Protection and Collection of Property of Bankrupt Estates

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Among the first steps that the trustee must take in administering the assets of the bankrupt is to find out what those assets are and what steps he must take to reach them. If a receiver has been appointed, he will succeed to the receiver and should start in where the receiver left off. He will not only take possession of the bankrupt's real estate, other than his homestead, and his goods and chattels, other than those of a purely personal nature, but he will also take over the bankrupt's books and papers relating to his business affairs. The trustee should at once initiate such investigation as may be necessary to inform himself concerning the bankrupt's business and financial affairs. The bankrupt, his accountant, and some of the creditors may furnish all or many of the facts needed.

Such property as the bankrupt's real estate may be known, in part at least, to the petitioning creditors before the date of the petition. The bankrupt's schedules should set forth his property. One of the most important items of business at the first meeting of creditors should be to ascertain whether through inadvertence, misunderstanding, or otherwise, the bankrupt has failed to schedule all his property. In addition to the examination of the bankrupt at that meeting prescribed by Section 55b, Section 21a provides that the court may upon the application of any officer, bankrupt or creditor require any designated persons, including the bankrupt and his or her spouse, to be examined concerning the acts, conduct or property of the bankrupt. This examination is under oath and hence potentially under the penalties of perjury. It is usually before the referee, who may not commit for contempt, but who may certify

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1. If the property of the bankrupt is leased or bailed to others, the trustee will ordinarily not in the first instance endeavor to disturb the possession. He will, however, notify bailees and lessees to make payments to him and otherwise to recognize him as landlord or bailor. In a suitable case he will invoke the bankrupt's assistance in procuring the cooperation of third parties.

2. § 7a(8); Bankruptcy Form 1, Schedules B-1—B-6.

3. The examination of the spouse is limited to business of the bankrupt transacted by such spouse or to which such spouse was a party. Section 7a(10) also makes it a duty of the bankrupt to submit to examination whenever the court so orders.

the facts to the judge for a summary hearing and commitment in proper cases. Of course one of the principal purposes of such an examination is to ascertain and verify the facts concerning the bankrupt's property.

Sources of Information and Guidance

The bankrupt is obviously under a duty to cooperate in furnishing any information that will help the trustee to decide what to do. If the bankrupt has hopes of obtaining a discharge, he is likely to be helpful. As in most business matters, a friendly attitude on the part of the trustee toward the bankrupt and his employees will tend to promote the business in hand, unless and until the trustee has reason to suspect concealment of assets or concealment of other facts relating to the business, in which case he may have to regard the bankrupt as an adversary.

If the creditors have appointed a committee, as they are authorized by Section 44b to do at their first meeting, the trustee may consult it in connection with the administration of the estate, and receive its recommendation concerning the discharge of his duties. While such conferences may be helpful, at least from the point of view of minimizing criticism from creditors, the trustee's chief legal safeguard is instructions from the referee. While the referee wants a trustee to administer the estate, and cannot be asked to administer it himself, the trustee should take the precaution of getting the referee's ruling upon any legal questions that his attorney cannot resolve with confidence, unless the amount is too small to warrant such attention. Furthermore, cautious trustees will not be adverse to getting the views of the referee upon important questions of business policy, and procuring a formal order in proper case. Referees differ concerning the extent to which they have time and inclination to attend to administrative questions, and if the trustee does not know how the referee will react to a given situation, he may have to find out on a trial and error basis. In general, referees

5. § 41. In re Charlotte Textile Co., supra note 4, came up on a contempt hearing.
6. It has been held an abuse of discretion to refuse an examination of corporation officers designed to disclose causes of action for mismanagement. Committee for Holders of Preferred Stock v. Kent, 143 F. 2d 684 (4th Cir. 1944). Proceedings in other courts tending to impede a 21a examination may be enjoyed. Steelman v. All Continent Corp., 301 U. S. 278 (1937).
7. While the statute refers to the court, the referee is the branch of the court that commonly attends to all matters of administration in the first instance, including the approval of trustee's accounts. §§ 2a(8), 47a(12), (13).
are more accessible than judges, and matters of no great importance can often be taken up with a referee informally.

**Recording**

In case the bankrupt has any real estate outside the county where the original record of the bankruptcy proceeding is kept, prompt steps should be taken to guard against its transfer to a bona fide purchaser. Section 21g provides for recording a certified copy of the petition with the schedules omitted, or, in the alternative, a certified copy of the decree of adjudication and the order approving the trustee's bond, in the office where conveyances of real property are recorded, in every county where the bankrupt has an interest in real property. The recording may be initiated by the bankrupt, trustee, receiver, custodian, referee, or any creditor, and the cost is an expense of administration of the bankrupt's estate. Unless such a certified copy has been recorded, the petition in bankruptcy is not constructive notice and does not affect the title of any subsequent bona fide purchaser or lienor for a present fair equivalent value without actual notice of the proceeding. Where such a purchaser or lienor has given less than such value, he has a lien to the extent of the consideration actually given by him. This provision of the Bankruptcy Act should, of course, be construed so as to work consistently into the scheme of recording in the state where the land lies. Thus, where a purchaser subsequent to the execution and delivery of an unrecorded deed to another does not prevail unless he records the conveyance to him before the earlier deed is recorded, a bona fide purchaser after bankruptcy should not prevail unless and until he records before record is made on behalf of the bankruptcy administrator. The purpose of Section 21g of the Bankruptcy Act manifestly is to prevent bankruptcy from casting an undue burden on title examiners. Where the trustee's title is confined to real estate in the county where the bankruptcy court sits, it is not too much to require the title examiner to examine the bankruptcy index or docket, but the trustee in bankruptcy automatically gets title to the bankrupt's realty throughout the United States, and it would be unduly burdensome to unsettle Kansas titles because the owner of Kansas real estate might have or acquire a residence in New York or California and go into bankruptcy

9. A proviso dispenses with recording in the county where the original record of the bankruptcy proceeding is kept. This applies even where there is a state Torrens system. *In re Kabbage*, 93 F. Supp. 515 (N.D. Ohio 1950).
11. § 70a.
there. To put the trustee in bankruptcy on a level with other grantees of the bankrupt's property with reference to the recording acts, there is no reason to hold that this subdivision is designed to alter the rules of the states establishing consequences of failure to record. In many states when land is successively granted for value by X to A, B, and C, each without notice of the other, and no one records, B's failure to record may defer him to C, but not to A. As a bona fide purchaser B relies on the record title in X and thereby prevails over A. C may, however, prevail over him by parity of reasoning. In any such case, whatever the state law, the purpose of the Bankruptcy Act is served if the trustee in bankruptcy is regarded as receiving a transfer by operation of law which is to be made manifest of record upon the same terms as a deed.

