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BANKRUPTCY - COLLECTION OF ASSETS - SATISFACTION OF CONVERSION CLAIM FROM NON-ESTATE ASSETS

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BANKRUPTCY — COLLECTION OF ASSETS — SATISFACTION OF CONVERSION CLAIM FROM NON-ESTATE ASSETS — It is well-settled that a trustee in bankruptcy must use due diligence in collecting the assets of the bankrupt estate, and that he will be charged with the value of assets lost by a failure to discharge this duty.[1] A difficult problem arises, however, where the bankrupt has converted and wasted estate assets, and subsequently acquires sufficient non-estate assets[2] to equal the value of the assets converted. If there is a method whereby the trustee can obtain restitution for the loss to the estate, he must use due diligence to collect the claim for the benefit of creditors, or be charged with the amount of the loss. The difficulty arises in determining what procedure is to be used to obtain satisfaction. Reparation might be enforced by threatening the bankrupt with criminal prosecution under the Bankruptcy Act or by withholding the discharge in bankruptcy; both such remedies, however, would require an element of criminal intent in the bankrupt.[3] This comment will concern itself solely with the civil remedies available to the trustee, wherein the intent of the bankrupt is immaterial.

It should be noted that while section 70c[4] of the Bankruptcy Act gives the trustee, as to all property in the possession or control of the bankrupt at the date of bankruptcy, all the rights, remedies and powers of a creditor then holding a lien thereon by legal or equitable proceedings, this provision will not help the trustee much in the instant case, for it was designed to allow him to attack various kinds of prior imperfect transactions of the debtor in states where only a creditor armed with process was allowed to act to set aside such transfers. The power gives the trustee no especial short-cut in collection of estate assets from the bankrupt, for turnover orders at least are still necessary to establish the fact that the property withheld is really estate property.[5]

I.

The standard mode of collecting estate assets from the bankrupt entails the use of a turnover order, enforceable by contempt proceedings. There is a plethora of dicta to the effect that a turnover order will never be issued where the bankrupt does not have the specific property or its proceeds within his control at the time the order is

[1] 2 REMINGTON, BANKRUPTCY, 4th ed., § 1127 (1936).

[2] E. g., an inheritance received more than six months after the petition in bankruptcy was filed.

[3] 52 Stat. L. 850, § 14c, 856, § 29 (1938), 11 U. S. C. (Supp. 1939), §§ 32c, 52.

[4] 52 Stat. L. 881 (1938), 11 U. S. C. (Supp. 1939), § 110c.

[5] Such was the practice under the Act of 1898, 30 Stat. L. 565, § 70 (1898), containing a provision similar to that of § 70c of the Chandler Act of 1938.

made;[6] and if the literal statement of this rule be indeed the law, then, on the facts assumed, no turnover order could be issued, inasmuch as it is presupposed that the assets converted have been wasted. The reasoning behind these dicta, however, suggests they were never meant to apply to a situation such as is here presented. One case has stated the policy rule thus:

> "If the money or property in controversy was a part of the estate of the bankrupt, but before the order for its delivery is made he has squandered, disposed of, or lost it, so that it is not in his control or possession, and he cannot obtain and deliver it at the time the order of delivery is made, or within a reasonable time thereafter, it cannot be a lawful order, because the court may not order one to do an impossibility, and then punish him for refusal to perform it."[7]

Also, it has been argued that imprisonment for contempt subsequent to refusal to comply with a turnover order, where the bankrupt did not have the specific property in his control, would amount to imprisonment for debt, and would hence be illegal.[8] It is clear that these policy arguments are not directed at all to situations such as the one here being considered. The bankrupt has sufficient assets with which to pay the claim, so it cannot be said he is being ordered to perform the impossible, if the turnover order directs him to turn over the property or its value. The imprisonment-for-debt argument may be more persuasive, but commitments following normal turnover orders are not so regarded, on the theory that the court is merely exercising its equitable powers in enforcing complete fidelity in the bankrupt to his creditors in return for the discharge of his debts. On this theory, the claim of the trustee, under the facts assumed, might well be regarded as no debt within the constitutional prohibition, by way of analogy to awards for alimony.[9] The trustee and bankrupt bear no ordinary creditor-

[6] DRYER, SUPREME COURT BANKRUPTCY LAW, § 12 (1937); Oriel v. Russell, 278 U. S. 358, 49 S. Ct. 173 (1929); In re Schoenberg, (C. C. A. 2d, 1934) 70 F. (2d) 321, where the Court said at 323, "A turnover order presupposes that the person against whom it is directed has possession of the property or money which he is directed to deliver up."

