Golden Gate University Law Review

Volume 6
Issue 2 *Ninth Circuit Survey*

Article 9

January 1976

Bankruptcy

Evert M. Makinen

BANKRUPTCY

INTRODUCTION

Business bankruptcies in the nation reached a four-year high in 1975, and bankruptcy filings in general in 1975 increased 26 percent over filings in 1974.[1] Bankruptcy filings from 1970 through 1974 never dipped below 170,000, and filings were 254,484 in 1975 as compared with 194,399 in 1970.[2] The Chief Judge of the Court of Appeals for the Ninth Circuit has characterized the area comprising this circuit as a "paradox of general prosperity and much bankruptcy."[3]

Twenty bankruptcy cases on appeal to the Ninth Circuit resulted in published opinions during the 1974-1975 period under review. Seventeen of these originated in California. In the area of personal bankruptcy, the court struck a blow for debtors against the hounds of the Internal Revenue Service;[4] creditors found a potential asset in the debtor's cause of action for personal injury restored to their common pot when a section of the California Civil Code was held unconstitutional;[5] creditors were also put on warning that they could not easily rely on a debtor's false statements in financing statements to have debts held nondischargeable;[6] at the same time, creditors were assured that the intent of the Uniform Commercial Code to promote and protect flexibility and diversity in forms of security agreements would be respected by the court so that their collateral would not be lost by the rigid application of formalities.[7] Of import to all parties in personal and corporate proceedings alike is the emphasis placed by the court

1. Girth, *Prospects for Structural Reform of the Bankruptcy System*, 63 CALIF. L. REV. 1546, 1553 (1975), *citing* DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES (1975).

2. *Id.*

3. Chambers, *Foreword* to D. COWANS, BANKRUPTCY LAW AND PRACTICE at vii (1963).

4. *See* Gwilliam v. United States, 519 F.2d 407 (9th Cir. June, 1975) (per East, D.J.).

5. *See In re* Kanter, 505 F.2d 228 (9th Cir. Nov., 1974) (per Wright, J.).

6. *See In re* Taylor, 514 F.2d 1370 (9th Cir. Apr., 1975) (per Kilkenny, J.).

7. *See In re* Amex-Protein Dev. Corp., 504 F.2d 1056 (9th Cir. Sept., 1974) (per curiam).

on strict compliance with certain rules of procedure.[8] Third-party property rights were protected against overzealous trustees.[9] And perhaps of special importance in these fitful times of errant sons and daughters is the reinforced vitality, if not respect, given by the court to the spendthrift trust.[10] These highlights provide the focus for the following discussion.

I. DISCHARGEABLE AND NONDISCHARGEABLE DEBTS

A. Taxes

Prior to 1966, debts for taxes were not affected by a discharge in bankruptcy.[11] One of the 1966 amendments to the Bankruptcy Act changed section 17(a)(1) to allow for the discharge of tax debts that became due and owing three years or more before bankruptcy.[12] Another amendment conferred express jurisdiction on the bankruptcy courts to hear and determine any questions arising as to the amount or legality of any unpaid tax, whether or not previously assessed, which has not been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction prior to bankruptcy.[13] The judicial history of these

8. *See In re* Great Western Ranches, Inc., 511 F.2d 1021 (9th Cir. Feb., 1975) (per curiam); *In re* Watkins, No. 74-2074 (9th Cir., June 18, 1975) (per Tuttle, J.).

9. *See In re* Marine Distrib., Inc., 522 F.2d 791 (9th Cir. Aug., 1975) (per Trask, J.); *In re* Wonderfair Stores, Inc., 511 F.2d 1206 (9th Cir. Feb., 1975) (per Carter, J.).

10. *See In re* Ahlswede, 516 F.2d 784 (9th Cir. Apr., 1975) (per Koelsch, J.).

11. Bankruptcy Act § 17(a)(1) (1938) (amended at 11 U.S.C. § 35(a)(1) (1970)), which provided:

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality . . . .

12. Bankruptcy Act § 17(a)(1), 11 U.S.C. § 35(a)(1) (1970), *formerly* ch. 575, § 1, 52 Stat. 851 (1938), which provides:

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy . . . .

13. Bankruptcy Act § 2(a)(2A), 11 U.S.C. § 11(a)(2A) (1970), *amending* 11 U.S.C. § 11(a) (1938), which provides:

> The courts of the United States hereinbefore defined as courts of bankruptcy are . . . created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in

amendments makes it clear that the Internal Revenue Service (IRS) has fought a long and widespread battle to circumvent and undo them.[14] One weapon of the IRS in this battle has been its refusal to file proofs of claim regarding taxes and its concomitant argument that in the absence of such filing there is no actual controversy over which the court can assert jurisdiction.[15]

In two cases of first impression decided the same day, the Ninth Circuit upheld the jurisdiction of the bankruptcy court to determine the amount of and to discharge debts for taxes even where the government had filed no proof of claim.[16] In *Gwilliam v. United States*,[17] the court upheld the jurisdiction of the bankruptcy court to order that federal taxes due and owing by the bankrupt for more than three years were provable debts and dischargeable. The court in *In re Dolard*,[18] relying upon *Gwilliam*, upheld the jurisdiction of a referee to order that a trustee in bankruptcy is not personally liable for any taxes which accrue against a bankrupt's estate after bankruptcy.

> vacation, in chambers, and during their respective terms, as they are now or may be hereafter held to . . . .
>
> . . . .
>
> . . . [h]ear and determine, or cause to be heard and determined, any question arising as to the amount of legality of any unpaid tax, whether or not previously assessed, which has not prior to bankruptcy been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction, and in respect to any tax, whether or not paid, when any such question has been contested and adjudicated by a judicial or administrative tribunal of competent jurisdiction and the time for appeal or review has not expired, to authorize the receiver or the trustee to prosecute such appeal or review . . . .

14. Gwilliam v. United States, 519 F.2d 407, 409-11 (9th Cir. June, 1975). For relevant judicial discussions see *In re* Statmaster Corp., 465 F.2d 978 (5th Cir. 1972); *In re* Durensky, 377 F. Supp. 798 (N.D. Tex. 1974); *In re* O'Ffill, 368 F. Supp. 345 (D. Kan. 1973); *In re* Savage, 329 F. Supp. 968 (C.D. Cal. 1971); *In re* Michaud, 317 F. Supp. 1002 (W.D. Pa. 1970); *In re* Standard Milling Co., 324 F. Supp. 386 (N.D. Tex. 1970); *In re* Braund, 289 F. Supp. 604 (C.D. Cal. 1968), *aff'd sub nom*. United States v. McGugin, 423 F.2d 718 (9th Cir.), *cert. denied*, 400 U.S. 823 (1970).

15. *In re* Dolard, 519 F.2d 282, 284 (9th Cir. June, 1975).

16. Gwilliam v. United States, 519 F.2d 407 (9th Cir. June, 1975); *In re* Dolard, 519 F.2d 282 (9th Cir. June, 1975). Both cases involved interpretation of 1966 amendments to the Bankruptcy Act cited at notes 12 & 13 *supra*. In both cases the bankruptcy court entered orders against the IRS, the district court reversed the orders, and the Ninth Circuit reinstated the bankruptcy court's orders.

17. 519 F.2d 407 (9th Cir. June, 1975) (per East, D.J.).

18. 519 F.2d 282 (9th Cir. June, 1975) (per East, D.J.).

Focusing on Congress' manifest grant of jurisdiction to the bankruptcy courts, the *Gwilliam* court found that Congress intended its 1966 amendments to fortify the bankruptcy court with ample tools, including the necessary jurisdiction, to deal with tax indebtedness.[19] This jurisdiction is limited by only two factors: (1) the subject tax must not have been paid; and (2) the tax must not have been contested and adjudicated prior to bankruptcy. Whether or not a proof of claim has been filed is immaterial to the question of jurisdiction.[20] The intent of Congress was further displayed in 1970 when it added subsection (c) to section 17 of the Act, providing that the dischargeability of *any* debt may be determined by the Bankruptcy Court.[21] These expressions of congressional intent have persuaded the Eighth Circuit—the only other circuit to face the issue—to adopt a position similar to that of the Ninth Circuit.[22]

In *Dolard*, where the question went to the liability of the trustee for tax debts accruing after bankruptcy, the court relied on

19. *See* 519 F.2d at 409. In both *Gwilliam* and *Dolard*, the IRS had convinced the district courts that the bankruptcy court lacked jurisdiction because the government had not waived its sovereign immunity or otherwise expressly consented to the jurisdiction of the bankruptcy court. "Statutory consent or waiver may not be found by implication in statutory provisions that omit refereence to the sovereign." *Id.* at 408. *See also* 519 F.2d at 284.

Judge East, who wrote both the *Gwilliam* and *Dolard* opinions, did not expressly address the question of waiver of immunity. The court's reading of the legislative history of the amendments convinced it that Congress had intended the bankruptcy courts to have the jurisdiction in question.

20. 519 F.2d at 409. The *Gwilliam* court relied on the analysis of the 1966 amendments in 3A COLLIER ON BANKRUPTCY ¶ 64.407[3], at 2234-35 (14th rev. ed. 1972) [hereinafter cited as COLLIER].

21. Bankruptcy Act § 17(c)(1), 11 U.S.C. § 35(c)(1) (1970), *amending* 11 U.S.C. § 35, which provides:

> The bankrupt or any creditor may file an application with the court for the determination of the dischargeability of *any* debt.

Id. (emphasis added).