In cases where the bankrupt has any real estate worth more than the encumbrances upon it, there will normally be a trustee. Upon his qualification he will acquire a title dating from the petition in bankruptcy, unless it is lost by failure to make a timely record. The list of parties authorized to record contemplates the need of taking this precaution sometimes without waiting for the appointment or qualification of a trustee. If a receiver is appointed, the duty will naturally fall on him, but a petitioning creditor may be well advised to record without waiting even for a receiver, and not to rely on the referee to see that somebody takes this simple precaution.

**Insurance and Physical Preservation of Assets**

Recording of real estate titles is but one aspect of preserving the bankrupt estate. Preservation raises more questions of business judgment than of law. There is a natural hesitancy to lay out cash for a trustee, or for any other purpose, if there is no assurance that there will be assets enough even to meet expenses entitled to stand in the first rank of priority. Even when the estate is not quite so lean, it is still not good business to squander the bulk of the assets on insurance, custodial services, precautionary litigation and the like, quite apart from any temptation on the part of receivers and trustees to magnify their own tasks in the hope of reward. There is the cogent need of those in a fiduciary position to protect themselves against charges of negligence. The cost of insuring property may be heavily loaded with underwriting and clerical charges. It may not be really a good gamble for the estate to pay a two per cent premium to cover a one-tenth per cent risk of loss, but if the

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13. The figures are purely hypothetical. But consider the cost of insuring registered mail or other goods of moderate value in transit.
unlikely loss should occur, the receiver or trustee who sought to economize for the benefit of the estate is likely to be confronted with the uncomfortable fact that hindsight is better than foresight, and he may not find a patient hearing for his suggestion that the small economy seemed like a good idea at the time.\textsuperscript{14}

In any event, whenever there are substantial assets, steps must be taken to secure them against avoidable deterioration, wastage or theft. If mines are not to be abandoned, they must be kept pumped out. If the bankrupt has real estate, at least stop-gap repairs must be made to leaky roofs or broken windows. Water must be turned off or heat maintained in freezing weather, and so on.

**Classes of Collection Problems**

Where the prospect of substantial assets calls for the appointment of a trustee, problems likely to consume the major portion of the attention and the energies of the trustee relate to the collection of assets. The trustee will, in most cases where assets are scheduled, be admitted without difficulty to possession of such assets as are in the direct control of the bankrupt or his agents. Difficulty arises with reference to several classes of property, which may be discussed separately, although they overlap to some extent. We may consider first the property which is still in the control of the bankrupt and concealed by him, which usually involves examination of the bankrupt and frequently proceedings against him to make him turn over such property; secondly, property belonging to the bankrupt’s estate, but held by his confederates or others under mere pretense of right; third, property that may be claimed by persons enforcing judicial process against the bankrupt; fourth, property transferred by the bankrupt by way of sale, gift, payment or security, which may involve suits against third parties to set aside fraudulent conveyances or preferences; and fifth, property claimed adversely to the bankrupt estate under a separate or paramount title and not by virtue of a transfer from him, voluntary or involuntary. This last is likely to involve litigation turning on law outside the Bankruptcy Act. The first two situations will be dealt with in this article.\textsuperscript{15}

\textsuperscript{14} In Miller v. Harvey, 221 N. Y. 54, 116 N. E. 781 (1917), a shipper was held negligent in failing to pay ten cents and to declare the value of an express shipment to be $95.43, with the consequence that the consignee’s recovery for loss in transit was limited to $50. No heed was paid to the facts that the statistical value of the risk was probably less than ten cents and that the loss distributing function of insurance is hardly applicable to such small losses as $45.

\textsuperscript{15} Suits turning on law outside the Bankruptcy Act are treated only with respect to the general procedural provisions relating to plenary suits, chiefly those of § 23 of the Act.
PROTECTION AND COLLECTION

TURNOVER PROCEEDINGS

The investigations on behalf of the bankruptcy administration will sometimes lead to the conclusion or at least suspicion that the bankrupt is concealing property, and the stage may soon be reached when it is desirable to invoke the power of the bankruptcy court to produce the property. This commonly done by serving on the bankrupt an order of the bankruptcy court to show cause why he should not be ordered to turn over certain money or property to the trustee. This initiates a typical "summary proceeding."

At the hearing upon the order to show cause, the usual issue is whether there is in fact certain money or other property in the possession or under the direct control of the bankrupt. Where a stock in trade or a bank account has melted away leaving little to show for it, a troublesome case frequently develops. It does not meet the issue to show that the bankrupt must have been careless in handling the property or even fraudulent in disposing of it. Grounds for criminal proceedings or specifications of objections to a discharge in bankruptcy are beside the point. But if the property is still held by the bankrupt or by some one subject to his order, a "turnover order" may issue. A bankrupt whose conduct has been less than straightforward now finds himself in an embarrassing position. Hesitating to confess his own crime or fraud, he draws upon his imagination to account for the missing assets. The court, confronted with an incredible story of thefts or gambling losses to parties unknown, may be disposed to order that the bankrupt turn over the property within a brief specified time. Upon failure to comply, the bankrupt will be brought before the judge to show cause why he should not be committed to jail for civil contempt, there to remain until he complies with the order to turn over the property (or until further order from the court). There can be little doubt that turnover proceedings are necessary and they are frequently efficacious. Certainly assets are sometimes forthcoming in response to such orders, and the existence of a summary proceeding with teeth in it doubtless has a salutary effect in increasing the number of bankrupts who are persuaded by gentler methods to make a clean accounting. From the nature of the situation, however, it is impossible to tell how often the bankrupt complies with a turnover order, not because he has the assets in his control, but because he

16. In the case of In re Levin, 113 Fed. 498 (S.D. N.Y. 1901), the bankrupt was adjudged in contempt for failure to turn over goods he claimed had been stolen.

17. In re Rosenberg, 145 F. 2d 986 (2d Cir. 1944); Rosenblum v. Marinello, 133 F. 2d 674 (2d Cir. 1943).
has replaced them through the efforts of his friends and relatives to keep him out of jail.

Whether a bankrupt has property he denies having is frequently a question to be resolved by drawing inferences rather than by resorting to any direct evidence. Frequently the only direct evidence concerning the transactions with the property is supplied by the bankrupt, and the adverse considerations are found in inherent probabilities, reinforced by evasions or inconsistencies in his testimony and by his disingenuous demeanor. The court is supposed to act only on "clear and convincing evidence," but it may be clearly convinced by the bankrupt that the bankrupt is lying.