[7] In re Rosser, (C. C. A. 8th, 1900) 101 F. 562 at 565-566. See also DRYER, SUPREME COURT BANKRUPTCY LAW, § 12 (1937).

[8] 5 REMINGTON, BANKRUPTCY, 4th ed., § 2409 (1936); In re Goldman, (C. C. A. 1st, 1932) 62 F. (2d) 421.

[9] That awards of alimony are not deemed debts within the constitutional prohibition, see 16 C. J. S. 593 (1939). Note that there is no provision in the federal constitution against imprisonment for debt. However, Congress has ordered that federal courts shall not order any imprisonment for debt in states where it has been abolished. 14 Stat. L. 543 (1867), 28 U. S. C. (1934), § 843.

debtor relationship to each other, but are in a position where mutual trust, confidence and fidelity must be exacted. It has indeed been suggested that from the time of filing his petition, the bankrupt holds all his property in trust to preserve it and turn it over as soon as a trustee is appointed.[10] This treatment of the bankrupt as a fiduciary should cause the imprisonment-for-debt policy argument to fail.

It is well-settled that property taken out of the custody of the bankruptcy court may be summarily ordered returned.[11] Property is deemed to be in the custody of the bankruptcy courts when, after the filing of the petition, it is in the possession of a bankruptcy receiver, trustee, marshal, referee, the bankrupt or his agents, or someone not claiming any beneficial interest therein.[12] Therefore, if, after the filing of the petition, the bankrupt converts estate property, he has taken the property out of the custody of the bankruptcy court; and one who receives estate property from the bankrupt after the filing of the petition, without giving a *quid pro quo* in return, is guilty of having taken property from the custody of the court. It has been held that where the assignee, who takes estate property after the filing of the petition and without paying value, cannot surrender back the same property transferred, it is proper for the court to order the turnover of the value of the property.[13] The theory of these cases is that the assignee was meddling with the possession of the bankruptcy court, and was hence subject to its summary order to return the property taken or its value.[14] Such power is necessary to enable a court to protect its own possession, and hence is a necessary incident to existence as a court, rather than a power peculiar to bankruptcy courts. No reason is apparent why the bankrupt himself should be accorded any different treatment than his assignee in fraud of creditors, where the bankrupt has converted prop-

[10] Free v. Shapiro, (C. C. A. 4th, 1925) 5 F. (2d) 578.

[11] 5 REMINGTON, BANKRUPTCY, 4th ed., § 2355 (1936); 1 COLLIER, BANKRUPTCY, 14th ed., § 2.09 (1940).

[12] 5 REMINGTON, BANKRUPTCY, 4th ed., § 2365 (1936); 1 COLLIER, BANKRUPTCY, 14th ed., § 2.09 (1940).

[13] In re Denson, (D. C. Ala. 1912) 195 F. 854; In re Schilling, (D. C. Ohio, 1920) 264 F. 357; Clay v. Waters, (C. C. A. 8th, 1910) 178 F. 385. See also, May v. Henderson, 268 U. S. 111 at 119, 45 S. Ct. 456 (1925), where the Court said, "Nor is it any answer to such a [summary] proceeding that the diverted assets are no longer under the control of the assignees. . . . The duty of a fiduciary to account for property entrusted to his care is fulfilled by delivery of the property, but if he has put it out of his power to deliver it, he may nevertheless be compelled to account for its worth. . . . He is subject to the summary order of the Bankruptcy Court to restore the property to the bankrupt's estate. If he has sold it or mingled it with his own, he may be compelled by summary order to restore the value of the property thus wrongfully diverted."

[14] See, 1 COLLIER, BANKRUPTCY, 14th ed., § 2.09 (1940).

erty in the custody of the bankruptcy court. The interruption with the possession of the court is the same; on the facts assumed, the bankrupt would be able to comply with an order to turn over the value of the property converted; and the bankrupt occupies the position of fiduciary even before the wrongful conversion. It is submitted that in the face of these three elements, a turnover order, worded in the alternative of the property or its value, and enforceable by contempt proceedings, should be available to the trustee on the facts stated. It has been held that bankruptcy courts cannot issue a summary order to a bankrupt to turn over the value of property withheld,[15] but in none of these cases does it appear that the bankrupt had property subject to levy, over and above that withheld, sufficient to pay the claim. This should be a substantially distinguishing factor.