22. Bostwick v. United States, 521 F.2d 741 (8th Cir. 1975). The court in *Bostwick*, like the court in *Gwilliam*, found convincing the analysis of congressional intent made by Judge Mahon in *In re* Durensky, 377 F. Supp. 798 (N.D. Tex. 1974). 521 F.2d at 743. The court in *Gwilliam*, noting that two courts had made a different reading of legislative history, went on to observe that the reading in each case was based on an incomplete and misleading portion of the legislative record and that, in any event, these two courts did not decide the jurisdictional question and their remarks thereon were only dicta. 519 F.2d at 409-10, *discussing In re* Statmaster Corp., 465 F.2d 978 (5th Cir. 1972); *In re* O'Ffill, 368 F. Supp. 345 (D. Kan. 1973). Further analysis favoring the conclusion reached by the Ninth Circuit can be found in BANKRUPTCY ACT AND RULES, PART 1: BANKRUPTCY ACT §§ 2, 17, at 21, 56-58 (Collier pam. ed. 1975) [hereinafter cited as BANKRUPTCY ACT]; D. COWANS, BANKRUPTCY LAW AND PRACTICE §§ 433-38, at 100-03, 108-11 (Supp. 1973); 3A COLLIER, *supra* note 20, ¶ 64.501.

Gwilliam and said it could find no logical reason why the language of section 11(a)(2A) of the Act investing the bankruptcy courts with jurisdiction to hear and determine any question arising as to the amount or legality of any unpaid tax should not apply with equal force to taxes accruing after bankruptcy.[23] Whether the tax arises before or after bankruptcy is immaterial to the jurisdictional grant of that section.

Gwilliam and *Dolard* are important in three respects. First, they frustrate an apparent attempt by the IRS to veto a congressional act through inaction.[24] Second, they support the right of the bankrupt (and trustee) to find relief from tax debts *in the bankruptcy court*.[25] In this respect, they represent a tendency to regard the bankruptcy court as the most appropriate forum for the resolution of as many bankruptcy-related issues as possible. In past years, a variety of courts were used to deal with bankruptcy

23. 519 F.2d at 286. *See* 11 U.S.C. § 11(a)(2A) (1970).

24. *See* 519 F.2d at 286.

25. Prior to the enactment of the 1970 amendment adding section 17(c)(1) to the Act (*see* note 21 *supra*), bankrupts granted a discharge had to look to state courts, tax courts, or other judicial forums where claims were brought against them in order to determine the effect of the discharge on the particular claim. Section 17(c) was enacted as part of Public Law 91-467, 84 Stat. 990, 992, which became effective December 18, 1970. The National Bankruptcy Conference memorandum in support of this legislation said the following about this subdivision:

> It has been the generally accepted rule that the bankruptcy court determines whether a discharge should be granted and the court in which a claim is sought to be enforced determines the effect of the discharge on that particular claim. In theory, this is an excellent division of labor, but in practice it does not work out well so far as bankrupts are concerned, and in many cases it does not work out well for the creditors.
>
> It should be emphasized that the power to determine dischargeability of a particular claim upon the application of the bankrupt in the exceptional case presently resides in the bankruptcy court by virtue of the decision of the Supreme Court in *Local Loan v. Hunt*, 292 U.S. 234 (1934). That power, however, under the guidelines laid down by the Supreme Court in the *Local Loan* case should not be exercised unless exceptional circumstances exist. Consequently, this bill will not effect any startling changes in the law. It will permit the bankruptcy court to do as a matter of course what it would otherwise do only where exceptional circumstances exist.
>
> One of the strongest arguments in support of the bill is that, if the bill is passed, a single court, to wit, the bankruptcy court, will be able to pass upon the question of dischargeability of a particular claim and it will be able to develop an expertise in resolving the problem in particular cases.

BANKRUPTCY ACT, *supra* note 22, § 436, at 223 (1963).

issues, but it is now recognized that, if the aim of the Act is to allow a bankrupt to start over, the bankruptcy court must be a forum of comprehensive finality and certainty. Third, *Gwilliam* and *Dolard* may reveal the development of a tendency to not view tax debts as deserving of special treatment apart from a bankrupt's other debts, and more of a tendency to recognize that "[p]ossibly the largest detour on the debtor's road to rehabilitation is found in claims of government for taxes."[26] The Ninth Circuit, in rebuffing the IRS in these cases, recognizes that the policy flowing from section 17(a) and (c) of the Act is "to allow a bankrupt to start over and to enhance the individual's chances of financially rehabilitating himself by eliminating his old tax debts."[27]

B. Debts Obtained Via Fraud or Misrepresentation

This past term three cases[28] examined the requirements for finding debts nondischargeable under section 17(a)(2) of the Act, which excepts from discharge

> liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his [the bankrupt's] financial condition made or published or caused to

26. D. Cowans, *supra* note 22, § 436, at 223 (1963).

27. 519 F.2d at 409. Notwithstanding the Eighth Circuit's agreement with *Gwilliam*, *see* Bostwick v. United States, 521 F.2d 741 (8th Cir. 1975), the issue of jurisdiction is far from resolved. The IRS apparently intends to persist in its challenge of the court's jurisdiction under section 2(a)(2A) of the Act. It appealed *In re* Durensky, 377 F. Supp. 798 (1974), to the Court of Appeals for the Fifth Circuit, which has thus far refused to review the case on its merits; at the time of this writing *Durensky* is still before the bankruptcy judge on remand. *See In re* Durensky, 519 F.2d 1024 (5th Cir. 1975), wherein the court explained that it was refusing to review the district court's remand and an interlocutory order of the bankruptcy judge because "definite operative finality" did not exist. *Id.* at 1030. The order denied the government's motion to dismiss the bankrupt's application to determine the dischargeability of his tax debts.

The court observed that the jurisdictional question would be one of first impression in the Fifth Circuit, *id.*, and that both the Eighth and Ninth Circuits had decided that question in support of the bankruptcy court's jurisdiction and adverse to the IRS. *Id.* at 1025-26, n.2. But because the order being appealed was interlocutory and did not permanently affect the rights of the moving party, review of it should await a decision by the bankruptcy court on the merits of the controversy. *Id.* at 1029-30.

28. *See* Abbott v. Regents of the University of California; 516 F.2d 830 (9th Cir. May, 1975); Wright v. Lubinko, 515 F.2d 260 (9th Cir. Apr., 1975); *In re* Taylor, 514 F.2d 1370 (9th Cir. Apr., 1975).

> be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another.

Together these cases illustrate both the heavy burden that a creditor may bear in attempting to show actual fraud and the apparently conflicting results that arise from application of the rule that a bankruptcy judge's findings of fact shall be accepted by the reviewing court "unless clearly erroneous."[29]

In re Taylor[30] and *Abbott v. Regents of the University of California*[31] both involved materially false statements made by the bankrupt on loan applications. In *Taylor*, the court upheld the bankruptcy judge's finding that a debt was dischargeable despite the debtor's failure to disclose to the credit company that only one month prior to his loan application he had given a lien to another creditor on the very furniture which he was tendering to the creditor here as security, and despite the debtor's testimony that he knew that the loan would not be approved if the second creditor knew how much he owed in prior debts.[32] In *Abbott*, however, where the debtor, in applying for a student loan, failed to disclose to the university that he had had previous student loans at other institutions, the court upheld the bankruptcy judge's finding that the debt was *not* dischargeable.[33]

Wright v. Lubinko[34] involved an allegation that the bankrupt had committed fraud in issuing securities. In *Wright*, a creditor sought to have a judgment debt found nondischargeable by relying on a judgment the creditor had obtained against the debtor in state court in a suit alleging stock fraud. A Ninth Circuit panel held for the debtor on the grounds that, while the state court had found the debtor liable for violating the state securities law by making a false material representation, there was no finding of actual intent to deceive.[35]

In all three cases, the court looked to whether there was *actual*

29. For a more detailed discussion see D. COWANS, *supra* note 22, § 1147, at 665 nn.73-78 (1963, Supp. 1973).

30. 514 F.2d 1370 (9th Cir. Apr., 1975) (per Kilkenny, J.).

31. 516 F.2d 830 (9th Cir. May, 1975) (per Wright, J.).

32. 514 F.2d at 1373-74.

33. 516 F.2d at 831.

34. 515 F.2d 260 (9th Cir. Apr., 1975) (per Wallace, J.).

35. *Id.* at 263-64.

intent to deceive.[36] Material misrepresentation is not in itself sufficient to bar discharge of a debt.[37] The party alleging fraud must show actual or positive fraud; there can be no mere imputation of bad faith.[38] The burden of proof is on the creditor to show that the debtor intentionally and purposefully attempted to deceive the creditor in incurring the challenged debt.[39] Further, the requirement of proof of intent is not limited to credit transactions; it applies whenever false representation is raised as a reason for barring discharge of a debt.[40]

What lends consistency to the apparently contradictory results in *Taylor* and *Abbott* is the Ninth Circuit's adherence to the requirement of Rule 52(a) of the Federal Rules of Civil Procedure, as applied to review of a bankruptcy judge's findings of fact, that the findings be "clearly erroneous" before they can be reversed.[41] The question of intent involved in these cases is peculiarly one for the referee to decide because the referee has an opportunity to hear and observe the demeanor of the bankrupt and the other witnesses.[42]

---

36. The general rule that nondischargeability of a debt for fraud or false representation requires proof of actual intent to deceive appears to be of long standing. 515 F.2d at 264, *citing* Forsyth v. Vehmeyer, 177 U.S. 177, 182, (1900). *See also* D. COWANS, *supra* note 22, § 224. But there are few circuit court decisions on this question, and since the 1970 amendment that inserted explicit language of "intent to deceive" into section 17(a)(2) of the Act, these may be the only circuit court decisions interpreting the statute in its present form.

