however, does not contain Sections 73 to 77, inclusive, these sections being the Acts of March 3, 1933.

Second: The General Orders in Bankruptcy—On the 28th of November, 1898, the Supreme Court of the United States adopted and established certain General Orders, to take effect on the first Monday, being the second day of January, 1899, and were meant to be *Rules* to aid in carrying into effect the Bankruptcy Act; and as stated in *Folda vs. Zilmer*, 14 Fed. (2nd) 843, have the force and effect of law so far as they are not in conflict with the express provisions of the Act.

The original draft of the General Orders were thirty-eight in number, and while some of them seem to reiterate the language of the Act itself, most of them are used for, or meant to be, aids in understanding the Act, or directions for practice under the Act.

On April 13, 1925, General Order No. 39 was adopted, and the last General Order adopted was that of May 15, 1933, relating to the appointment of *Ancillary Receivers*.

There are also General Orders relating to the practice under the *new Bankruptcy Act* of 1933, comprising Sections 74, 75, 76 and 77. There are now fifty-one of these General Orders in effect.

At the time of the adoption of the original General Orders in 1898, the Supreme Court prepared and promulgated what they called *"Forms in Bankruptcy."* These forms are in skeleton form, but represent workable outlines of the various petitions, orders, notices, etc., used in bankruptcy proceedings by bankrupts, creditors, clerks, referees, and others. These forms are numbered from one to seventy-five, inclusive, and are made for the purpose of obtaining uniformity in the practice and proceedings throughout the United States.

Gilbert Collier, in his Second Edition, has added to the official forms—taken from Hagar and Alexander—to a total of 221 forms.

In the District of Colorado, like in other judicial districts, the Court has adopted *District Rules in Bankruptcy* covering subjects not embodied in the foregoing literature on the subject of bankruptcy—notably, the defining of the bankruptcy districts in the jurisdiction, the matter of publication of notices to creditors (the notices are lengthened from those provided in Section 58 of the Act), the subject of attorneys' fees; the return date of subpoenaes, reclamation proceedings, etc.

The *literature on the subject of bankruptcy* comprises the decisions of the District Courts of the United States, Courts of Appeal, and the Supreme Court of the United States, which have been of such importance in the last few years as to strengthen the operation of the law materially and substantially.

Text books on the subject of bankruptcy are numerous. The ones ordinarily used are: Collier on Bankruptcy in the original edition of 1923, known as the 13th Edition, comprising four volumes; and the re-write of the text in the Amendment of 1927, known as Gilbert's Collier on Bankruptcy; and the Amendment, known as the Second Edition of Gilbert's Collier on Bankruptcy, brought down to November 1, 1930. Also, Remington on Bankruptcy, comprising nine volumes, with annotations, and also including an Annual Supplement service which includes annotations of the text annually; Prentice-Hall, Inc., have a loose-leaf annotated volume which includes the law itself and the General Orders.

The cost of these various volumes, in the latest editions, in the cheapest bindings, is: Gilbert's Collier, 2nd Ed.. $25;

Remington on Bankruptcy, $35; and Prentice-Hall, Inc., $10.

The practitioner who desires to follow this practice is almost required to have at least one of the *text books* in addition to the *General Orders* and *Forms.*

To practice in Bankruptcy Courts requires a *certificate of admission to the District Court of the United States* at the residence of the practitioner. Being thus equipped, let us suppose that John Doe, an individual, presents himself as your client to be initiated into the mysteries of a bankruptcy proceeding. You have certain *preliminary duties* to yourself, to the bankrupt and to the Court, which should not be overlooked, before you accept the employment.

First, you should secure from the bankrupt the *information necessary to include in his schedule.* This information should be accurate and in detail, and should correctly represent the debts of the bankrupt, segregated into prior or lien claims, taxes, wage claims, etc., so that they may be properly inserted in the schedule; then a complete list of creditors whose claims are unsecured and which have no priorities, under Section 64 of the Law, including the name of the general creditors—alphapetically arranged—their addresses, by street number, city or town and state; and the details of the origin of the debt. All these debts are a part of *Schedule A.*

The second part of the *schedule, B,* relates to the assets of the Bankrupt, and here should appear in detail all the information regarding his property—real, personal or mixed —where located, its value, and such details as will enable the Trustee to readily locate it and take it into his possession.