**Res Adjudicata**

Difficulties are rendered more acute by the prevailing rule that a turnover order constitutes an adjudication that the bankrupt has the power to comply with it.\(^{18}\) When he is later cited for contempt, he says he did not turn over the property because he did not have it, and unsuccessfully seeks to retry the issue found against him on the turnover order. He then goes to jail, and the question arises how long he should stay there. This situation was dramatized by Judge Frank. A bankrupt's failure to account for a shortage of assets late in 1941 led to a finding early in 1943 that he had secreted them and an order that he then turn them over to the trustee. In June, 1943, he was committed for contempt of this order and appealed. Judge Frank complained that he was bound by the precedents in the Second Circuit to affirm this order, in order to put pressure upon the bankrupt's friends and relatives to put up the money; that he must accept the fiction that the bankrupt still had the property, although the only reasonable inference was that the bankrupt, obviously needing money, disposed of the property in 1941 and spent the cash long before the turnover proceedings.\(^ {19}\) Judge Swan concurred in the result, thus disassociating himself from the opinion.\(^ {20}\) The United States Supreme Court reversed, saying that of course it was unnecessary to follow any fiction to an obviously false and harsh conclusion. At the same time the Court adhered to the rule followed below that the turnover order did adjudicate the power of the bankrupt over the property at the date of the order.\(^ {21}\) The majority opinion indicated that the bankruptcy court may come

**Notes**

19. *In re Luma Camera Service*, 157 F. 2d 951 (2d Cir. 1946).
20. Judge Learned Hand appears to have concurred in the opinion.
21. Maggio v. Zeitz, 333 U. S. 56 (1948); United States v. Moore, 294 F. 852 (2d Cir. 1923); *In re Frankel*, 184 Fed. 839 (S.D. N.Y. 1911); Reardon v. Pensoneau, 18 F. 2d 244 (8th Cir. 1927).
to the conclusion that the bankrupt cannot deliver the goods if he stays in jail long enough. Even if there is no escape from the adjudication that the bankrupt had the goods in his power at the date of the turnover order, the presumption that that state of facts persists can be rebutted by something less than a satisfactory account of what subsequently became of the goods. The mere lapse of time may suffice if the court is disposed so to find. This concession does not afford much comfort to fraudulent bankrupts. Less can be said for the opinion of the two dissenting Supreme Court Justices, who would require proof beyond reasonable doubt before imprisonment for civil contempt.

The Court of Appeals for the Third Circuit follows the peculiar practice of issuing turnover orders upon the facts as of the date of bankruptcy, and permitting the bankrupt upon contempt proceedings to show facts occurring after the bankruptcy diseningabling him to comply with the order. While this avoids the precise difficulty involved with adjudication of ability to comply at the date of the turnover order, the advantages of the procedure are not apparent. To issue an order without reference to the bankrupt's ability to comply with it seems, on its face, to be improvident. Furthermore, if the bankrupt has secreted or dissipated the goods in fraud of the Bankruptcy Act before his bankruptcy, but has successfully concealed the fact, the same difficulty arises from an adjudication that he had the assets at the date of bankruptcy. If he secreted or dissipated them between the petition and the turnover order, he is not likely to say so, and, although actually unable to

22. In re Bar Craft Dresses, Inc., 101 F. Supp. 921 (S.D. N.Y. 1952). See In re Std. Coal Mining Corp., 178 F. 2d 819, 821 (7th Cir. 1949). The judge may, without vacating the turnover, terminate the commitment, if its continuance will serve no useful purpose. In re Morris, 152 F. 2d 178 (7th Cir. 1945). Maggio was released without complying with the turnover order a few months after his case came back from the United States Supreme Court. A few months frugal living and borrowing to live, without complying with a turnover order, does not suffice, however. In re Sossman, 85 F. Supp. 570 (S.D.N.Y. 1949). For a more elaborate discussion of the metaphysics of the Maggio case, see Hanna and MacLachlan, Cases on Creditors' Rights 324 n. (1949), Consolidated 4th ed. 389 n. (1951); cf. Oglebay, Some Developments in Bankruptcy Law, 22 J. N. A. Ref. Bankr. 82 (1948).

23. In the case of In re Milgram, 94 F. Supp. 762 (S.D. N.Y. 1950), however, the Maggio case was read to destroy the presumption of continued possession. The majority opinion definitely disclaims that result. See 333 U. S. at 68. An analogous presumption that proof of possession at the date of bankruptcy will support a turnover order may be rejected when the interval is found unduly long. Brune v. Fraidin, 149 F. 2d 325 (4th Cir. 1945) (nearly three years).

comply with the order, he is in peril of being found guilty of contemn. There is no simple procedural formula to ease the task of steering turnover proceeding between an inefficacious Scylla and a harsh Charybdis.

Sole reliance need not always be placed on contempt proceedings, however. In one case, at least, a turnover order was taken into a state court and made the basis of a new judgment, which was sold to a creditors' committee for enforcement against possible after acquired or after discovered assets of the bankrupt. Of course a bankrupt who fails to comply with such an order is in no position to procure a discharge.

**SUMMARY AS DISTINGUISHED FROM PLENARY PROCEEDINGS**

The term plenary suit is used in contradistinction to summary proceedings in bankruptcy. A plenary suit is an ordinary suit at law or in equity, whether in a state or a federal court. It is commonly commenced by filing a declaration or complaint shortly preceded or followed by a service of legal process, such as a summons, upon the defendant. It is entered on a law docket or an equity docket or a general docket, and goes upon a corresponding trial calendar if it is not disposed of on the pleadings. Jury trials are had, unless waived, when the applicable non-bankruptcy law so provides. A bankruptcy court is not organized to try a plenary suit, and does not do so, although inartistic references have been made to the United States District Courts as "bankruptcy courts" when sitting upon some plenary suits involving trustees or receivers in bankruptcy.

The summary proceeding is commenced by a show cause order or its equivalent. The General Orders in Bankruptcy and district bankruptcy rules control the procedure on points where they differ from the Federal Rules of Civil Procedure. The matter is normally contested before the referee in bankruptcy, without the intervention of a jury. The first review is then by the district judge upon a petition for review, which the referee is bound to facilitate by a certificate stating the questions presented, his findings and orders thereon, together with a transcript of the evidence or summary thereof, and all exhibits.

The jurisdiction of the bankruptcy court to issue turnover orders

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26. §§ 60b, 67e, 70e(3). This language dates from 1903—Act of Feb. 5, 1903, §§ 13, 16, 32 Stat. 797, 800.

27. General Order 37.

28. §§ 39a(8), 39c.
is a summary jurisdiction having no basis in the express language of the Bankruptcy Act except the language of Section 2a that "courts of bankruptcy are hereby invested . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act . . . to . . . (7) cause the estates of bankrupts to be collected . . . and determine controversies in relation thereto . . . and to . . . (15) make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act . . . ."

While such a proceeding should observe all the essentials of due process of law, including notice, representation by counsel, confrontation with the evidence, right to be heard, with privilege against self incrimination, it tends to be less formal than a plenary suit at law or in equity and may often progress with less delay.

It may be helpful to regard all proceedings in bankruptcy as essentially summary. The proceedings leading to the adjudication, the creditors' meetings, and the hearings upon specifications of objection to a discharge in bankruptcy are all controlled by the bankruptcy statute and are not likely to be confused with ordinary suits at law or in equity. The bankrupt is at all times subject to the orders of the bankruptcy court with reference to the bankruptcy proceeding. An order upon him to show cause why he should not turn over assets claimed by the trustee to be assets of the estate is merely incidental to that proceeding. The bankrupt cannot object to such an order. He may defend by showing that the property is exempt or otherwise not "of a nature to be assignable under this act."

