

Michigan Law Review

Volume 45 | Issue 7

1947

BANKRUPTCY - CHAPTER X REORGANIZATION - POWER OF THE TRUSTEE TO SUE IN A FOREIGN JURISDICTION

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Recommended Citation

Shubrick T. Kothe S.Ed., *BANKRUPTCY - CHAPTER X REORGANIZATION - POWER OF THE TRUSTEE TO SUE IN A FOREIGN JURISDICTION*, 45 MICH. L. REV. 906 (1947).

Available at: <https://repository.law.umich.edu/mlr/vol45/iss7/8>

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RECENT DECISIONS

BANKRUPTCY — CHAPTER X REORGANIZATION — POWER OF THE TRUSTEE TO SUE IN A FOREIGN JURISDICTION—Plaintiffs, trustees appointed under Chapter X of the Bankruptcy Act, as amended,¹ by the District Court for the Eastern District of Virginia, sued defendants in the District Court for the Southern District of New York to recover corporate assets, alleging a conspiracy to defraud the debtor corporation. Jurisdiction was rested, not upon diversity of citizenship, but upon sections 2 and 102 of the Bankruptcy Act, and certain sections of the Judicial Code, not pertinent here. The district court dismissed the action for want of jurisdiction.² On appeal, *held*, reversed. The reorganization trustee under Chapter X may maintain an action in a federal district court other than the reorganization court to recover assets of the debtor corporation in its district without alleging separate grounds for federal jurisdiction. *Austrian v. Williams*, (C.C.A. 2d, 1946) 159 F. (2d) 67.

If sections 2, 23 and 102 of the Bankruptcy Act are read without regard to past decisions interpreting various of their provisions, it seems clear that the result achieved by the court of appeals in the principal case is correct. Although it is believed that strong considerations of policy support this decision, a complete discussion of them is beyond the scope of this note.³ However, the District Court for the Southern District of New York reached a different conclusion in this case, primarily on the ground that prior decisions conclusively settled the proposition that section 2 referred only to summary proceedings in bankruptcy, and therefore, that section did not confer upon the federal district courts jurisdiction to entertain a plenary action.⁴ The cases relied upon by the lower court are *Bardes v. First National Bank of Hawarden*⁵ and *Schumacher v. Beeler*.⁶ It is submitted that these cases are not binding authority for the ruling of the district court, and that the circuit court of appeals here is supported historically as well as by better reason. Under the Bankruptcy Act of 1867,⁷ the Supreme Court held in *Lathrop v. Drake*⁸ that a trustee might sue to recover assets in a federal circuit court, then a court of original jurisdiction, in a district other than the district in which the trustee was appointed, and without alleging diversity or a federal question. Specifically, the court relied upon section 2 of that act, for the reason that the suit was instituted in a federal circuit court, and that section conferred original jurisdiction upon the circuit courts concurrent with that of the district courts in "all suits at law or in equity, which may or shall be brought by the assignee in bankruptcy against any person claim-

¹ 52 Stat. L. 840 (1938).

² Principal case, (D.C. N.Y. 1946) 67 F. Supp. 223.

³ Judge Clark, in the principal case at p. 70, presents an excellent policy argument, augmented by convincing references.

⁴ For a discussion of the difference between summary and plenary actions, and the consequences of each, see 2 COLLIER, BANKRUPTCY, 14th ed., 436 et seq. (1940). Suffice it to say here, that an action such as the one brought in the principal case is considered plenary.

⁵ 178 U.S. 524, 20 S. Ct. 1000 (1900).

⁶ 293 U.S. 367, 55 S. Ct. 230 (1934).

⁷ 14 Stat. L. 517.

⁸ 91 U.S. 516 (1875).

ing an adverse interest, or by such person against such assignee, touching any property or rights of property of said bankrupt transferable to or vested in such assignee." Section 1 dealt only with the district courts.⁹ However, in reaching its decision, the court categorically endorsed an earlier circuit court opinion¹⁰ which had held that the district courts had jurisdiction to entertain a plenary suit by a foreign trustee to recover assets of the bankrupt's estate. There, the decision quite obviously relied on section 1 as authority. The Bankruptcy Act of 1898 did not include a provision similar to section 2 of the 1867 act, but its section 2 was similar in substance to section 1 of the earlier act. It provided that "courts of bankruptcy . . . are hereby invested . . . with such jurisdiction, at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings . . . to . . . (7) cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided. . . ." ¹¹ The last clause referred to section 23¹² which provided generally that the trustee could sue in a plenary action only in the courts in which the bankrupt could have sued, had not bankruptcy intervened, unless the proposed defendant consented to the suit. It was held in *Bardes v. Hawarden Bank*¹³ under these provisions that the trustee must allege diversity or a federal question separate from the bankruptcy proceedings to sue in federal courts in a plenary action. The problem of the principal case stems from that decision. There, a trustee appointed by a federal district court in Iowa to administer the estate of a bankrupt sued an adverse party in the same court to recover assets conveyed by the bankrupt to the proposed defendant within four months prior to the institution of proceedings in bankruptcy. All the parties were citizens of Iowa. The Supreme Court held that the federal court did not have jurisdiction of this controversy. Section 23 would seem to compel this decision,¹⁴ but the court buttressed its argument by citing *Lathrop v. Drake*¹⁵ as authority for the proposition that section 2 conferred only summary jurisdiction. The reasoning, briefly summarized, was that the *Lathrop* case held that section 2 of the 1867 act conferred upon the