37. 515 F.2d at 263.

38. 514 F.2d at 1373.

39. *Id.*

40. 515 F.2d at 263-64.

41. 514 F.2d at 1373-74. For an indiciation of the lack of agreement among Ninth Circuit judges as to when findings are "clearly erroneous" see Judge Duniway's sharp dissent in *Taylor*. *Id.* at 1374-76.

Judge Duniway was persuaded that the debtor's failure to list a substantial debt on his loan application, and his subsequent testimony that he did not list it because he felt that if the lender knew how much he owed he would not be able to get a loan in the first place, could only be viewed as a deliberate attempt by the bankrupt to obtain a loan by deception:

> Giving as much weight to the [bankruptcy judge's] opportunity to weigh Taylor's credibility as I can, I cannot accept his finding "[t]hat the evidence does not sustain the burden of proving the bankrupt intended to deceive Public Finance." . . . Obvious false swearing cannot sustain a finding.

Id. at 1376. What was obvious to Judge Duniway was not obvious to Judges Kilkenny and Solomon, however. The latter chose to accept the findings of the bankruptcy judge on the grounds that he was able to observe the demeanor of the bankrupt and of the other witnesses who testified. *Id.* at 1374.

42. In this latter respect, the cases surveyed illustrate the importance of creating a

C. Debts for Attorneys Fees in Dissolution Proceedings

A bankrupt's debt to a spouse's attorney for legal fees established by state court order in dissolution proceedings was held nondischargeable in *Jones v. Tyson*.[43] Noting that section 17(a)(7) of the Act[44] allows the discharge of debts "except [those] . . . for alimony . . . or for maintenance or support of wife or child," the Ninth Circuit rejected the bankrupt's contention that the fees were incurred in connection with the property settlement and thus should not be regarded as nondischargeable alimony.[45] It is proper to consider the award of attorneys fees as being "in the nature of alimony," and thus not dischargeable, the court felt: (1) where state policy favors such an award to the economically disadvantaged spouse to enable that spouse to obtain legal services; (2) where the court's order does not explicitly distinguish fees related to the division of property; and (3) where attorneys fees have not been taken into account by way of an adjustment in the property division.[46] Moreover, where the nature of the award is clear on the face of the state court judgment, the bankruptcy judge does not err in refusing to hear testimony offered by the bankrupt about the purpose for which the attorney's services were rendered.[47]

The *Jones* court stated, however, that a debt for attorneys fees might be dischargeable as a debt arising from the division of community assets in circumstances where spouses contemplating divorce agree to treat legal fees as community liabilities and take such fees into account in equally dividing the community assets.[48] Thus, the impact of the holding in this context will turn on the facts in each case. It would seem, though, that *Jones* would encourage counsel for both parties to a dissolution to think carefully about the way they structure the economics of dissolution and about the form of court orders they may propose.

II. PROPERTY WITHIN AND WITHOUT THE ESTATE OF THE BANKRUPT

Depending on the nature of the property in question and the

record with sufficient factual content at the hearing stage so that the bankruptcy judge's findings can withstand a challenge on appeal.

43. 518 F.2d 678 (9th Cir. June, 1975) (per Ely, J.).
44. 11 U.S.C. § 35(a)(7) (1970).
45. 518 F.2d at 680-81.
46. *Id.*
47. *Id.* at 681.
48. *Id.*

relation to it of the bankrupt and third parties, it may pass to the trustee for distribution to creditors, to non-creditor third parties, or remain with the bankrupt.[49] The case of most significance in this area is one in which the Ninth Circuit held that the trustee has a right to the bankrupt's personal injury cause of action and that a California statute seeking to prevent this result is unconstitutional.[50]

A. Personal Injury Causes of Action

The Ninth Circuit declared section 688.1(b) of California's Code of Civil Procedure[51] unconstitutional in *In re Kanter*.[52] The case involved the question of whether title to a bankrupt's personal injury cause of action, pending at the time of bankruptcy, vested in the trustee or was exempt under California law. In 1964 the Ninth Circuit had examined section 688.1[53] in the case of *Carmona v. Robinson*,[54] and found that under this section a debtor's personal injury cause of action was "subject to attachment, execution, garnishment, sequestration, or other judicial process" within the meaning of section 70(a)(5) of the Bankruptcy Act,[55] and that title to such cause of action thus vested in the trustee.[56] Subsequently, the California Legislature amended section 688.1

49. The statutory source of the trustee's title is section 70(a) of the Bankruptcy Act, 11 U.S.C. § 110(a) (1970). In general, title to most of the non-exempt property owned by the bankrupt as of the date of the bankruptcy petition vests in the trustee. Exempt property is defined by state and federal statutes and remains with the bankrupt. Bankruptcy Act § 6, 11 U.S.C. § 24 (1970). For a detailed analysis see D. Cowans, *supra* note 22, §§ 551-631 (1963, Supp. 1973); 1A Collier, *supra* note 20, ¶¶ 6.13-.17. Third-party rights to property involve the questions of the nature of the bankrupt's interest in the property and who has possession at the time of bankruptcy. These questions often arise with respect to claims to sums due under performance bonds or letters of credit issued in behalf of the bankrupt and payable to third parties. *See In re* Marine Distribs., Inc., 522 F.2d 791 (9th Cir. Aug., 1975) (per Trask, J.). A case decided by the Ninth Circuit just prior to the survey period denied the trustee's claim to penal sums on a contractor's licensing bonds. *See In re* Buna Painting & Drywall Co., 503 F.2d 618 (9th Cir. 1974).

50. *In re* Kanter, 505 F.2d 228 (9th Cir. Nov., 1974) (per Wright, J.).

51. Cal. Code Civ. Pro. § 688.1(b) (West 1970).

52. 505 F.2d 228 (9th Cir. Nov., 1974).

53. Cal. Code Civ. Pro. § 688.1 (West 1955), *as amended*, *id.* § 688.1(a) (West 1970), provided in pertinent part:

> Upon motion of a judgment creditor . . . the court or judge . . . may . . . order that the judgment creditor be granted a lien upon the cause of action and upon any judgment subsequently procured in such action or proceeding . . . .

54. 336 F.2d 518 (9th Cir. 1964).

55. 11 U.S.C. § 110(a)(5) (1970).

56. Carmona v. Robinson, 336 F.2d 518, 521 (9th Cir. 1964).

by adding subsection (b).[57] The *Kanter* court found that this amendment was specifically intended to undo the results of *Carmona*, since section 688.1(b) prohibits an assignee *by operation of law* of a party to a personal injury action from acquiring an interest in, or lien rights to, any money recovered in such action.[58] By thus singling out the trustee, the amendment frustrated the purposes of Congress in enacting the Bankruptcy Act, and therefore had to fall under the supremacy clause of the United States Constitution.[59]

The *Kanter* court recognized that the estate of the bankrupt does not include property exempt under state law, that state law controls as to the validity of particular exemption claims, and that state exemption statutes are to be applied liberally.[60] It held, however, that section 688.1(b) was not a valid exemption statute.

Congress' purpose in permitting exemptions under state statutes was to recognize the limitations imposed by the states on the ability of creditors to reach assets of the bankrupt.[61] The *Kanter* court characterized the intent underlying exemption provisions as being to "assist the bankrupt in making a fresh start, to protect the expectations of creditors and debtors under state law," and to prevent creditors from using the Bankruptcy Act to reach assets of the bankrupt which they could not reach under state law.[62] These purposes were not fostered by section 688.1(b).

Section 688.1(b) would have kept title to the cause of action out of the hands of the trustee, but subjected it to creditors' liens. It thus "revives the race to the courthouse by creditors seeking to

57. CAL. CODE CIV. PRO. § 688.1 (West 1970), *amending id.* § 688.1 (West 1955), provides in pertinent part:

> (a) Except as provided for in subdivision (b), upon motion of a judgment creditor . . . the court or judge . . . may . . . order that the judgment creditor be granted a lien upon the cause of action, and upon any judgment subsequently procured in such actions or proceeding . . . and. . . .
> (b) Nothing in this section shall be construed to permit an assignee *by operation of law* of a party to a personal injury action to acquire any interest in or lien rights upon any moneys recovered by such party for general damages.

Id. (emphasis added).

58. 505 F.2d at 230-31.

59. *Id.* at 231.

60. *Id.* at 230.

61. *Id.*

62. *Id.*

avoid the threat of having both their claims discharged and the assets necessary to satisfy them denied to the trustee."[63]

Several points must be noted about the *Kanter* decision. It does not hold that personal injury causes of action *generally* are part of the estate of the bankrupt, title to which vests in the trustee. In fact, it suggests that causes of action for personal injury can be exempted by state laws if such laws are enacted to further the purpose of the Bankruptcy Act, *i.e.*, to give the bankrupt a fresh start by preserving the asset for him or her.[64] The case does mean that *in California* at present such causes of action are not exempt, and the proceeds from them, if any, are to be distributed among claimants according to applicable bankruptcy law. A primary aim of the Bankruptcy Act is "to bring about a ratable distribution among creditors of a bankrupt's assets,"[65] and the *Kanter* decision favors creditors as a class as opposed to the individual creditor who might have won the "race to the courthouse" to establish a judgment lien.