2.

A second procedure the trustee might use to obtain satisfaction for the conversion claim under the facts stated is suggested by an enigmatic dictum in *In re Cole*.[16] In this case, the court held that contempt proceedings were not available, inasmuch as the bankrupt did not possess or control the property ordered to be turned over, but at the end of the opinion the court dropped this teasing hint:

> "In our previous decision in regard to this proceeding we found, as we have said, sufficient to enable us to sustain the District Court in entering a judgment against Mrs. Cole [the bankrupt] for the amount claimed by the trustee, and we leave him the ordinary remedies which the law gives for collecting a judgment from a debtor who is insolvent, or who claims to be so."[17]

The court seems to be suggesting that a turnover order may be treated as an ordinary money judgment, collectible by execution, levy on and sale of the bankrupt's levyable property. The existence of a power in the bankruptcy courts to give a turnover order the status of an ordinary money judgment has been denied,[18] but the question is worthy of some consideration.

[15] In re Goldman, (C. C. A. 1st, 1932) 62 F. (2d) 421; Samel v. Dodd, (C. C. A. 5th, 1906) 142 F. 68; In re Reynolds, (D. C. Ala. 1911) 190 F. 967; In re Elias, (D. C. N. C. 1917) 240 F. 448; In re Sax, (D. C. Pa. 1905) 141 F. 223. *Contra*, In re H. Magen & Co., Inc., (C. C. A. 2d, 1925) 10 F. (2d) 91; In re D. Levy & Co., (C. C. A. 2d, 1904) 142 F. 442; Kirsner v. Taliaferro, (C. C. A. 4th, 1912) 202 F. 51; Goldstein v. Johnson, (C. C. A. 6th, 1925) 3 F. (2d) 228.

[16] (C. C. A. 1st, 1907) 163 F. 180.

[17] Id. at 189.

[18] 5 REMINGTON, BANKRUPTCY, 4th ed., § 2423 (1936); In re Frankel, (D. C. N. Y. 1911) 184 F. 539; In re Goldman, (C. C. A. 1st, 1932) 62 F. (2d) 421.

The scope of the jurisdiction of bankruptcy courts and referees is defined in section 2a of the Chandler Act.[19] It is apparent that this jurisdiction encompasses power to make the bankrupt account for all property passing to the trustee under section 70 of the act. The courts seem agreed that the determination of a referee or bankruptcy court on matters submitted to him or it by the act is res judicata.[20] Therefore, when a turnover order worded in the alternative of the property or its value[21] is made, that decision should be res judicata on the question whether the bankrupt does owe the amount claimed.

It is generally considered that a bankruptcy court is a court of equity with all the powers incident thereto.[22] By statute and court rule, it is now held that when a money decree is rendered in equity, the party obtaining the decree may avail himself of the process of courts of law as well as that process peculiar to equity;[23] and, by the weight of authority, an action at law may be maintained on an equitable decree for payment of money where the decree is solely for the recovery of a specified sum of money and subject to no conditions.[24] If, as has been suggested, bankruptcy courts have power to issue orders to the bankrupt to turn over property or its value, and if such order is conceded to have the force of res judicata, there would appear to be no reason why such order should not be enforceable by ordinary legal procedure, as was hinted in the *Cole* case, especially in view of the fact that equity

[19] Bankruptcy courts are given such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under the act 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, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate, whether under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest . . . (15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act: *Provided, however*, That an injunction to restrain a court may be issued by the judge only." 52 Stat. L. 843, § 2a (1938), 11 U. S. C. (Supp. 1939), § 11a.

[20] Ullman, Stern & Krausse v. Coppard, (C. C. A. 5th, 1917) 246 F. 124; Hargadine-McKittrick Dry Goods Co. v. Hudson, (C. C. A. 8th, 1903) 122 F. 232; In re Davidson, (D. C. Cal. 1914) 211 F. 687; Elmore Quillian & Co. v. Henderson-Mizell Mercantile Co., 179 Ala. 548, 60 So. 820 (1912); Clendening v. Red River Valley Nat. Bank, 12 N. D. 51, 94 N. W. 901 (1903); De Watteville v. Sims, 44 Okla. 708, 146 P. 224 (1915).