The bankruptcy court disposes of the fund before it for administration. The title to and the possession of the assets actually coming into the custody of the court is not to be determined by other tribunals without the consent of the bankruptcy court. Determination of the extent of the custody of the court sometimes

30. Exempt property is to be set aside to the bankrupt by the trustee (§ 47a(6)) and allowed as exempt by the court (§ 6). The quoted language occurs in § 1(28) defining a secured creditor. Most rights too personal to pass to the trustee are not likely to be the subject of turnover proceedings. If the bankrupt is a bona fide trustee or agent of another, he may also defend.
31. "The jurisdiction to dispose of property . . . in the court's actual or constructive possession, and as ancillary thereto to deal with all claims of title to or interest in or liens upon it . . . is not peculiar to courts of bankruptcy, but appertains to all courts having possession of property for disposition, and rests largely upon necessity. . . ." Per Sibley, Circuit J., in Chandler v. Perry, 74 F. 2d 371, 372 (5th Cir. 1934).
evokes fine distinctions. When a railroad in bankruptcy reorganization was in possession of a fenced right of way claiming in fee, its possession gave the bankruptcy court discretion to produce and market oil from the property, but the trustee was directed to sue in a state court to determine the title to the oil, while in another case of oil property the bankrupt’s possession of the physical property was held to support summary jurisdiction in the bankruptcy court over rights of action against the oil company engaged in production on the land. A permit in the bankrupt’s name to operate a taxicab, although not assignable without the consent of a police commissioner, has been held to be in the bankrupt’s possession, so as to bring the permit into the custody of the bankruptcy court and to subject its disposition to the summary jurisdiction. One of the nicest metaphysical questions so far developed in the cases involved scrambled possession of a chose in action.

The assets in the hands of the bankrupt at the date of the petition are theoretically in the custody of the court. The estate is protected under this theory against spoliation by dealings with the bankrupt after the petition. In such a case, if the facts are clear, summary proceedings lie to regain the possession of assets diverted from the estate after that date, unless the adverse party can bring himself

33. Davidson v. Scofield, 153 F. 2d 7 (10th Cir. 1946).
34. England v. Nyhan, 141 F. 2d 311 (9th Cir. 1944).
35. In Schwartz v. Horovitz, 131 F. 2d 506 (2d Cir. 1942), the defendant was a partial assignee from the bankrupt of claims for commissions from a casualty company and its agency. The debtors were sued by the trustee "in the bankruptcy court" and an order of the referee brought the defendant "into the bankruptcy suit... and enjoined him from continuing an action in the state court" against the debtors. Under the state law a partial assignee might proceed without making the assignor a party unless the obligor objected, in which case plaintiff must join the assignor on peril of suffering dismissal. If the obligor failed to raise the objection, he abandoned it. In this situation it was held that both the assignee and the trustee in bankruptcy of the assignor had control of the choses in action to the same extent. The referee’s order bringing the assignee into the bankruptcy suit was affirmed, but the order enjoining the prosecution of his suit in the state court was reversed. Thus the failure of the debtors to require a joinder of the trustee and the partial assignee in the same action effectuated a practical severance of the choses in action sued on. The trustee could go ahead with his suit and the assignee could go ahead with his. Double recovery or double satisfaction from the debtors was not discussed. That was the debtors’ problem. Cf. In re Odell Const. Co., 119 F. Supp. 578 (D. Colo. 1954).
within the limited terms of a saving clause in Section 70d in favor of parties who give the estate full value in good faith before the adjudication or the appointment of a receiver. If there is serious doubt about the fact of possession at the date of bankruptcy, a defendant may be entitled to a plenary suit upon principles about to be discussed.

SUMMARY PROCEEDINGS AGAINST OTHERS THAN THE BANKRUPT

When the trustee seeks to collect assets of the estate which the bankrupt did not possess at the date of bankruptcy from a party other than the bankrupt, the question is likely to arise whether he may proceed summarily in the bankruptcy court. Property may be held by a confederate of the bankrupt who sets up a claim in his own right. Such a situation would be presented by a transfer for a fictitious consideration, or by an agent of the bankrupt who claims property in his own right. It occurs with many variations and nuances when the bankrupt has had real or pretended business transactions with his wife, and the existence of real transactions may complicate the disentangling of fictitious ones. She takes the furniture out of his store to the house or barn, and claims that it is hers. She may be required by summary order to show when and how it became hers, and a sufficiently unconvincing showing will lead to a turnover order against her. Any such case involves the difficulties of evidence and procedure just considered in relation to proceedings against the bankrupt and is likely to raise an additional question concerning the propriety of summary proceedings.

A person other than the bankrupt served with an order to show cause why he should not turn over property to the trustee may, of course, turn the property over or may come in without objecting to the proceeding and endeavor to defend on the merits. In either of these cases no substantial question arises concerning the existence of summary jurisdiction or the propriety of its exercise.

37. Summary jurisdiction—corporate officer claiming funds of corporation—In re Kansas City Journal-Post Co., 144 F. 2d 819 (8th Cir. 1944); In re Car Leasing of America, 109 F. Supp. 642 (S.D. Cal. 1953).

38. Turnover orders—Rogers v. Kaffee, 141 F. 2d 374 (2d Cir. 1944); Simon v. Schaezelt, 189 F. 2d 597 (10th Cir. 1951).


It is sometimes said in other connections that parties cannot
confer jurisdiction over a given subject matter or confer federal
jurisdiction by consent, but that statement only his validity when
there is an attempt to circumvent a statutory or constitutional
limitation. The bankruptcy power of Congress carries with it all
necessary or convenient power to specify the scope of bankruptcy
administration, within the bounds of reason. The administrative
advantages of centralizing all controversies relating to the assets or
alleged assets of a bankrupt suggests it to be within the bounds of
reason to draw all such questions in the bankruptcy court for deter-
mination. Congress has stopped far short of this in providing (with
exceptions not here relevant) that plenary suits by receivers and
trustees in bankruptcy shall be brought only in courts where the
bankrupt might have brought them in the absence of bankruptcy,
unless by consent of the defendant.\(^3\) The point has not been com-
parably spelled out in the statute with reference to summary juris-
diction, but the cases properly assume that the same principles apply.
Litigation has involved such questions as whether the defendant
did in fact consent or whether he made sufficiently timely objection.\(^4\)

It is settled that a person other than the bankrupt asserting a
bona fide claim of right adverse to the bankruptcy administration
cannot be compelled to submit to summary proceedings without his
consent, while bankruptcy courts have found it necessary to brush
aside any manifestly false or merely dilatory claims designed to keep
the trustee from collecting the assets. Claims that are "only colorable"
are thus distinguished from bona fide adverse claims of right.