Finally, *Kanter* suggests that creditors in other states who are denied benefits that another creditor or class of creditors has achieved as a result of a state exemption statute may be able to successfully challenge the statute on constitutional grounds, if they can show that it would prevent assets from passing to the trustee but still leave them subject to creditors' remedies in state courts.

B. State Created Priorities

State law was again made to yield to the Bankruptcy Act in *In*

63. *Id.* at 231.

64. One commentator has noted that such a cause of action is often the only sizeable asset an ordinary person ever has the opportunity to acquire, and that state law in most states (California is in the minority) preserves it for the bankrupt by protecting it from creditors generally. D. Cowans, *supra* note 22, § 573. From this point of view, California might be well advised to exempt this asset for persons unfortunate enough to suffer both bankruptcy and personal injury. The preservation of such an asset for their sole enjoyment might keep them off the welfare rolls and provide them not only with a fresh start, but with the only non-welfare source of income available to them. This "fresh start" value of the potential recovery from a personal injury action was recognized by the Commission on Bankruptcy Laws of the United States which Congress established in 1970. Commission on the Bankruptcy Laws of the United States, Report of the Commission, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., pt. 1 (1973). The Commission's proposal for a new bankruptcy act would provide for a uniform national basis for exemptions and would, among other things, exempt rights arising from personal injury. *See id.* pt. 2, §§ 4-503(c)(3)-(4), (7)-(9). For further discussion of the proposed act see Kennedy, *A Discussion of the Proposed Bankruptcy Acts*, 63 Calif. L. Rev. 1427 (1975).

65. 505 F.2d at 231, *citing* Young v. Higbee Co., 324 U.S. 204, 210 (1945).

re Leslie.[66] Sections 24073 and 24074 of the California Business and Professions Code provide a procedure that generally governs the transfer of liquor licenses and the distribution to the transferor and its creditors of proceeds from the sale of the license and liquor business.[67] In *Leslie*, where the bankrupt contracted for the sale of his business, opened an escrow account, obtained approval for the sale from the Alcoholic Beverages Commission and subsequently filed for bankruptcy, the Ninth Circuit held that proceeds from the sale had to go to the trustee for distribution in accordance with the Bankruptcy Act.[68] Distribution according to section 24074 of the Business and Professions Code would have given priority to a favored group of unsecured creditors. State created priorities, however, with one exception, were eliminated from the Bankruptcy Act in 1938.[69] The state law, otherwise presumed valid for the regulation of liquor license transfers in a non-bankruptcy context, must yield to federal law as to disposition of the proceeds of such transfer upon the intervention of bankruptcy.[70]

Since the bankrupt held title to the funds in escrow after approval of the sale by the state Alcoholic Beverage Control Department, subject to the claims of bona fide creditors, title to these funds vested in the trustee under section 70(a)(5) of the Act.[71] The

66. 520 F.2d 761 (9th Cir. June, 1975) (per Duniway, J.). Note that in this case the state law in question was not in itself found invalid.

67. CAL. BUS. & PROF. CODE §§ 24073-74 (West Supp. 1976). Section 24073 provides for the filing of a notice of intended transfer and a transfer application. Section 24074 requires the establishment of an escrow account for the purchase price and provides that transferor's creditors be paid out of escrow funds according to a schedule of seven classes of priorities which generally are: (1) wages and benefits, (2) secured creditors, (3) federal taxes, (4) mechanics liens, (5) escrow and related fees, (6) claims for goods and services, and (7) all other claims.

68. 520 F.2d at 762-63.

69. The Chandler Act, also known as the Amendatory Act, made comprehensive changes in the Bankruptcy Act in 1938. Chandler Act of 1938, ch. 575, 52 Stat. 840. Among these changes was a revision of the Bankruptcy Act § 64, 11 U.S.C. § 104 (1970). Prior to the revision, section 64 included in its fifth class of priorities those debts owing to any person entitled to priority under state law. Thus, where sufficient assets were avilable to pay off the first four classes of priorities, all state laws establishing priorities among creditors became applicable in the bankruptcy proceedings. The Chandler Act, however, eliminated this provision. Since 1938, the only state created priority applicable in bankruptcy is one for rent to a landlord, and this is limited to rent legally due and owing for the actual use and occupancy of the premises which accrued within three months prior to the date of bankruptcy. Bankruptcy Act § 64(a)(5), 11 U.S.C. § 104(a)(5); 1 MODERN BANKRUPTCY MANUAL § 558 (1966).

70. 520 F.2d at 763. *See In re* Crosstown Motors, Inc., 272 F.2d 224, 227 (7th Cir. 1959), *cert. denied sub nom*. Commercial Credit Corp. v. Allen, 363 U.S. 811 (1960).

71. 520 F.2d at 763; Bankruptcy Act § 70(a)(5), 11 U.S.C. § 110(a)(5) (1970).

only priorities that could thereafter affect their distribution were those provided for in section 64 of the Act.[72]

C. Letters of Credit

The Ninth Circuit held, in *In re Marine Distributors, Inc.*,[73] that the trustee had neither actual nor constructive possession of letters of credit issued by a bank on behalf of the bankrupt. Based on this fact, the panel concluded that the bankruptcy court was without summary jurisdiction over the letters of credit or the money they represented.[74] The underlying issue in *Marine Distributors* was whether the bankruptcy judge was empowered to enjoin the issuing bank from making payments on the letters of credit.

It is a long standing rule that the bankruptcy court's summary jurisdiction extends to property of the bankrupt that is in the actual or constructive possession of the court.[75] If property is not in the court's possession, and a third party asserts a bona fide and substantial claim adverse to the trustee's, the claimant has a right to have the merits of the claim adjudicated in a court of plenary jurisdiction.[76] The bankruptcy court cannot then retain jurisdiction over the property in question unless the claimant consents to such jurisdiction.[77]

In the instant case, the Ninth Circuit found that the bank and the beneficiaries were adverse claimants who had explicitly and

72. 520 F.2d at 763. Bankruptcy Act § 64, 11 U.S.C. § 104(a) (1970) provides for five classes of priorities: (1) costs and expenses of administration of the bankrupt's estate; (2) wages and commissions earned by employees of the bankrupt prior to commencement of bankruptcy proceedings; (3) costs and expenses incurred by creditors in defeating an arrangement or wage earner plan, or discharge of the bankrupt, or in securing a conviction under 18 U.S.C. ch. 9; (4) taxes; and (5) priority under federal or state law.

73. 522 F.2d 791 (9th Cir. Aug., 1975) (per Trask, J.).

74. The restraining order had enjoined the bank from making payments to the sellers of the assets which were sold to the bankrupt. The letters of credit were irrevocable; they had been issued to the claimants to secure a debt for the assets sold, pursuant to Cal. Comm. Code. §§ 5103(1)(a), 5106(2), 5114(1) (West 1964); claimants had complied with conditions of the letter, and payment was not dependent on the bankrupt's solvency or willingness to pay.

75. Cline v. Kaplan, 323 U.S. 97, 98 (1944).

76. *Id.* at 99. The Ninth Circuit has consistently applied this rule in a manner that reinforces the rights of third parties to have their claims adjudicated in courts of plenary jurisdiction as provided for in section 23 of the Bankruptcy Act, 11 U.S.C. § 46 (1970). *In re* Barasch, 439 F.2d 1393 (9th Cir. 1971); Sulmeyer v. Pfohlman, 329 F.2d 915 (9th Cir. 1964); Martoft v. Elliott, 326 F.2d 204 (9th Cir. 1963). For a more detailed discussion see 1 Modern Bankruptcy Manual §§ 43-55 (1966).

77. 323 U.S. at 99.

consistently refused to consent to the bankruptcy court's jurisdiction.[78] The letters constituted a contract between the issuer bank and the beneficiaries, independent of the underlying contract between the bankrupt and the appellant beneficiaries; the letters were not secured by property of the bankrupt, and thus they represented an obligation of the issuer bank independent of the bankruptcy proceedings.[79] The letters were in the possession of the claimants, and the funds were held by the bank. The bankrupt, and thus the trustee, had neither actual or constructive possession of either the money or the documents, and the court was therefore without jurisdiction to enjoin payment by the bank to the beneficiaries.[80]

D. Property Subject to Lease or Contract

The existence and nature of encumbrances on a bankrupt's property has an obvious effect on the value of the estate, and is of concern to both the trustee and the bankrupt's creditors. Where an owner-developer of commercial or industrial land that is subject to an agreement to lease and build goes bankrupt prior to construction of the contemplated buildings, the agreement may constitute a considerable burden on the bankrupt's estate and diminish its sale value.

Section 70(b) of the Act provides that "[t]he trustee shall assume or reject any executory contract, including an unexpired lease of real property, within sixty days after the adjudication. . . . Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected."[81] The section goes on to provide: "[u]nless a lease of real property expressly otherwise provides, a rejection of the lease or of any convenant therein by the trustee of the lessor does not deprive the lessee of his estate."[82] In other words, a trustee may reject an executory contract entered into by a bankrupt with a third party, but the trustee may not deprive a third party lessee of his or her leasehold estate in the bankrupt's property unless the lease expressly provides therefor.