Of the things that are of *importance in addition* to the items to be entered in his schedule, you should know something of the history of the bankrupt's business at least twelve months prior to the date of his petition, as it may be found that the bankrupt has advisedly, or otherwise, committed acts inimical to the law which will prevent his discharge, or possibly involve him in more serious trouble.

If your client has been a *member of a co-partnership* in which he has a personal liability and from which he seeks to be discharged, you should be sure to have your schedule show the name of the co-partnership and other details to indi-

cate that a discharge is desired from such partnership liabilities, as distinguished from his personal debts.

If your client is a *partnership only,* you should, in addition to the schedule of partnership liabilities and assets, schedule the assets and liabilities of the individual partners; and in partnership cases you must have *all* the partners sign the petition and schedules.

If your client is a *corporation,* you should see that the corporation directors have adopted a resolution authorizing the filing of the petition and schedules, and authorizing some person named in the resolution to sign the petition and also to sign the schedule on behalf of the corporation.

Before you file the schedule, you may *yet pause and reflect* as to whether, in fact, you may have discovered some fact not in the petition or schedule—something that would prevent the bankrupt's discharge—because his liability is not measured entirely by what the Court may know from the record filed, but also by what the creditors might know *off the record.*

The proceeding incident to filing a petition and schedule for a bankrupt upon his own application is known as a *voluntary* proceeding and is open to any person who is not able to pay his debts and who desires his creditors to receive a distribution of his property through the Bankruptcy Court, and who desires to receive a discharge from his debts.

A voluntary petition does not require the bankrupt to be insolvent, necessarily. He may be perfectly solvent and yet file a petition in bankruptcy.

The second class of proceedings is known as *involuntary* proceedings, which are initiated by not less than three unsecured creditors of the bankrupt holding debts aggregating not less than $500, and which proceeding is without the consent of the bankrupt. When the petition is filed by the creditors, it must, in general terms, allege some ground for adjudication against him. These grounds are enumerated in Section 3 of the Act; and the proceeding is not permissible unless the person proceeded against is insolvent at the time of the filing of the petition; and if the person proceeded against is able to show that he was not insolvent, the adjudication will be refused, and the bankrupt has the right, if he so de-

mands it, of a jury to try the question of his insolvency (See Sec. 19).

Neither a voluntary petition can be filed by, nor an involuntary petition filed against, a municipal corporation, a railroad corporation (except under Section 77, enacted in 1933); nor an insurance company, nor a banking corporation; and since the Amendment of 1932, a building and loan association; and the person against whom an involuntaary petition is filed must owe debts to the aggregate amount of $1,000 or over.

When a petition is filed—whether voluntary or involuntary—the petitioner must pay to the Clerk of the United States District Court a *fee of $30;* and if this fee is advanced by a third party, it is recoverable as a priority out of the assets of the estate.

When a voluntary petition is filed, it is *adjudicated by* the Judge on the same or a subsequent date, by an *ex parte* order. If no answer is filed in an involuntary proceeding within the time fixed by the subpoena, adjudication follows in like manner upon suggestion of the petitioning creditors.

If either a voluntary or an involuntary petition is filed at a time when the Judge is absent from the District, the Clerk makes a certificate of the absence of the Judge and sends the papers to the Referee who makes the adjudication.

Following adjudication, the *case goes to the Referee* for further proceedings and the Referee then becomes the Court to issue all orders and try all questions of fact and law, and render final decisions thereon, subject only to *petition for review,* as provided in General Order No. 27.

Orders that may *not* be made by the Referee are: Orders approving compositions under Section 12; orders of discharge, under Section 14; and injunction orders to stay proceedings of a Court, officers of the United States, or of the State, under General Order No. 12.

These *orders,* however, are generally made by the Judge as a result of a trial before the Referee and upon his opinion and recommendation, at the consideration of which *parties may appear,* and present reasons why the Referee's recommendations should not be adopted by the Judge.