There are a host of cases determining that issue. The bankruptcy
courts have always been sustained in taking the position that they
need not be stultified or obstructed by manifestly false claims of
adverse right.\(^4\) While generalization may merely substitute a sterile,
unauthorized formula for the established language of the courts, the
suggestion may be ventured that if the bankruptcy court encounters
substantial doubt about either the facts or the law controlling the
defendant's claim, the defendant will be found to be asserting a sub-

\(^3\) § 23b.

\(^4\) E.g., Cline v. Kaplan, 323 U. S. 97 (1944).

\(^4\) In re Rock Spring Co., 140 F. 2d 566 (3d Cir. 1944) (mortgage void
beyond fair doubt, because of false recital of consideration); In re Patrick,
194 F. 2d 750 (7th 1952) (defendant's claim discredited by testimony of party
for whom he claimed to hold); In re Sagman, 109 F. Supp. 815 (S.D. N.Y.
1952) (pretended security); In re Journal-News Corp., 104 F. Supp. 843
(S.D. N.Y. 1951) (piracy of literary property without substantial claim);
In re Bartlett, 71 F. Supp. 514 (N.D. N.Y. 1947) (no gift of non-assignable
war bonds).
substantial adverse claim of right. The court should not and will not usually proceed then and there to resolve the doubt. The summary proceeding will be dismissed and the trustee must start all over again in a plenary proceeding, if he still believes that he has a good case.

Cases where the defendant acquired the property from a third person and where neither party purported to act on behalf of the bankrupt may turn on questions of title arising upon transfers made before either the bankrupt or the defendant acquired an interest in the property. Such cases are likely to involve substantial and bona fide adverse claims and so, where the property has not come into the custody of the bankruptcy court, they cannot be determined summarily without the consent of the defendant. But mere complexity of juggling will not require a summary proceeding. It may indeed suggest an unwholesome fog. If the referee has good reason to believe that the defendant is lying he will be sustained in issuing a turnover order.

Particularly when the case goes to the court of appeals upon a challenge to the propriety of a ruling as to whether summary proceedings lie, much time and money have been wasted by failure to initiate plenary proceedings in the first place. Indeed a circuit judge has taken occasion to warn trustees against such futile procedure. He suggested that plenary suits might be tried and appealed almost as quickly as summary proceedings. While this admonition was doubtless appropriate in connection with the case in which it was made, in many districts plenary suits are much slower. Furthermore, the trustee often thinks the bankruptcy court is more likely

42. Schafer v. Hughes, 139 F. 2d 438 (8th Cir. 1943) (security against contingent liability); In re Ealain, 154 F. 2d 717 (2d Cir. 1946) (bank asserting account in trust for third persons); In re Italian Cook Oil Corp., 91 F. Supp. 72 (D. N. J. 1950) (bank account blocked by outstanding stopped check); In re Carburetor Corp., 202 Fed. 75 (E. D. N. Y. 1953) (landlord in possession after bankrupt tenant's default); In re Paramount Fireproof Door Co., 43 F. 2d 558 (E. D. N. Y. 1930) (bona fide assignee of account receivable); In re Worall, 79 F. 2d 88 (2d Cir. 1935) (stock exchange seat); Milens v. Bostin, 139 F. 2d 282 (8th Cir. 1943) (administrator not to be called summarily to account for interest of bankrupt renouncing heir). But cf. First Bank of Marianna v. Pinckney, 139 F. 2d 575 (5th Cir. 1944).

43. There was an unsuccessful attempt in a case where the defendant was in possession as a lessee of a third party. In re No. Indiana Oil Co., 180 F. 2d 669 (7th Cir. 1950).

44. In a case corresponding to the above description the defendant's case suffered when his father, who was employed by him in a laundry and who had helped juggle the bankrupt's funds, told the usual fantastic tale of losses on horse races. The circuit court of appeals reversed the district judge and restored the referee's turnover order. In re Rosenberg, 145 F. 2d 896 (2d Cir. 1944).

than a state court to take his view of the case. There is no reason to
believe that trustees will abandon the practice of trying to collect
assets on summary proceedings, nor will they be dissuaded from
the attempt every time a defendant maintains he is asserting a
bona fide adverse claim of right. While the necessity of proceeding
from the referee to the district judge and thence to the court of ap-
peals, if the issue is forced so far, does not lead to a rapid disposi-
tion of the question, sight should not be lost of the many cases that are
quickly and adequately handled by summary turnover proceedings.
Surely contumacious defendants should not be encouraged to exact
settlements damaging to the estate by exploiting their powers of
procrastination.

It remains one of the most difficult tests of practical judgment to
be encountered in the administration of a bankrupt estate whether
to proceed summarily or not without the consent of a defendant in
possession of property.

46. It has been suggested, however, that the opinion will "compel
many unnecessary and delaying plenary actions." See Oglebay, supra
note 22, at 86.

47. "A trustee in bankruptcy usually prefers to have adverse claims to
property of the insolvent estate adjudicated by the court of bankruptcy. If
the trustee's investigation convinces him that some person is wrongfully
holding property belonging to the estate, the trustee is likely to regard
the claim of that person as merely colorable. To the person who has the property
and believes that he is entitled to retain it, the claims seem real and substi-
tual. If the trustee elects to proceed in the court of bankruptcy, the very
fact that he does so is often enough to create resistance to the jurisdiction of
that court on the part of the adverse claimant. When the matter comes before
a referee in bankruptcy, he is first obliged to conduct a preliminary inquiry to
determine the question of jurisdiction. If the debtor was not in actual posses-
sion of the property in suit at the time of the filing of the petition, the referee
must ascertain whether the debtor was in constructive possession. If, from
the preliminary inquiry, it appears that the adverse claimant did not wrong-
fully obtain the property from the bankrupt or the trustee after the petition
was filed, and if the claimant is not an agent or bailee of the bankrupt, then
the referee must decide whether the adverse claim is real and substantial or is
merely colorable. An adverse claim is real and substantial if the claimant's
contention discloses a contested matter of right involving some fair doubt
and reasonable room for controversy either in matters of fact or law; and
the claim is not to be held 'merely colorable' unless the preliminary inquiry
shows that it is plainly without color of merit, and a mere pretense. Harrison,
Trustee v. Chamberlin, 271 U. S. 191, 195. If, upon the application of these
rather vague tests to the facts disclosed by the preliminary inquiry, the
referee concludes that the claim is merely colorable, he then proceeds to try the
controversy upon the merits. Since, upon the preliminary inquiry he has, in
effect, determined that the adverse claim is a mere pretense, the referee will, un-
less other facts are brought to his attention which compel a different conclusion
or unless he is convinced that he erred in taking jurisdiction, enter a decree
in favor of the trustee. If the adverse claimant has confidence in his conten-
tion that his claim is real and substantial, he will petition for review, assign-
ing as error the failure of the referee to dismiss for want of jurisdiction. If
the District Judge, on review, affirms the referee, the claimant will then
appeal. If the Circuit Court of Appeals decides that the adverse claimant had
a substantial claim or that, for any reason, the court of bankruptcy did not
have constructive possession of the property in suit, all that has been done
TIME OF OBJECTION TO SUMMARY PROCEEDINGS

Section 2a(7) as amended in 1952 provides that objection must be made to the summary jurisdiction by answer or motion within the time fixed by law or rule of court for filing an answer to a pleading. This conforms to the Federal Rules of Civil Procedure.48 It abrogates a Supreme Court decision of a few years standing which allowed an objection to the summary jurisdiction to be sustained after a hearing at which the referee had indicated an intention to make an adverse ruling.49 The decision is most easily explained as an inadvertence.50 In any event there seems to be no danger that the new statutory provision will not be literally applied.