In *In re Wonderfair Stores, Inc.*,[83] the trustee sought to avoid or invalidate an agreement by the bankrupt lessor to lease and con-

78. 522 F.2d at 795.
79. *Id.*
80. *Id.*
81. Bankruptcy Act § 70(b), 11 U.S.C. § 110(b) (1970).
82. *Id.*
83. 511 F.2d 1206 (9th Cir. Feb., 1975) (per Carter, J.).

struct a building on land in a proposed shopping center. The trustee desired to sell the land free of encumbrances,[84] and thus attacked the agreement as being: (1) an executory contract for a lease rather than a lease; (2) not sufficiently definite and certain to be enforceable; (3) in violation of the Rule Against Perpetuities; and (4) improperly recorded, even if a lease, and thus subordinate to the rights of the trustee.[85] Applying state property and contract law, the Ninth Circuit rejected the trustee's arguments and held that the agreement was an enforceable lease.[86] The trustee could thus take title to the property, but could only sell it subject to the superior rights of the lessee.[87]

In reaching its holding, the *Wonderfair* court found the terms of the agreement sufficiently clear to indicate that the parties had intended to enter into a lease of the land itself, with a present interest vesting in the lessee, rather than merely a contract to lease a building to be constructed in the future.[88] Moreover, a provision for construction of the building according to plans satisfactory to the lessee was not too indefinite to be enforced;[89] the

84. *Id.* at 1208.

85. *Id.* at 1210-14.

86. *Id.* at 1208. The student and general practitioner should keep in mind that substantive and procedural questions in bankruptcy often turn on the application of state statutory or case law. Thus, for example, the Ninth circuit's resolution of bankruptcy issues depended on its review of bankruptcy court interpretations of state law in Jones v. Tyson, 518 F.2d 678 (9th Cir. June, 1975) (applying California law to decide whether an award of attorneys fees in dissolution proceedings was nondischargeable as alimony); *In re* Amax-Protein Dev. Corp., 504 F.2d 1056 (9th Cir. Sep., 1974) (applying California law to decide whether or not a creditor had a secured interest in a bankrupt's property); *In re* Marine Distrib., Inc. 522 F.2d 791 (9th Cir. Aug., 1975) (applying California law to determine whether letters of credit were part of a bankrupt's estate); Owners of "SW 8" Real Estate v. McQuaid, 513 F.2d 558 (9th Cir. Mar., 1975) (applying Washington law, in part, to decide whether petitioners' deeds establishing their real property ownership for purposes of chapter XII standing were void); and *In re* Wonderfair Stores, Inc., 511 F.2d 1206 (9th Cir. Feb., 1975) (applying California and Arizona law to decide whether an instrument was a lease or executory contract and, if a lease, whether void as improperly recorded or in violation of the Rule Against Perpetuities).

87. The trustee had already sold and conveyed title to the land in issue, subject to encumbrances or obligations of record. When the lessee filed suit to protect its interest in a federal district court in Arizona, summary judgment was granted against the lessee and for the purchaser. The lessee's appeal from the trial court's order was consolidated with the trustee's appeal of the instant case. For the reasons stated in *Wonderfair*, the Ninth Circuit reversed the decision granting summary judgment against the lessee and remanded that case with instructions to the district court to enter judgment in favor of lessee. 511 F.2d at 1215.

88. *Id.* at 1206, 1210-13.

89. *Id.* at 1210.

parties had exchanged architectural plans, specifications and drawings, and the law provided for the inference of reasonableness and good faith on the part of the parties to give effect to their intent where the agreement, on its face, appeared uncertain.[90]

The court also concluded that the Rule Against Perpetuities was not violated, because the lease gave the lessee a presently vested right in the land. Even if the lessee had had only a contingent estate in the building to be constructed, the court observed that it would be unreasonable to assume that the lessee would neither cancel the lease nor construct the building itself, as permitted by the lease, within 21 years.[91]

Finally, the court found that the failure to reacknowledge the lease after revisions were made in a previously recorded version, but prior to recording the revised version, was not a fatal flaw.[92] The revisions were minor, and if there was a technical violation of the recording statute, it did not interfere with the statute's purpose of giving notice of encumbrances.[93]

Wonderfair appears to be a case of first impression, although the court does not so indicate.[94] Although the circumstances giving rise to the instant case may occur relatively infrequently, the case demonstrates, in the attention paid by the court to the language of the document at issue,[95] the importance of keeping bankruptcy implications in mind when drafting documents affecting property rights. For this reason, the case deserves special attention from attorneys involved in commercial real estate practice.

III. SPENDTHRIFT TRUSTS

Although the court rebuked California's legislature and certain state agencies in cases discussed in section III above, it gave due deference to California case law upholding spendthrift

90. *Id.*
91. *Id.* at 1213.
92. *Id.* at 1214.
93. *Id.* Moreover, the trustee was put on inquiry notice by a conspicuous 35-foot sign on the premises during the period in issue, indicating that the lessee was a tenant of the shopping center.
94. Research revealed no reported bankruptcy cases which dealt with the precise lease-executory contract issue involved here.
95. *See id.* at 1208-09 n.2, 1210-13.

trusts[96] in *In re Ahlswede*.[97] The bankrupt was one of four beneficiaries of a "spendthrift trust" created by his father. The Crocker Citizens National Bank was trustee,[98] and it held, as assets of the trust, various promissory notes executed by the bankrupt for unsecured loans he had obtained from his father or the bank.[99] Upon the beneficiary's filing for bankruptcy, the bank, as trustee of the trust, filed a claim against the estate for the indebtedness remaining on the notes.[100]

The bankruptcy judge ruled that the trust's claim against the bankrupt's estate for the loan debt was provable,[101] but then subordinated it to claims of other unsecured creditors.[102] The court of appeals found that this was an abuse of the judge's equitable powers and affirmed the district court's reversal: the claim of the trust was to have equal status with claims of other unsecured creditors.[103] The bankruptcy court, as a court of equity,[104] can overlook form in its search for substance, but it cannot substitute its judgment for statutory requirements and thereby subordinate a claim where the claimant has not overreached or otherwise acted improperly.[105] Since there was no evidence that the bank

96. A spendthrift trust is created when a trustor gives property in trust for another and provides that the beneficiary cannot assign or otherwise alienate his interest, and that it shall not be subject to the claims of the beneficiary's creditors. 7 B. WITKIN, SUMMARY OF CALIFORNIA LAW 5452 (8th ed. 1974). California statutes do not expressly provide for the creation of spendthrift trusts, but California judicial decisions recognize and uphold the validity of the device. *Id.* at 5453.

97. 516 F.2d 784 (9th Cir. Apr., 1975) (per Koelsch, J.).

98. The trust provided for periodic distributions of income and principal to the beneficiaries, but if a beneficiary was indebted to the trust when a distribution was scheduled, the beneficiary's distributive portion was to be applied to offset the indebtedness. *Id.* at 786.

99. *Id.*

100. *Id.*

101. The provability of debts is governed by section 63 of the Act. Bankruptcy Act § 63(a)(1), 11 U.S.C. § 103(a)(1) (1970), provides in pertinent part: "Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability as evidenced by a judgment or an instrument in writing . . . ." The *Ahlswede* court did not discuss this section of the Act, but did note that the bankruptcy judge "apparently conclude[d] that the notes reflected bona fide debts rather than anticipatory distributions of the bankrupt's share of the trust estate." 516 F.2d at 786.

102. The bankruptcy judge's rationale was that it was unfair that a spendthrift trust should insulate the bankrupt's beneficial interest in the trust from his general creditors, but share with the creditors in the bankrupt's other assets and thus be able subsequently to distribute a portion of those assets to the bankrupt free of creditors' claims. *Id.* at 786-87.

103. *Id.* at 787.

104. Bankruptcy Act § 2(a)(2), 11 U.S.C. § 11(a)(2) (1970).

105. 516 F.2d at 787-88. The *Ahlswede* court is not explicit as to the statutory requirement being departed from. However, Bankruptcy Act § 65(a), 11 U.S.C. § 105(a) (1970)

had engaged in fraudulent or inequitable conduct in acquiring or asserting its claim, there was no basis for subordination of the claim.[106]

Perhaps the *Ahlswede* decision was made easier by its recognition that the general creditors were not worse off here than they would have been had the bankrupt executed promissory notes payable to a bank other than that which administered the trust.[107] That is, the arguably inequitable benefit to the bankrupt was less important than the absence of prejudice to the creditors. Nonetheless, the *Ahlswede* court gives the impression of not being happy with its decision, noting that the trustee's real complaint is with the fact that California law allows property to be tied up in spendthrift trusts and that Congress "saw some value" in providing for the enforcement of state rules of property law.[108]

IV. SECURED INTERESTS: FORM OF SECURITY AGREEMENT REQUIRED UNDER THE CALIFORNIA COMMERCIAL CODE

In re Amex-Protein Development Corp.[109] examines the impact of the California Commercial Code[110] on the creation of secured interests in property of the bankrupt.[111] This decision will give comfort to secured creditors since it stands for the proposition that the validity of their liens will not turn on conformity with rigid technical formalities, but will be judged according to the spirit of flexibility embodied in the Uniform Commercial Code.

In *Amex-Protein*, the creditor had sold equipment on open account and later substituted the debtor's promissory note which

---

provides: "Dividends of an equal per centum shall be declared and paid *on all allowed claims*, except such as have priority or are secured." (emphasis added). Departure from this requirement of pro rata distribution of assets by subordinating the claims of certain creditors is allowable when the bankruptcy court determines that the circumstance surrounding the claim require such a distribution in order to avoid injustice or unfairness. Pepper v. Litton, 308 U.S. 295, 306-10 (1939).

106. 516 F.2d at 788.