[21] Arguments in favor of the propriety of such an order have been made earlier in this comment.

[22] BLACK, BANKRUPTCY, 4th ed., § 69 (1926).

[23] 19 AM. JUR. 289 (1939); Freel v. County of Queens, 154 N. Y. 661, 49 N. E. 124 (1898).

[24] 21 C. J. 698 (1920).

money decrees have been given the same effect as law judgments in the law courts.

It has been held that the allowance of a claim by a referee in a bankruptcy proceeding is no "judgment or decree" within the meaning of the statute of limitations,[25] and that it is not a judgment such as could be sued on in independent proceedings in a state court.[26] The exact holdings may be distinguishable on the facts from those of the case being considered, but the reasoning is hard to avoid, especially when a court says:

> "It is evident from these authorities that there was no intention upon the part of the lawmakers to give the bankruptcy courts jurisdiction to render personal judgments against bankrupt debtors as in civil suits at law or in equity. . . ."[27]

To sustain this rule, the court relied on *Bardes v. Hawarden Bank*,[28] which merely decided that there was a lack of jurisdiction in bankruptcy courts to entertain law actions or plenary suits in equity. This holding, however, does not affect the power of a bankruptcy court to issue a summary order for the repayment of the value of property converted and taken from its possession, and to have such order enforced by ordinary legal methods. One case has specifically held that a bankruptcy court may, in the exercise of its summary jurisdiction, order one who has taken property from the jurisdiction of the court, to surrender back the property or its value, and enforce such order by treating it as a judgment on which execution could issue.[29] There is no reason conceivable why the result should be any different when the order is directed at the bankrupt himself, rather than at a third person, so long as the bankrupt has property on which a levy may be made. Regarding such exercise of power as a part of the court's jurisdiction to protect property in its custody, it would seem that an express gift of such power in the Bankruptcy Act would be unnecessary, inasmuch as such power is a necessary incident to the bankruptcy courts' existence as courts.

In the face of these authorities, the courts would probably in a proper case be willing to address a turnover order, worded in the alternative of the property or its value, to the bankrupt and allow enforcement of the order by ordinary legal methods. Certainly all considerations of policy should favor the result, since concealment, conversion,

[25] Maxwell v. Pappas, 173 Minn. 263, 217 N. W. 126 (1927).

[26] Maryman v. Dreyfus, 117 Ark. 17, 174 S. W. 549 (1915).

[27] Id., 117 Ark. at 22.

[28] 178 U. S. 524, 20 S. Ct. 1000 (1900).

[29] Clay v. Waters, (C. C. A. 8th, 1910) 178 F. 385.

or wasting of estate assets by the bankrupt is not to be favored, and the rights of creditors affected by the proceedings should be protected in so far as possible.

3.

A third method by which the trustee might get satisfaction of the conversion claim from non-estate, levyable assets is by the use of an ordinary suit at law for conversion. Under section 70 of the Chandler Act,[30] the trustee of a bankrupt estate is, upon his appointment or qualification, "vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy" to all estate property. It is clear that the trustee may maintain trover upon his title given by section 70a.[31] The mere fact that the suit is brought against the bankrupt would be no bar to the suit, for under section 11 of the Chandler Act, the only actions against the bankrupt which may be stayed are actions on claims provable in bankruptcy and dischargeable thereby.[32] Since any claim the trustee may have against the bankrupt for conversion of estate assets can accrue only after the filing of the petition in bankruptcy, the claim cannot possibly be one dischargeable in bankruptcy, for debts or claims coming into existence after the filing of the petition are not affected by the discharge.[33] As between the bankrupt and the trustee, it is clear that title rests in the latter, and a conversion of estate property is an injury to the trustee for which the law should allow reparation. The mere existence of summary jurisdiction does not ordinarily bar use of plenary actions to recover estate property in suits against third persons,[34] and no reason is apparent why the rule should be otherwise in case of a suit against the bankrupt himself. Nevertheless, there is a dearth of recorded authority on the point.

It was early held that a judgment creditor could bring an action on the case against a debtor and his accomplice for conspiracy to defraud creditors.[35] Since, under section 70c of the Chandler Act, the trustee is given all the powers of a creditor armed with process,[36] it would seem he should have the same power to obtain a money judgment against a bankrupt debtor. In several cases it has been held that the trustee may sue at law for fraud the bankrupt and his transferees in fraud of creditors; and money judgments were held obtainable

[30] 52 Stat. L. 879 (1938), 11 U. S. C. (Supp. 1939), § 110a.