Even in the absence of such legislation, attorneys for defendants could not confidently rely upon cheaply exploiting the nuisance value inherent in a tardy objection to the summary proceedings, because such tardy objections were not favored in the bankruptcy courts, and there seemed to be no general conviction on the part of the referees that the Supreme Court would actually adhere to its approval of dilatory practice, if the relevance of Rule 21h were suitably pressed upon its attention. Nevertheless, compelling an early objection goes to ease the lot of the trustee. He gets the advantage, not only of waivers, but of timely warnings to bring plenary proceedings. If he gets such a warning before an inkling of the referee's opinion on the merits, he will be less tempted to pursue a course leading to waste and frustration.

FILING OF CLAIM AS SUBMITTING TO SUMMARY COUNTERCLAIM

It is a question of some difficulty whether a creditor who files a claim in bankruptcy thereby submits generally to the summary jurisdiction, so that the trustee in bankruptcy may proceed in the bankruptcy court to avoid preferences or fraudulent conveyances or to will be undone and the proceeding ordered dismissed for want of jurisdiction. This puts the trustee right back where he started from, not because he was not entitled to a decree upon the merits, but because he failed to recognize that, under the facts and the law, the bankruptcy court could not properly exercise jurisdiction. [Citing cases.] While such controversies over jurisdiction may be of some academic interest to the legal profession, they are profitless to litigants and wasteful of the assets of bankrupt estates. Certainly something can be done toward making the jurisdiction of the courts of bankruptcy, with respect to such controversies, more definite and certain than it is at present. From a Committee Report, Sanborn, Circuit J., Chairman, to the National Judicial Council, Aug. 21, 1944.

collect other sums claimed from the creditor on behalf of the estate. Clearly the trustee in bankruptcy may defend against the claim. Section 57g provides that the claim may not be allowed if the creditor has received a transfer voidable under the Act. That defense is frequently maintained. If the creditor's claim is not so disqualified, the ordinary principles of setting off "mutual debts or mutual credits" are expressly made applicable in bankruptcy. The merits of a claim against the creditor may thus be adjudicated by the bankruptcy court in the process of determining whether the creditor's claim is to be allowed. An adjudication against the creditor in such a proceeding may settle all the really controverted issues, so if the trustee in bankruptcy is limited to defending against the claim and compelled to resort to a plenary suit to collect anything from the creditor, the procedure may seem needlessly protracted, cumbersome and expensive.

Bankruptcy courts were influenced to take this point of view by a Supreme Court decision in 1935 that parties filing claims in a receivership liquidating a corporation submitted themselves to counterclaims in greater amount, although there was otherwise no jurisdiction over their persons in the district where the court sat and no diversity of citizenship to support an original suit against them in a federal court.

Federal Rule of Civil Procedure 41(a)(2) provides that, if a counterclaim has been pleaded, an action shall not be dismissed over objection, unless the counterclaim remains pending for independent

51. By § 68, subject to a clause protecting the estate against persons who buy claims against a prospective bankrupt as a cheap way of getting out of indebtedness to him.

52. In the case of In re Continental Producing Co., 261 Fed. 627, 629 (S.D. Cal. 1919), the judge deemed it the duty of the referee to refrain from determining the amount of the counterclaim. "If the amount of the counterclaim as asserted was clearly in excess of the amount of the creditor's claims as allowed, and if the trustee did not then and there waive a recovery and the right to proceed further against the creditor for all amounts in excess of the claims actually allowed, then it would seem as if, under the authorities, it was the instant duty of the referee to refuse to enter upon a determination of the merits of the asserted counterclaim, because of the fact that he lacked jurisdiction. 34 Cyc. 646. He should have contented himself with merely staying the payment of the creditor's claims until there had been a final judgment on the counterclaim, remitting the trustee in his prosecution of the same to a court possessing the requisite jurisdiction."

53. Waste can be minimized by giving "summary judgment" in the plenary proceeding upon the strength of the adjudication in the bankruptcy court, and this has been done. Giffin v. Vought, 175 F. 2d 186 (2d Cir. 1949); Schwartz v. Levine & Malin, Inc., 111 F. 2d 81 (2d Cir. 1940). But not all jurisdictions have adequate summary judgment procedure and the application of this method of disposition, if available, goes to emphasize the sterility of the elaboration of procedure.

adjudication. If this is not inconsistent with the Bankruptcy Act, General Order 37 makes it applicable to bankruptcy. The question then arises whether Section 23 of the Bankruptcy Act, limiting suits by trustees or receivers in bankruptcy to courts in which the bankrupt might have sued, unless by consent of the defendant, represents a policy which should control the limits upon counterclaims. In bankruptcy, it would seem that claims are commonly filed by creditors as a routine matter consequent upon the liquidation and they do not evoke the same circumspection on the part of the claimant as the commencement of a suit at law or in equity. Often circumspection would suggest to a creditor that he would be unwise, on the chance of collecting a meagre dividend, to submit much more substantial counterclaims to the jurisdiction of the bankruptcy court. Not being a petitioning creditor, he probably had nothing to do with the selection of the bankruptcy forum. He may feel that the bankruptcy court is collection minded, and he may regard it as an inconvenient forum to which he would not lightly submit. There is a growing list of cases holding the filing of a claim to be such a submission to the summary bankruptcy jurisdiction. If a limit is to be put upon the subject matter of such counterclaims, they may perhaps be restricted to those arising out of the same transaction or occurrence as the creditor’s claim, but trustees in bankruptcy are likely to resist any such limitation on the theory that a recovery on any cause of action will go to build up the bankruptcy estate, which is the res against which the claims are filed. Well advised claimants will doubtless become cautious, but administration of cautious claims policies costs creditors time and money, even in cases where


Contra: Fitch v. Richardson, 147 Fed. 197 (1st Cir. 1906); In re Continental Producing Co., 261 Fed. 627 (S.D. Cal. 1919); In re Patterson, 284 Fed. 281 (W.D. Wash. 1922); Metz v. Knobel, 21 F. 2d 317 (2d Cir. 1927); Triangle Elec. Co. v. Foutch, 40 F. 2d 353 (8th Cir. 1930); B. F. Avery & Sons v. Davis, 192 F. 2d 255 (5th Cir. 1951); In re Tommie’s Dine & Dance, 102 F. Supp. 627 (N.D. Tex. 1952).