107. *Id.* at 789.

108. *Id.* The court could not resist commenting that "in some circumstances the Bankruptcy Act allows a bankrupt to enjoy his fresh start in life with a silver spoon in his mouth." *Id.*

109. 504 F.2d 1056 (9th Cir. Sept., 1974) (per curiam).

110. CAL. COMM. CODE §§ 1201(37), 9105(1)(h), 9110, 9203 (West 1964).

111. The existence or nonexistence of such secured interests is a matter of obvious concern among creditors. Secured interests give the secured creditors a definite source of satisfaction, but they leave unsecured creditors with less to look to in the bankrupt's estate for satisfaction of their claims.

described the collateral by reference to certain invoices. When the debtor went bankrupt, the validity of the creditor's lien was challenged by the trustee as not meeting the requirements of sections 1201(37),[112] 9105(1)(h),[113] 9110,[114] and 9203[115] of the California Commercial Code. The Ninth Circuit affirmed per curiam, adopting the district court opinion which held that the bankruptcy judge had erred in finding the lien invalid.[116]

The court rejected the bankruptcy judge's conclusion that the California Commercial Code requires specific words of grant in the instrument creating the security interest.[117] Although no magic words or precise forms are necessary, certain minimal re-

---

112. CAL. COMM. CODE § 1201(37) (West Supp. 1976) provides in pertinent part: "Security interest means an interest in personal property or fixtures which secures payment or performance of an obligation."

113. CAL. COMM. CODE § 9105(1)(h) (West 1964), *as amended*, *id.* § 9105(1)(l) (West Supp. 1976) provides: "'Security agreement' means an agreement which creates or provides for a security interest."

114. *Id.* § 9110 (West Supp. 1976) provides in pertinent part:

> For the purposes of this division any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described. Personal property may be referred to by general kind or class if the property can be reasonably identified as falling within such kind or class or if it can be so identified when it is acquired by the debtor.

115. *Id.* § 9203(1)(a)-(b) (West 1964), *as amended*, *id.* § 9203(1)(a) (West Supp. 1976) provides in pertinent part:

> (1) Subject to the provisions of section 4208 on the security interest of a collecting bank and section 9113 on a security interest arising under the division on sales, a security interest is not enforceable against the debtor or third parties unless
>
> (a) The collateral is in the possession of the secured party; or;
>
> (b) The debtor has signed a security agreement which contains a description of the collateral . . . .

116. The district court's opinion is reprinted at 504 F.2d 1056, 1057-62.

117. *Id.* at 1058. The court explained that:

> No magic words or precise form are necessary to create or provide for a security interest so long as the minimum formal requirements of the Code are met. This liberal approach is mandated by an expressed purpose of the secured transaction provisions of the Code:
>
> "The aim of this Article is to provide a simple and unified structure with which the immense variety of present-day security financing transactions can go forward with less cost and with greater certainty.
>
> . . . .
>
> The Article's flexibility and simplified formalities should make it possible for new forms of secured financing, as they

quirements still have to be met. A financing statement alone does not qualify as a security agreement, but little is needed to turn it into one.[118] A promissory note reciting that it is secured by a financing statement, plus a subsequently filed financing statement with notice of the note, is sufficient.[119] These minimal requirements were met in *Amex-Protein*.[120]

The court also held that the code does not require that the collateral be described within the four corners of the security agreement.[121] The description required by California Commercial Code section 9203 is sufficient if it "reasonably identifies what is described."[122] The use of extrinsic aids to identify the collateral is permissible where, as in the instant case, there was an incorporation by reference of certain invoices, and where there was reference in the security agreement to more specific description in the financing statement.[123] The description in the security agreement is sufficient if it provides such information as would lead a reasonable inquirer to the identity of the collateral.[124]

V. PROCEDURE UNDER THE BANKRUPTCY ACT

A. Propriety of Summary Judgment in Involuntary Bankruptcy Proceedings

A district court order granting partial summary judgment against a debtor in an involuntary bankruptcy proceeding was upheld in *Diamond Door Co. v. Lane-Stanton Lumber Co.*[125] notwithstanding the debtor's timely demand for a jury trial pursuant to section 19(a) of the Act.[126] *Diamond Door* appears to be the first

---

> develop, to fit comfortably under its provisions . . . . Comment to U.C.C. and Cal. Comm. C. § 9101."

Id. at 1058-59.

118. *Id.* at 1059.
119. *Id.*
120. *Id.* at 1060.
121. *Id.*
122. Cal. Comm. Code § 9110 (West 1974).
123. 504 F.2d at 1060.
124. *Id.*
125. 505 F.2d 1199 (9th Cir. Oct., 1974) (per Hamley, J.).
126. Bankruptcy Act § 19(a), 11 U.S.C. § 42(a) (1970), provides:

> A person against whom an involuntary petition has been filed shall be entitled to have a trial by jury in respect to the question of his insolvency, except as herein otherwise provided, and of any act of bankruptcy alleged in such petition to have been committed, upon filing a written application

circuit court decision on the issue of whether section 19(a) of the Act prohibits summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure in an involuntary proceeding.[127]

In *Diamond Door*, the creditors filed a petition, pursuant to section 3 of the Act,[128] to have the debtor adjudicated an involuntary bankrupt. They alleged that the Diamond Door Company, while insolvent and within four months of their petition, had committed an act of bankruptcy[129] by executing and delivering to one of its creditors a security agreement and financing statement listing its physical assets with the intent of securing a previously unsecured debt.[130] After the debtor answered petitioners' request for admissions,[131] petitioners filed their motion for summary

---

> therefor at or before the time within which an answer may be filed. If such application is not filed within such time, a trial by jury shall be deemed to have been waived.

127. Other circuits have decided the propriety of summary judgment in other aspects of proceedings in bankruptcy. *See* Yorke v. Harry's Dep't Store, Inc., 343 F.2d 814 (5th Cir. 1965); *In re* Yellow Transit Freight Lines, 207 F.2d 602 (7th Cir. 1953); Beall v. Pinckney, 132 F.2d 924 (5th Cir. 1943). Cohen v. Eleven West 42nd Street, 115 F.2d 531 (2d Cir. 1940), involved an involuntary proceeding for reorganization under chapter X of the Act, but the motion for summary judgment there was made by the debtor.

128. Bankruptcy Act § 3(b), 11 U.S.C. § 21(b) (1970), provides in pertinent part: A petition may be filed against a person within four months after the commission of an act of bankruptcy.

129. Acts of bankruptcy are enumerated in the Bankruptcy Act § 3, 11 U.S.C. § 21 (1970). In *Diamond Door*, creditors alleged that the debtor "made . . . a preferential transfer, as defined in subdivision (a) of secton 96 of this title," in violation of 11 U.S.C. § 21(a)(2) (1970).

130. 505 F.2d at 1201. Bankruptcy Act § 60(a)(1), 11 U.S.C. § 96 (1970), provides:

> A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

131. FED. R. CIV. P. 36 provides in pertinent part:

> (a) A party may serve upon any other party a written request for the admission, for purposes of the pending action only, of the truth of any matters within the scope of Rule 26(b) set forth in the request that relate to statements or opinions of fact or of the application of law to fact, including the genuineness of any documents described in the request.
>
> . . . .
>
> (b) Effect of Admission. *Any matter admitted under this rule is conclusively established* unless the court on motion permits withdrawal or amendment of the admission.

Id. (emphasis added). In response to the petitioners' request for admissions, the debtor admitted that it had executed a financing statement and security agreement in favor of

judgment.[132]

The district court found that five of the six elements of a preferential transfer had been established by the debtor's answers to the request for admissions[133] but that there was a genuine issue of material fact as to the debtor's insolvency.[134] Summary judgment was thus granted with respect to all elements of the alleged act of bankruptcy except the question of insolvency, which was left for jury trial.[135]

A Ninth Circuit panel affirmed the district court's order. The court in *Diamond Door* first noted that the seventh amendment right to jury trial in civil cases[136] does not preclude the granting of summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure when there is no genuine issue of material fact.[137] It then reasoned that, although the right to trial by jury in bankruptcy proceedings derives from the Bankruptcy Act and not from the seventh amendment (since bankruptcy proceedings are equitable in nature), this right is no more absolute than that afforded by

---

a previously unsecured creditor, in order to secure its debts to that creditor. The property in which the security interest was taken included all of the debtor's goods, chattels, and tangible and intangible properties. 505 F.2d at 1201.

132. FED. R. CIV. P. 56 provides in pertinent part:

> (a) A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.
>
> . . . .
>
> (b) . . .The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, *and admissions on file*, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law
>
> . . . .

Id. (emphasis added).

133. 505 F.2d at 1202. The six elements are set forth in Bankruptcy Act § 60(a)(1), 11 U.S.C. § 96(a)(1) (1970).

134. 505 F.2d at 1202.