Further *appeals* may be had by the litigant to the Court of Appeals, under Sections 24 and 25 of the Act—under Section 24 to superintend and revise in matters of law, and under Section 25 as an appeal in equity from adjudging, or refusing to adjudge the defendant a bankrupt; or denying a discharge, or allowing or rejecting a debt or claim of $500 or over.

Both sections provide for a *review* on a petition to be filed within thirty days after the judgment appealed from.

These controversies may be certified to the Supreme Court of the United States from the Circuit Court.

The duty of the Bankrupt, or his attorney, is to *deposit with the Referee $30 for costs,* after which the *first meeting of creditors* of the bankrupt is called, upon 14 days' notice, by mail, and at this time it is the *duty of the bankrupt to be present,* with his books and accounts, prepared to answer all questions of creditors, or of the Bankruptcy Court, these duties being defined in Section 7 of the Bankruptcy Act.

At this first meeting of creditors, it is well for the attorney to observe the usual modesty of the profession in refraining from objecting to the bankrupt giving testimony, even though the questions directed at him may be in the nature of leading questions, because it seems that at that meeting the rules of evidence as to leading questions are not observed by most of the Referees, under the approved practice in such cases.

If it appears at this meeting that there are assets to be administered, a *Trustee* is selected and he is required to qualify by signing his acceptance and executing a surety bond in the amount fixed. The subsequent duties of a Trustee who takes possession of the property, is to cause it to be *inventoried, petition* for an order of *sale,* upon notice as required by Section 58 of the Act; and on the day and hour fixed, *offer* it for sale; and following the sale, to *make a report in writing* to the Referee, of the bids received; and upon *confirmation* by the Referee, to *deliver* the property and *collect the purchase price;* or, if not confirmed, to *reoffer* it until a sale can be made.

When the sale is made and confirmed, the *money is deposited* in a depository bank named usually by the Judge

of the Court, which has given a *bond* in an amount fixed by the Court, in compliance with Section 61 of the Bankruptcy Act; and thereafter, if there are no other complications, unsettled litigation, or other property to be turned into money, a *meeting of creditors* is called, at which *attorneys' fees* and other *claims* are allowed, *dividends* ordered paid, and the *case is closed* as far as the administration of the assets are concerned.

The Referee keeps a complete *docket* of all orders made, proceedings had and hearings held, witnesses examined, money received, money paid out, with all of the details of the payments, which is always done by check signed by the Trustee and countersigned by the Referee; and at the closing of the case, all papers are forwarded to the Clerk of the Court, together with a statement of all financial and other transactions, including cancelled checks and vouchers.

The case is then *closed* with the *exception* of the vital part to the bankrupt, which is his *discharge.*

The records of a case are preserved in the Clerk's files.

Filing of claims against a bankrupt estate is provided for in Section 57 of the Bankruptcy Act, and General Order No. 21.

Prior to 1926, creditors were allowed *one year* to file claims, but subsequent to that date, and at *present,* claims must be filed within *six months* after the date of adjudication, unless they are unliquidated claims and litigation is pending, and one on which a subsequent judgment is rendered; but claims of infants and insane persons, without guardians, without notice, may be filed within one year after adjudication.

In filing claims, the forms in bankruptcy provide the forms of proof. These are known generally as forms 31. 33, 34 and 35, being separate forms for individuals, corporations, copartnerships, and agents, and may be obtained at almost any stationery store or printer of blank forms.

If the claim is simply an account, unsecured note, or for merchandise, it should be signed by the claimant or his agent, authorized in writing; if a corporation, by its treasurer or other chief officer; and properly sworn to—to which should

be attached an itemized statement of account, the note, or contract.

If a claim is based on a *mortgage,* or lien, or priority claim, the *original documents* must be filed with the claim. These documents are the note, mortgage, or other evidence of the debt. After the claim is allowed these originals may be withdrawn upon application and order by the Referee, on substituting copies.

Proof and *allowance* of a claim is a prerequisite to its payment, or for any order affecting it.

WAGES of workmen, clerks and servants are the subject of the first priority in payment out of the assets of an estate. Following that priority, comes the payment of TAXES.