56. Federal Rule of Civil Procedure 13 recognizes this as the test of a “compulsory counterclaim.” The broad provisions in this rule for unlimited permissive counterclaims do not seem to have been drawn with bankruptcy proceedings in mind.
no counterclaims prove to be in prospect. This should be weighed against the great convenience to the bankruptcy administration in getting general summary jurisdiction over all parties filing claims.

CLOGS ON UNDERSTANDING SUMMARY AND PLENARY JURISDICTION

The differentiation of summary and plenary proceedings and the meaning of various passages in the Bankruptcy Act in relation to the one or the other has been clouded by several misfortunes, one in 1898, one in 1903 and one in 1938. Under the Act of 1898, Section 2 spelled out the powers of the bankruptcy court sitting in bankruptcy, which is the only way it can sit, properly speaking. Every one of the 19 clauses then in that section related to the conduct of the bankruptcy proceeding itself. Clause (7) consisted of the opening language of the present clause. It conferred power to “cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided.”57

The way a bankruptcy court in a regular proceeding (as distinguished from a reorganization) collects the assets is to exercise its summary jurisdiction subject to the limitations above explained and to authorize the trustee to start a plenary suit under the rules of Section 23 when that seems appropriate. There is nothing in Section 23 inconsistent with Section 2. Consequently, the phrase “herein otherwise provided” makes a misleading insinuation. No harm is done while both sections operate together. They coexist harmoniously and the insinuation is sterile. It may have been intended to emphasize that the bankruptcy court should not attempt to exercise a plenary jurisdiction nowhere conferred, but there is little reason to suppose that bankruptcy courts would make any such attempt. The limitations upon summary jurisdiction are self-imposed by the courts on the basis of concepts of tradition, of due process, and of common sense. A complete omission of Section 23 from the Act of 1898 and its amendments would have had two consequences. One—the courts would have had to decide whether a case arose under a law of the United States so as to confer plenary federal jurisdiction merely because a receiver or a trustee in bankruptcy was a party. Without the bankruptcy law, there could be no receiver or trustee in bankruptcy, so at least consequentially the suit arises by reason of a federal law and thus, argumentatively, under it. Section 23 expressly disclaimed intent so to enlarge the federal jurisdiction. Two—in the absence of Section 23, diversity of citizenship, following the usual rule in relation to trustees in-

57. 30 Stat. 544, 546 (1898).
vested with legal title to property, would have been determined with reference to the citizenship of the trustee rather than that of the bankrupt. Section 23 thus prevented the trustee's succession to the bankrupt's title from setting up a new criterion of diversity. On neither point is there any contradiction of Section 2. Section 23 governs the plenary jurisdiction, and Section 2 the summary, and the relation between them in purely complementary, notwithstanding the misleading recital of conflict in Section 2a(7).

The Amendment of 1903 conferred plenary jurisdiction on the United States District Courts to entertain suits by the receiver or trustee to avoid preferences or fraudulent conveyances. Unfortunately, however, the statute referred to them as “bankruptcy courts.” The venue might be laid in the federal district of the bankrupt, but the district courts entertaining such cases do not sit as bankruptcy courts. Such suits have been docketed and tried as suits at law and in equity. They have not been referred to referees. They have been governed by the Conformity Act, the Equity Rules, or the Federal Rules of Civil Procedure. They have never been governed by the General Orders or Forms in Bankruptcy. This language implying in form what has always been rejected in substance—that a bankruptcy court can exercise plenary jurisdiction—was retained in Section 60b, 67d and 70e as amended by the Chandler Act. No importance was attached to that language and none would have accrued, but for the third misfortune.

Corporate reorganizers wished to strengthen the administration of reorganization in bankruptcy. Chapter X carried farther the reforms of Section 77B, which made great advances over equity receivership procedure. Apparently with the feeling that Section 23 was more restrictive of federal jurisdiction than it should be, that section was made inapplicable to Chapter X proceedings without putting anything else in its place. There seemed to be no recognition that Section 23 covered the subject matter of the plenary jurisdiction and thus conferred jurisdiction as well as constricted it. The

59. In most cases of individual bankruptcy, the trustee and the bankrupt have the same citizenship, but the bankrupt may reside in New Jersey and the bankruptcy may be in New York or Philadelphia, if he commutes to a principal place of business in either city. The Trustee may also have only an office in the state where the bankruptcy takes place and may reside elsewhere.
60. 32 Stat. 797, 799, 800, §§ 13, 15, amending Bankruptcy Act §§ 60b and 67e.
61. The author collaborated in drafting Chapter X, but this point was over his head at the time—1937. The above text is the fruit of study since 1946, when the circuit court of appeals decision appeared.
Second Circuit Court of Appeals and the Supreme Court filled the void by holding the necessary plenary jurisdiction to be conferred by Section 2a(7). This tour de force should not be given recognition beyond the area where the necessity for it arose. Except in Chapter X cases, Section 2 confers no plenary jurisdiction.

These “misfortunes” might be deemed academic rather than practical, were it not for the fact that difficulty in understanding the character and the bounds of the summary and the plenary jurisdictions is not confined to students. Confusion at the bar is confounded with difficulties associated with appeals to the court of appeals as we shall shortly observe.

**Controversies Between Third Parties**

When property comes into the custody of the bankruptcy court, that court sometimes finds itself in the position of deciding a controversy in which the bankrupt estate has no substantial interest. Thus, where a consignor for sale, a trust receipt holder, and the trustee in bankruptcy all asserted claims to property held by the bankrupt for sale, the claim of the trustee was pushed into the background by the consideration of the conflicting claims of the other parties. As long as the bankruptcy court gets the benefit of any procedural advantages attendant upon possession, it will find it difficult to avoid the responsibility of determining at least the immediate disposition of any property under its wing. It would doubtless be admissible in some cases, when it appears that there is no equity in the property for the bankrupt estate, to turn the property over to a public warehouse or place it in other responsible and disinterested hands, and remit the contestants to settlement or litigation outside the bankruptcy court. But, at least in those cases where the trustee starts out by asserting the bankrupt’s title, it will usually be the line of least resistance for the bankruptcy court to determine the relative rank of the prior claims against the property. Such action has afforded an occasion to repeat the common but imprecise statement that a bankruptcy court is a court of equity.

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62. Austrian v. Williams, 159 F. 2d 67 (2d Cir. 1946), aff’d, 331 U. S. 642 (1947). The trustee was suing to recover assets of the bankrupt diverted by the defendant. According to the opinions (see also Austrian v. Williams, 67 F. Supp. 223 (S.D. N.Y. 1946)), he did not rely on § 70e or any basis for jurisdiction other than § 2a(7). Followed, Magidson v. Duggan, 180 F. 2d 473 (8th Cir. 1950). Here the reorganization court took over a controversy from a state court. The expansion of federal jurisdiction was more sweeping in the Austrian case, for there a federal district court in a different district from the reorganization court exercised the jurisdiction.