135. *Id.*

136. U.S. CONST. amend. VII provides:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

137. 505 F.2d at 1203.

the seventh amendment in other civil proceedings.[138] Therefore, the jury trial provision of the Bankruptcy Act would not preclude summary judgment in involuntary proceedings if Rule 56 were applicable in bankruptcy proceedings generally.[139]

The Supreme Court's General Orders in Bankruptcy, No. 37,[140] in effect when summary judgment was entered in *Diamond Door*, provided for the Federal Rules of Civil Procedure to be followed insofar as they were not inconsistent with the Bankruptcy Act.[141] Under this Order, Rule 56 was deemed applicable to bankruptcy proceedings, so that the section 19 right to jury trial would not prohibit the rule's proper application.[142] Because the Diamond Door Company's admissions established beyond dispute that it had made a preferential transfer, there were no genuine issues of material fact to be tried except for the question of insolvency, and Rule 56 was properly applied.[143]

It is important for creditors to recognize that proceedings to have a debtor declared an involuntary bankrupt do not necessarily entail a jury trial, even upon demand by the debtor. Summary judgment can be a useful tool for creditors in these proceedings.[144] If creditors can establish, by admissions or other discov-

138. *Id.*

139. *Id.*

140. Order 37, General Orders in Bankruptcy, *reprinted in* D. COWANS, *supra* note 22, at 932 (Appendix). Order 37 provides:

> In proceedings under the Act the Rules of Civil Procedure for the District Courts of the United States shall, insofar as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be.

141. *Id. See* 505 F.2d at 1203.

142. 505 F.2d at 1204.

143. *See id.* at 1204-06.

144. Order 37 was abrogated by the new bankruptcy rules which became effective on October 1, 1973. Rule 756 of the new rules provides for FED. R. CIV. P. 56 to apply in "adversary proceedings." BANKRUPTCY RULES & OFFICIAL BANKRUPTCY FORMS, Rule 756, U.S.C.A. (West Pam. 1975). However, the Ninth Circuit noted, 505 F.2d at 1204, that a petition for a declaration of involuntary bankruptcy is not an "adversary proceeding" for purposes of Rule 756 because Rule 701 provides:

> The rules of this Part VII govern any proceeding instituted by a party before a bankruptcy judge to (1) recover money or property, other than a proceeding under Rule 220 or Rule 604, (2) determine the validity, priority, or extent of a lien or other interest in property, (3) sell property free of a lien or other interest for which the holder can be compelled to take a money satisfaction, (4) object to or revoke a discharge, (5) obtain an injunction, (6) obtain relief from a stay as provided in Rule 401 or 601, or (7) determine the dischargeability of a debt. Such a proceeding shall be known as an adversary proceeding.

ery techniques, the acts of bankruptcy alleged or the fact of insolvency, no genuine issues of material fact as to these matters will remain to be placed before a jury.[145] Creditors may find it worthwhile to spend additional time and money on discovery[146] if the result seems likely to be the avoidance of pretrial delay and the greater expense of jury trial before the debtor's estate can be disposed of.

B. Time Requirement for Filing Petition to Review Bankruptcy Judges' Orders

Close attention must be paid to the ten-day limit established

---

Bankruptcy Rules & Official Bankruptcy Forms, Rule 701, U.S.C.A. (West Pam. 1975).

Nonetheless, the *Diamond Door* court indicated, 505 F.2d at 1203-04 n.7, that it might still apply summary judgment procedure to involuntary bankruptcy proceedings through the interaction of Bankruptcy Rules 121 and 914. These rules provide in pertinent part:

> Except as otherwise provided in Part I of these rules and unless the court otherwise directs, [Rule 756] in Part VII [will] apply in all proceedings relating to a contested petition . . . . For the purposes of this rule a reference in the rules in Part VII to adversary proceedings shall be read as a reference to proceedings relating to a contested petition . . . .

Bankruptcy Rules & Official Bankruptcy Forms, Rule 121, U.S.C.A. (West Pam. 1975).

> In a contested matter in a bankruptcy case not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. In all such matters, unless the court otherwise directs, [Rule 756] shall apply . . . . The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply . . . . For the purposes of this rule a reference in the rules in Part VII to adversary proceedings shall be read as a reference to contested matters.

Id. Rule 914.

145. The only issues on which a person against whom an involuntary petition in bankruptcy has been filed is entitled of right to a jury trial are the issues of: (1) the person's insolvency; and (2) the commission of the acts of bankruptcy that have been alleged. Faucher v. Lopez, 411 F.2d 992, 994 (9th Cir. 1969); Wynne v. Rochelle, 385 F.2d 789, 798 (5th Cir. 1967). *See* Elliott v. Toeppner, 187 U.S. 327, 331 (1902).

146. The importance of using the discovery technique of requests for admissions is highlighted by the *Diamond Door* court's comment that it assumed, without deciding, that summary judgment may not be based on a bankruptcy judge's findings where a jury trial is demanded; but where answers to requests established the basis for a judgment, the judgment is supportable without reference to the judge's findings. Such findings, however, are admissible into evidence and may be read to a jury for consideration on issues they must decide. 505 F.2d at 1204, *citing* Fed. R. Civ. P. 53(c)(3).

by section 39(c) of the Act[147] for filing petitions for review of orders of the bankruptcy court.

Prior to 1960, the bankruptcy court had discretion to entertain petitions filed outside the ten-day time period under the ruling in *Pfister v. Northern Illinois Finance Corp.*[148] In that year, however, Congress adopted an amendment to the Bankruptcy Act[149] which was specifically intended to overrule *Pfister*, to remove the bankruptcy court's discretion, and to lend finality and certainty to its orders.[150]

Two cases decided during the year under review,[151] and one case decided just prior thereto,[152] held that the time limitation is to be strictly construed and compulsorily applied.[153] The party seeking review of a bankruptcy court's order must either file a petition or obtain an extension of time for filing before the ten-day period expires; if the party does neither, the order becomes final.

In *In re Great Western Ranches*,[154] the court held that the ten-day period began to run from the day of entry of the order on the bankruptcy court's docket,[155] even though the clerk failed to notify the creditor until fourteen days after the order was entered, and another three days elapsed before the creditor received written notice of the order.[156] The creditor's failure to act as required within the strictly defined time period resulted in the Ninth Circuit affirming the dismissal of his petition for review of an order disallowing his claim.[157] *In re Watkins*[158] merely reiterates the holding of *Great Western*.

---

147. Bankruptcy Act § 39(c), 11 U.S.C. § 67(c) (1970), *amending* 11 U.S.C. § 67(c) (1938), provides in pertinent part:

> A person aggrieved by an order of a referee may, within ten days after the entry thereof or within such extended time as the court upon petition filed within such ten-day period may for cause shown allow, file with the referee a petition for review of such order by a judge . . . .

148. 317 U.S. 144 (1942).

149. Act of July 14, 1960, Pub. L. No. 86-662, 74 Stat. 528, *amending* 11 U.S.C. § 67(c) (1938).

150. *In re* Benefiel, 500 F.2d 1219, 1220 (9th Cir. 1974).

151. *In re* Watkins, No. 74-2074 (9th Cir., June 18, 1975) (per Tuttle, J.); *In re* Great Western Ranches, Inc., 511 F.2d 1021 (9th Cir. Feb., 1975) (per curiam).

152. *In re* Benefiel, 500 F.2d 1219 (9th Cir. 1974) (per curiam).

153. *See In re* Great Western Ranches, 511 F.2d 1021, 1024 (9th Cir. Feb., 1975).

154. *Id.* at 1021.

155. *Id.* at 1024.

156. *Id.*

157. *Id.*

158. No. 74-2074 (9th Cir., June 18, 1975). *Watkins* held that entry of judgment on the

The new bankruptcy rules, effective October 1, 1973, further restrict the time during which review may be sought. Rule 802(a) places a twenty-day limit on any extension of time that may be granted when a request for an extension has been made within the ten-day statutory period.[159] This limitation represents another step in lending certainty and finality to the bankruptcy court's orders.

VI. CORPORATE BANKRUPTCY, REORGANIZATIONS, AND ARRANGEMENTS

A. TRUSTEE'S POWERS OF COMPROMISE

In re Wonderbowl, Inc.[160] and *In re Equity Funding Corp. of America*[161] affirmed a long standing rule of review that compromises entered into by a trustee and approved by the district court will not be overturned absent a showing of a clear abuse of discretion by the bankruptcy court.[162]

Section 27 of the Bankruptcy Act provides:

> The receiver or trustee may, *with the approval of the court*, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.[163]

This section has been applied to chapter X reorganization proceedings as well as to straight bankruptcy proceedings.[164] One court has characterized this part of the Act as a statutory recogni-

---

bankruptcy court's docket was sufficient to commence the running of the ten-day period. *In re Benefiel* upheld a district court's dismissal of bankrupt's petition for review of a bankruptcy court's order when the petition was filed on the *eleventh* day after the order. 500 F.2d at 1220.

159. BANKRUPTCY RULES & OFFICIAL BANKRUPTCY FORMS, Rule 802(c) (West Pam. 1975). *See* BANKRUPTCY ACT AND RULES: PART 2, at 962-64 (Collier Pam. ed. 1975) [hereinafter cited as BANKRUPTCY RULES].

160. 515 F.2d 18 (9th Cir. Apr., 1975) (per curiam), *cert. denied*, Fallon v. Jonas, 44 U.S.L.W. 3205 (U.S. Oct. 6, 1975) (No. 194).

161. 519 F.2d 1274 (9th Cir. July, 1975) (per Wright, J.).

162. It is well settled that the approval of a compromise is a discretionary order which can be reversed only upon a clear showing of an abuse of discretion. Connecticut Ry. & Lighting Co. v. New York, N.H. & H.R.R., 190 F.2d 305, 308 (2d Cir. 1951); Daniel Hamm Drayage Co. v. Willson, 178 F.2d 633, 635-36 (8th Cir. 1949); *In re* Prudence Co., 98 F.2d 559 (2d Cir. 1938), *cert. denied*, 306 U.S. 636 (1939).