Attorneys at law are given favorable mention in Section 64 which permits *one reasonable attorney's fee* to be paid out of the assets of the estate as costs of administration. This "reasonable fee" is defined to be one fee in each case, which means a distributive fee equivalent to one reasonable fee to attorneys for the bankrupt, and attorney for the petitioning creditors jointly; and *Rule 5* of the rules of the District of Colorado defines the *maximum* fees to be allowed to attorneys other than attorneys for trustees, and a rule is now being prepared to cover that subject.

The DISCHARGE may be applied for by the bankrupt *after one month* and *within twelve months* after the date of adjudication; and when filed, a *meeting of his creditors* is called on an order made by the Court, fixing a date for *hearing before the Referee.* Upon this order the Referee gives *notice* to creditors under Section 58 of the Act, and on a day appointed, hears the *petition* for discharge, enters in the record any appearances in *opposition* thereto, if any; and if no opposition is filed and the record of the bankrupt is clear, the Referee refers it to the Judge, *recommending* that the discharge be *granted.*

However, if any creditors desire to *object,* they must appear on the day fixed for the appearance of the bankrupt before the Referee on the petition for discharge, and at that time, file *specifications* of objections which must contain one or more of the grounds stated in Section 14 of the Act.

The Referee then sets the objections for hearing before him under authority of the standing order of reference, takes the testimony and writes his conclusions and recommendations, and files them for the attention of the *Judge* in granting or refusing a discharge.

The Bankrupt has the right of *appeal* from a refusal of discharge, under Section 25 of the Act, which may proceed as far as the Supreme Court of the United States.

EXEMPTIONS are allowed bankrupts in accordance with the laws of the State in which the petition is filed, which include exemptions on insurance policies and homesteads, in addition to other general exemptions.

COMPOSITIONS are authorized by Section 12 of the original Act and by Sections 74 and 75 of the Act of March, 1933.

A composition is simply a means authorized by the law, by which a bankrupt, or a debtor, may bargain with his creditors to settle their debts, either in full or on such terms of payment as he feels himself able to make, measured by the value of the property he owns. These proceedings may be had after an adjudication in bankruptcy, or they may be had without adjudication.

Section 12 is the section under which all classes of debtors may seek composition, whether they are individuals, corporations, co-partnerships, etc.

Section 74 of the new Act applies to *individuals* only and permits extensions of time for payment or compositions of debts, in the manner thereinafter provided.

Section 75 of the Act of 1933 allows the same relief to *farmers only*—and they must be dirt farmers at that.

Bankruptcy Courts are governed by certain *rules* set down in the sections named as to *confirmation of compositions*, the theory being that the debtor and his creditors may make almost any contract they desire to make except that a *majority* of the whole *number of creditors* plus a *majority* in *amount of dollars* of their total claims can control a composition, and the minority creditors are then bound by the settlement so made.

The Bankruptcy Courts will therefore examine the proceeding to determine that the debtor has acted fairly, and

that the majority of creditors are not to profit in any way as against the non-consenting creditors; and will also consider the ability of the debtor, measured by the whole value of his property, and if the transaction seems to be fair and reasonable, *confirmation* of the Court will follow, in which case the *proceedings are dismissed*, and the debtor and creditors are left to their own resources in carrying out their contract.

Other subjects that may be mentioned are: Summary trials, ancillary proceedings and equity jurisdiction of Bankruptcy Courts.

In almost all bankruptcies of importance, *litigation* arises between trustees and claimants of property under contracts made with the bankrupt; and the question of the right of the Bankruptcy Court to try these controversies summarily becomes an important consideration.

The claimant may not desire to submit the case to the decisions of the Referee, in which case he will file with the Referee, in response to an order to deliver, or an order to show cause why delivery should not be made, or other order affecting his property, a *plea to the jurisdiction* of the Referee to try the case in a summary proceeding, which means a proceeding without the intervention of a jury.

The right of the Trustee to have his case tried in a summary proceeding before the Referee depends largely upon the possession of the property at the time of the filing of the petition in bankruptcy. If the property was taken from the bankrupt more than four months before he filed his petition, the claimant to it is entitled to have his case tried in a plenary suit in a State Court; or, in certain cases, in a plenary suit to a jury in the Federal Court; or, if the party proceeded against has a claim to the property based upon some substantial right which is not colorable, he may likewise have it removed to the State Court for trial; but in all that class of cases where, upon examination of the facts the Bankruptcy Court finds that the bankupt had possession of the property, either by himself or by his agent, or that the property has come into the possession of the Bankruptcy Court or its Receiver or Trustee, then the claimant is not entitled to have the controversy tried in a plenary suit over the objections of the Receiver or the Trustee.