The trustee has been permitted to set up the paramount lien of a secured creditor when a junior encumbrancer sought possession of property in the custody of the court. A conditional sale of pictures was valid as against the bankrupt, but invalid by reason of late filing as against the mortgagee of the bankrupt's real estate. In deciding for the trustee in bankruptcy, the New York Court of Appeals stated that "he represented all creditors and was interested in reducing a possible deficiency claim against the bankrupt on the mortgage." The trustee, however, does not represent secured creditors and it is not apparent why it is any better for the bankrupt estate to reduce the deficiency on one secured debt instead of the deficiency on another. When such a case arises in reclamation proceedings in the bankruptcy court, competing secured creditors should be notified. The bankruptcy court should not submit to having the trustee sued outside the bankruptcy court in relation to property in his possession, unless there is adequate provision for intervention or other third party practice to deal with competing claims.

**Controversies Arising in Bankruptcy Proceedings**

Turnover proceedings against parties other than the bankrupt, as well as proceedings brought by such parties to reclaim property in the custody of the bankruptcy court give rise to what are known as "controversies arising in proceedings in bankruptcy." This phrase occurs in Section 24 of the Act. Its relevance is only with reference to appeals to the court of appeals. Interlocutory orders may be reviewed by the court of appeals in proceedings under the Bankruptcy Act, but not in controversies arising in such proceedings. Prior to the Chandler Act this distinction involved additional consequences. At present the consensus of bankruptcy specialists indicates that the distinction causes more trouble than it is worth, and the National Bankruptcy Conference has sponsored an amendment to abolish it. So long as the distinction remains, it should be borne in mind that a proceeding in bankruptcy relates to the conduct of the bankrupt and to the administration of the fund which comes to the trustee in bankruptcy as property assignable under the Act. Whether the bankrupt should be adjudicated and whether he should receive his discharge are questions determined as a part of a proceeding in bankruptcy. The same applies to orders allowing or disallowing claims, for such orders relate only to the disposition of the fund administered by the trustee. The bankruptcy court exercises power

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67. Reclamation procedure is not spelled out in the Bankruptcy Act as is might well be. *Cf.* the current Canadian statute. 13 Geo. VI c. 7, § 50 (1949).
over the person of the bankrupt as a part of the administration of the estate and so there is basis for saying that a dispute with the bankrupt concerning whether property is exempt or too personal to pass to the trustee is a part of the bankruptcy proceeding. Where however, parties other than the bankrupt assert title or possessory rights in property held by the trustee, they are claiming to take property out of the fund properly administered in bankruptcy. The controversy “arising in a proceeding in bankruptcy” so created may in this aspect be regarded as involving questions external to the bankruptcy administration, as distinguished from the proceedings themselves, which involve questions internal to the bankruptcy administration.

A controversy may arise in bankruptcy proceedings not only when a reclamation proceeding is started, but also when the trustee claims that the possession of a party other than the bankrupt is founded upon a claim of right that is not bona fide but only colorable. The adverse claim in the latter case is set up defensively and may be said to give rise to a controversy concerning whether there is a real controversy. Unless the defense in such a case is obviously only colorable, it would seem that an appeal from an interlocutory order should not be allowed.

Considerable trouble has been caused by the fact that Section 23 relating to plenary suits describes them as “controversies at law and in equity, as distinguished from proceedings under this Act.” The prospects for confusion here have been compounded by a disposition of the Bar to shorten the phrase “controversies arising in proceedings in bankruptcy” in Section 24 to the word “controversies,” which is used in contradistinction to “proceedings,” the corresponding shorthand for proceedings in bankruptcy. This shorthand has caused controversies arising in proceedings in bankruptcy under Section 24 to be confused with controversies at law or in equity as distinguished from proceedings under this Act in Section 23.68

**Compromise and Arbitration**

The trustee may, pursuant to the direction of the court, submit to arbitration any controversy arising in the settlement of the estate,

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68. This confusion obtained in a circuit court of appeals when both counsel agreed that a plenary suit was a controversy arising in bankruptcy proceedings. The court recited this agreement without criticism, thereby apparently placing the stamp of its approval upon the confusion. Childs v. Ultramares Corp., 40 F. 2d 474 (2d Cir. 1930). The point in issue was a motion to transfer the case from the equity to the law side of the court. This mere statement should suffice to show that the controversy did not arise in bankruptcy proceeding, for there is no equity and no law side in such a proceeding, and there never was—only a bankruptcy side.
by submission to three arbitrators pursuant to a proceeding sketched in Section 26. The word "controversy" here appears to have no definite technical connotation such as that encountered in Section 24 concerning appeals. Fortunately this has not caused trouble.

The arbitration procedure is little used. There is much more use of Section 27, authorizing the trustee, with the approval of the court, to compromise any controversy arising in the administration of the estate. Creditors are commonly given a right to be heard with reference to the compromise of important matters, and Section 58a(6) specifies that they shall be entitled to ten days' notice by mail of the proposed compromise of any controversy in which the amount claimed by either party exceeds a valuation of $1,000. Without reference to monetary limits or other qualification, General Order 33 requires a written application by the receiver or trustee setting forth the reason for arbitrating or compromising any controversy. This precludes giving immediate effect to an impromptu compromise in open court, although, of course, such a compromise could be duly formalized and approved. The consideration of a compromise, being once properly initiated, may proceed informally, so that an order may issue without renewed notice to a creditor who has expressed doubt or disapproval.

The compromise may relate only to a controversy subject to the judgment of the bankruptcy court, such as an adjustment for shortages in delivery by the trustee under a bankruptcy sale, but the term "controversy" is broad enough here, as in Section 26, to cover a claim by the trustee which he would have to prosecute by suit outside the bankruptcy court, if he finds it necessary to invoke legal proceedings. That is not a controversy arising in bankruptcy proceedings, for the simple reason that it would arise outside the bankruptcy proceedings. Nevertheless, the trustee's attempt to collect without suit will produce a controversy arising in the administration of the estate within the language of Section 27. This obviously requires, and therefore permits, the court to estimate liabilities it has no jurisdiction to determine by litigation.

In approving a compromise of a suit by the trustee, the court will naturally weigh such factors as difficulties in establishing the trustee's case when the bankrupt who is a material witness dis-

70. In re Kansas City Journal-Post Co., 144 F. 2d 816 (10th Cir. 1944).
71. In re California Assoc. Products Co., 183 F. 2d 946 (9th Cir. 1950).
appears, but if the bankruptcy court is in possession of property, a compromise of an invalid claim against it has been disapproved. A compromise once approved may be enforced by the bankruptcy court against the outside party as well as against the trustee.