[31] Burns v. O'Gorman Co., (C. C. R. I. 1906) 150 F. 226; Foster v. Hackley, (C. C. Mich. 1869) 9 F. Cas. 545, No. 4971.

[32] 52 Stat. L. 849 (1938), 11 U. S. C. (Supp. 1939), § 29.

[33] 8 C. J. S. 1510-1511 (1938).

[34] Whitney v. Wenman, 198 U. S. 539, 25 S. Ct. 778 (1905).

[35] Collins v. Cronin, 117 Pa. St. 35, 11 A. 869 (1887).

[36] See note 4, supra.

against each defendant, including the bankrupt.[37] In none of these cases, however, did the court give any consideration to the fact that it was allowing the trustee to get a money judgment against the bankrupt for a tort. Also, in the case of suits brought by the bankrupt, courts have allowed the trustee to intervene and have thus settled disputes between trustee and bankrupt.[38] From these cases, it may at least be said that the state courts have shown no disinclination to adjudicate fully the respective rights of trustee and bankrupt or to render money judgments against the bankrupt in favor of the trustee. In one early case, it was clearly held that a trustee could sue the bankrupt for conversion of property belonging to the bankrupt estate, and that such suit could properly be brought in a state court.[39] The court held the suit proper because the bankrupt was sued in his private character, whereas the bankruptcy courts have jurisdiction only of suits against the bankrupt in his character as bankrupt. The poverty of the defendant was deemed no argument in bar of the suit, since his after-acquired property might be subjected to satisfaction of the judgment. The case was very well considered, and nothing has been found in any of the revisions of the bankruptcy acts which would cause any different holding in a proper suit today. The case should be conclusive of the point whether a trustee may sue the bankrupt at law to obtain a money judgment for conversion.

One problem remains, that of determining what courts would have jurisdiction to entertain such suits. The provisions of the act regarding the jurisdiction of bankruptcy courts have been set forth above;[40] the act also provides, in section 23,[41] for the jurisdiction of the federal district courts. It thus appears that sections 2 and 23 confer two distinct classes of jurisdiction: (a) jurisdiction on courts of bank-

[37] Allen v. Gray, 201 N. Y. 504, 94 N. E. 652 (1911); Cole v. Goodman, 234 App. Div. 562, 255 N. Y. S. 720 (1932); Levy v. Miller, 48 R. I. 250, 137 A. 7 (1927).

[38] Morgan's Trustee v. Morgan, 237 Ky. 69, 34 S. W. (2d) 945 (1931).

[39] Carr v. Gale, (C. C. Me. 1847) 3 Woodb. & M. 38, 5 F. Cas. 123, No. 2435.

[40] See note 19, supra.

[41] "a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

"b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act." 52 Stat. L. 854, § 23 (1938), 11 U. S. C. (Supp. 1939), § 46.

ruptcy over proceedings in bankruptcy; and (b) jurisdiction on federal district courts to set aside preferences under section 60 and fraudulent transfers under sections 67 and 70, and of controversies at law or in equity, as distinguished from bankruptcy proceedings. The first class of jurisdiction is exclusive in the bankruptcy courts, while the second class is concurrent with the state courts.[42] A law action for conversion could hardly be classified as a bankruptcy proceeding, and hence would come within the rule of *Bardes v. Hawarden Bank*.[43] Under this rule, only the state courts could have jurisdiction of such a suit, since there would probably be no diversity of citizenship between the trustee and the bankrupt. That a suit for conversion, brought by the trustee against the bankrupt, could not be heard in the bankruptcy courts has been suggested by at least one eminent judge,[44] and the authorities heretofore examined lead to the same conclusion.

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[42] See generally, 1 COLLIER, BANKRUPTCY, 14th ed., § 2.06 (1940).

[43] 178 U. S. 524, 20 S. Ct. 1000 (1900).

[44] In re Frankel, (D. C. N. Y. 1911) 184 F. 539, where Judge Learned Hand suggested at 540-541, "If the bankrupt has seized and disposed of property belonging to the trustee, that may well be a civil tort, for which the trustee might sue him in conversion and get a judgment; but he could not do so in the bankruptcy court."