On the question of *possession,* the Bankruptcy Court is the judge of its own jurisdiction.

It is hardly ever advisable for a claimant to file a plea to the jurisdiction unless he can prove the adverse possession at the date of bankruptcy, or within four months prior thereto; or show the possession of the property for a valuabale consideration. It is only necessary that the claimant have a substantial right to litigate a claim to the property which is not colorable, to succeed in his plea to the jurisdiction.

Ancillary proceedings are used in that class of bankruptcies where property exists outside of the primary jurisdiction; where, for instance, a bankrupt adjudicated in California had a store in Denver, the Trustee in California has the right, if he can, to sell the property in Colorado; but if, for any reason, he desires to have it handled by local officers, or in case of litigation of the property in Colorado, it is permissible for the Court of primary jurisdiction to certify the record, which may be filed in the United States District Court in Colorado, on which the Colorado Court will appoint an *ancillary receiver* who simply acts under the direction of the Court itself, or a *special master* of the Court in the matter of the property within the ancillary jurisdiction, and remit the proceeds to the Court of primary jurisdiction, out of which claims are paid and in which claims are usually allowed.

The question of ancillary proceedings often raises the question of the jurisdiction of the Bankruptcy Courts over property outside of the State, but this question has been set at rest by the Supreme Court of the United States in the case of *Isaacs vs. Hobbs Tie & Timber Co.,* 282 U. S. 734, and some other cases later referred to herein.

It is currently rumored on the street corner that *Courts of Bankruptcy* are *Courts of Equity,* and we might profitably examine the basis of this rumor.

Section 2 of the Bankruptcy Act provides, *inter alia,* that:

"The District Courts of the United States in the several states, the Supreme Court of the District of Columbia, the District Courts of the several territories and possessions, and the United States Court in the District of Alaska are hereby made Courts of Bankruptcy and are hereby invested, within their respective territorial limits, * * * with such jurisdiction in law and in equity as will enable them to

exercise original jurisdiction in bankruptcy proceedings in vacation in chambers and during their respective terms."

General Order 37 provides:

"In proceedings in equity instituted for the purpose of carrying into effect the provisions of the Act, or for enforcing the rights and remedies given by it, the rules of equity practice established by the Supreme Court of the United States shall be followed as nearly as may be."

Remington on Bankruptcy, Volume I, Section 23, states the rule as follows:

"Bankruptcy proceedings are a branch of equity jurisprudence,"

citing in the note a long line of cases.

"* * * The Bankruptcy Court has the incidental power to grant any equitable relief which may be necessary in the administration and distribution of the estate."

I think, however, there is considerable reason to believe that the statute should be strictly followed where it speaks, and that the equitable jurisdiction should apply only where the statute does not speak.

The sections quoted state that the rules of practice in equity shall be followed "as nearly as may be" and equity would apply more especially in aid of bankruptcy proceedings, as, for example, suits in equity to recover preferences; to set aside fraudulent transactions, etc.

The last few years have been prolific in notable *decisions* of the Supreme Court of the United States upon many questions arising in bankruptcy! but as a ground-work for the bankruptcy lawyer, only those cases dealing with the larger questions are of basic interest. Other decisions are of interest only when concrete cases arise.

Among the cases of general interest which should be familiar to all lawyers practicing in Bankruptcy Courts, are the following:

May vs. Henderson, 5 Amer. Bankruptcy Reports, New Series, 739. (Opinion April, 1925.)
Taubell vs. Fox, 264 U. S. 426. (Opinion 1924.)
Isaacs vs. Hobbs Tie & Timber Co., 282 U. S. 734. (Opinion 1931.)
Straton vs. New, 283 U. S. 318. (Opinion 1931.)
Cooper vs. Dasher, 290 U. S. 106.
Conrad, Rubin & Lesser vs. Pender, Trustee, 289 U. S. 472.