⁹ Since it is necessary to compare this section with section 2 of the 1898 act, subsequently quoted in part in the body of the note, the material provisions will be set forth: ". . . the several District Courts of the United States be, and hereby are, constituted courts of bankruptcy, and they shall have original jurisdiction in their respective districts in all matters and proceedings in bankruptcy. . . . And the jurisdiction hereby conferred shall extend to all cases and controversies arising between the bankrupt and any creditor or creditors who shall claim any debt or demand under the bankruptcy; [and] to the collection of all the assets of the bankrupt. . . ." 14 Stat. L. 517 (1867).

¹⁰ *Sherman (Shearman) v. Bingham*, 7 Bank. Reg. 490, 21 Fed. Cas. No. 12,762 (1872).

¹¹ 30 Stat. L. 544 (1898).

¹² *Id.* at 552.

¹³ *Bardes v. First National Bank of Hawarden*, 178 U.S. 524, 20 S. Ct. 1000 (1900).

¹⁴ But see Ross, "Federal Jurisdiction in Suits by Trustees in Bankruptcy," 20 IOWA L. REV. 565 (1935). The article is a critical essay on the courts' interpretations of sections 2 and 23, and deals with a number of problems related to that of the principal case.

¹⁵ *Supra*, note 8.

federal courts whatever plenary jurisdiction they had, and section 1 conferred upon the district courts only summary jurisdiction. Therefore, since the old section 1 was substantially reenacted in the new section 2, and the old section 2 was omitted from the 1898 act, the new section 2 also referred only to summary proceedings. Whatever plenary jurisdiction the federal courts had, existed by virtue of the contingent grant of section 23. In this analysis, the court seems to have failed to estimate properly the Supreme Court's earlier approval of *Shearman v. Bingham*,¹⁶ and to have ignored the true reason section 2 was relied upon in the *Lathrop* case. The reasoning of the *Bardes* case was affirmed in *Schumacher v. Beeler*,¹⁷ but this case too was concerned with the application of section 23. In equity reorganization, an action such as this would normally, assuming it could have been maintained, have necessitated an ancillary appointment,¹⁸ and this procedure presents a somewhat different problem.¹⁹ Under section 77B, the jurisdiction of the federal courts was still limited by section 23, so no different result could be expected.²⁰ Section 102 of the present Bankruptcy Act, as amended, expressly excludes section 23 from application to proceedings under Chapter X. Therefore, section 2 of the present act, similar in every material respect to section 1 of the 1867 act, sets forth the limits of federal jurisdiction under Chapter X. There seems to be no doubt that Congress has power to confer jurisdiction on the federal courts to adjudicate the rights of trustees to property adversely claimed.²¹ The question then is whether it has done so here. The decision most nearly in point appears to be *Shearman v. Bingham*.²² In rendering a contrary decision, the lower court admitted that there appeared to be no good reasons as a matter of policy why the trustee should not be permitted to sue in this manner.²³ Certiorari has been granted,²⁴ and it is submitted that the Supreme Court should and can with reason and authority finally establish the rule laid down by Judge Clark in the principal case.

Shubrick T. Kothe, S.Ed.

¹⁶ *Supra*, note 10.

¹⁷ *Supra*, note 6.

¹⁸ *Great Western Mining & Mfg. Co. v. Harris*, 198 U.S. 561, 25 S. Ct. 770 (1905); *Fowler v. Osgood*, (C.C.A. 8th, 1905) 141 F. 20, 4 L.R.A. (n.s.) 824 (1906).

¹⁹ Cf. *White v. Ewing*, 159 U.S. 36, 15 S. Ct. 1018 (1895); *Barfield v. Zenith Tire & Rubber Co.*, (D.C. Ohio 1924) 9 F. (2d) 204.

²⁰ The precise question seems not to have been decided. But see *In re Standard Gas & Elec. Co.*, (C.C.A. 3d, 1941) 119 F. (2d) 658; *Thompson v. Terminal Shares*, (C.C.A. 8th, 1939) 104 F. (2d) 1; *In re Prima*, (C.C.A. 7th, 1938) 98 F. (2d) 952.

²¹ *Taubel-Scott-Kitzmilller Co., Inc. v. Fox*, 264 U.S. 426, 44 S. Ct. 396 (1924).

²² *Supra*, note 10.

²³ Principal case, 67 F. Supp. 223 at 230.

²⁴ *Williams v. Austrian*, (U.S. 1947) 67 S. Ct. 675.