163. Bankruptcy Act § 27, 11 U.S.C. § 50 (1970) (emphasis added).

164. *See* Parker v. Baltimore Paint & Chem. Corp., 273 F. Supp. 651, 653 (D. Colo. 1967). *See also* cases cited at note 162 *supra*.

tion of the policy of the law generally to encourage settlements.[165] Compromise settlements are intended to "avoid the determination of sharply contested and dubious issues."[166] In so doing they may avoid the delay and expense of litigation, the possibility of judgments adverse to the estate, and the deterioration in value of assets of the estate.[167]

In *Wonderbowl* the district court, in approving a lease, sale, and compromise package effected by a trustee, found that the corporate bankrupts' estates were in danger of losing their assets and that the trustee's package would benefit the estates.[168] In a brief opinion, the Ninth Circuit held that the district court did not abuse its discretion where its findings were amply supported by the record and not clearly erroneous.[169] The more detailed factual analysis of *Equity Funding* further illustrates the court's unwillingness to disturb a district court's approval of a trustee's compromise. There the court of appeals held that where the district court approves a trustee's compromise of a claim, it is not necessary to find that the claimants would have prevailed, but only that the outcome of their claim was doubtful.[170] If the claim had substantial foundation and was not invalid as a matter of law, the district court and trustee cannot be said to have abused their discretion in compromising it.[171]

---

165. Florida Trailer & Equip. Co. v. Deal, 284 F.2d 567, 571 (5th Cir. 1960).

166. Daniel Hamm Drayage Co. v. Willson, 178 F.2d 633, 635-36 (8th Cir. 1949), *citing In re* Prudence Co., 98 F.2d 559 (2d Cir. 1938).

167. *See In re* Equity Funding Corp. of America, 519 F.2d 1274, 1277-78 (9th Cir. July, 1975); *In re* Equity Funding Corp. of America, 492 F.2d 793,794 (9th Cir.), *cert. denied sub nom.* Herman Inv. Co. v. Loeffler, 419 U.S. 964 (1974); and cases cited *supra*, note 165.

168. 515 F.2d at 20.

169. *Id.*

170. Subsequent to Equity's filing for a chapter X reorganization in 1973, its Illinois subsidiary insurance company was seized by the state director of insurance who filed a plan of liquidation. This plan, in part, settled the subsidiary's claims against Equity and was approved by Equity's trustee but objected to by parties with fraud claims against the subsidiary. The trustee then entered into an amended compromise with these claimants, which in turn was challenged by another group of claimants who brought this action. In the amended compromise, the trustee gave up $1,250,000 provided for in the original compromise in order to settle fraud claims of over 300 million dollars. The court found it relevant that the delay and publicity resulting from the claims against the subsidiary could have undermined the business of Equity's other subsidiaries, and that a substantial basis existed for believing that the claim against the subsidiary could have undermined the basic settlement. The trustee provided a reasoned explanation of the costs and benefits of his decision, and the district court based its decision on a thorough and impartial report by a bankruptcy judge sitting as a special master. 519 F.2d at 1275-78.

171. *Id. See* Daniel Hamm Drayage Co. v. Willson, 178 F.2d 633 (8th Cir. 1949),

B. Standing for Chapter XII Arrangements[172]

Chapter XII[173] of the Bankruptcy Act is a product of the Chandler Act of 1938.[174] The purpose of this chapter is to "provide effective machinery for the rehabilitation of weakened but still viable business enterprises."[175] Unlike ordinary proceedings in bankruptcy which result in liquidation of the bankrupt's estate, chapter XII arrangements are aimed at providing debtors with a way of paying their creditors over a period of time while retaining their real property.[176] In order to take advantage of the arrangement provisions of chapter XII, debtors must be persons, other than corporations, who own real property which is security for a debt.[177] The bankruptcy court's exercise of jurisdiction in a chapter XII proceeding depends on the debtor's meeting these requirements.[178]

Owners of "SW 8" Real Estate v. McQuaid[179] involved the question of whether petitioners met the jurisdictional requirement of owning real property. Petitioners owned small, undivided interests in a portion of a shopping center, against the original owner of which an involuntary petition for reorganization under chapter X had previously been filed. Petitioners sought a real property arrangement under chapter XII of the Act. They were opposed by the trustee appointed when the original owner and developer was adjudicated a bankrupt in the chapter X proceeding.[180]

---

where an Eighth Circuit panel stated:

> Hence, to succeed upon this appeal the appellant must show, assuming there are no issues of fact in dispute, that the rules of law for which she is contending are so clearly correct that it was an abuse of discretion for the district court to approve the settlement . . . .

Id. at 636 (emphasis added).

172. Standing was also an issue in *In re Wonderbowl*, discussed above. There, the president of a corporation undergoing chapter X reorganization was held to have standing to appeal as a stockholder from the district court decision approving the trustee's compromise, even though the president's promotional stock, subordinate to outstanding common stock, was worthless and the court doubted that he was seeking to vindicate his own interests. 515 F.2d at 19.

173. Bankruptcy Act §§ 401-526, 11 U.S.C. §§ 801-926 (1970).

174. *See* 11 U.S.C.A. § 1255, at 357-59, 386-88 (West 1970) (commentary to Title 11 by G. Johnson).

175. *In re* Colonial Realty Inv. Co., 516 F.2d 154, 157 (1st Cir. 1975).

176. *In re* Dick, 296 F.2d 912, 914 (7th Cir. 1961).

177. Bankruptcy Act § 406(6), 11 U.S.C. § 806(6) (1970).

178. *See In re* Tinkoff, 156 F.2d 405, 408 (7th Cir. 1946), *cert. denied*, 330 U.S. 820 (1947).

179. 513 F.2d 558 (9th Cir. Mar., 1975) (per Trask, J.).

180. *Id.* at 561.

Reversing both the bankruptcy and district courts, the Ninth Circuit rejected the trustee's contention that the petitioners were not "debtors" as defined by the Act.[181] The trustee had argued that petitioners had made investments in the shopping center and received interests that were merely securities in the nature of personal property.[182] The *SW 8* court agreed that each fractional interest "was of a size and nature to make it useless . . . as an ordinary parcel of real estate," that the grantees had waived their right to partition and severely limited their right to encumber their interests, and that they had no right of immediate possession.[183] However, although each grantee's purchase was in essence an investment, it nonetheless remained a purchase of an interest in real property. The combined interests constituted a parcel that was subject to a mortgage, some of it was under lease and producing income, and in sum it was a parcel "having considerable value."[184] In the absence of other offsetting considerations,[185] the petitioners' interests satisfied the jurisdictional requirement of legal or equitable ownership of real property imposed by section 406(6) of the Act.[186]

VII. FEES FOR ATTORNEYS AND COURT OFFICERS

The costs of bankruptcy administration have been a matter of continuing concern which has led to an increasing recognition of the necessity for close judicial supervision of these costs.[187] *In re U.S.A. Motel Corp.*,[188] where the court reduced the award of cer-

181. *Id.* at 561-62.

182. *Id.* at 561.

183. *Id.* at 562.

184. *Id.*

185. In the instant case, these considerations were (1) the sufficiency of the proposed arrangement and (2) whether petitioners represented or had to be joined by other co-owners of the shopping center. The latter point was raised in a concurring opinion. *Id.* at 563-64 (Sneed, J., concurring). However, the case was remanded for further proceedings only with respect to the issue of the sufficiency of the arrangement. *Id.* at 563.

186. *Id.* at 562.

187. BANKRUPTCY RULES, *supra* note 159, at 850 (Advisory Committee Comment to Rule 219).

188. *In re* U.S.A. Motel Corp., 521 F.2d 117 (9th Cir. Aug., 1975) (per curiam). Bankruptcy Act § 246, 11 U.S.C. § 646 (1970), provides:

> Upon the dismissal of a proceeding under this chapter, or the entry of an order adjudging the debtor a bankrupt, the judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in such proceeding . . . by any persons entitled thereto . . . and shall make provision for the payment thereof, and for

tain legal and administrative fees while approving others, illustrates how closely such supervision may be applied.

When a petition for chapter X reorganization fails, the petitioner's attorney may be awarded reasonable attorneys fees to the extent that the attorney's services benefitted the estate.[189] However, according to *U.S.A. Motel*, when a chapter X proceeding is unsuccessful, a debtor's attorney should receive less than he or she would have received had the reorganization been successful.[190] Unmoved by the petitioner's attorney's argument that his efforts gave the debtor-petitioner breathing time and helped establish the value of his assets, the Ninth Circuit reduced the district court's award of $11,650 in attorneys fees to $5,000, eliminating compensation for preparing the petition and defending it against the successful motion for dismissal.[191] At the same time, the court upheld awards to the referee ($2,500) and trustee's attorney ($10,500 for 350 hours of work) but reduced the award to the trustee ($12,500 for 200 hours) on the ground that the award, based on a fee of $62.50 per hour, was "grossly excessive." The court held that $35 per hour was sufficient for the trustee, considering the nature of the trustee's responsibilities.[192]

Evert M. Makinen

---

the payment of all proper costs and expenses incurred by officers in such proceedings.

189. 521 F.2d at 119.

190. *Id.*

191. In an earlier appeal the court had found that the petition had not been filed in good faith and that the chapter X proceedings had been brought to resolve internal disputes in the corporation. These proceedings resulted in an unnecessary burden on the court and on the corporation's shareholders. *In re* U.S.A. Motel Corp. 450 F.2d 499, 504-06 (9th Cir. 1971).

192. *Id.*