BANKRUPTCY

WAIVER OF DISCHARGE IN SUBSEQUENT PROCEEDING

In a 1931 bankruptcy proceeding a bankrupt was discharged of all debts. In 1934 one of the creditors filed suit in an Oregon state court to recover on a claim, alleging that after the bankrupt had filed his petition and prior to his discharge he had expressly promised to pay the debt and had made payments on it both before and after discharge. The bankrupt set up his discharge in bankruptcy as a defense. Judgment in the state court was rendered for the creditor. In 1941 the bankrupt filed a second bankruptcy petition and listed the 1934 judgment as his only unsecured debt. The referee granted a qualified discharge, excepting therefrom the judgment debt. The District Court sustained the referee, holding that a bankrupt who waives his discharge by promising to pay a discharged debt is forever barred from a later discharge in bankruptcy of the same debt.[1] The Circuit Court of Appeals reversed: a new debt based upon moral consideration was created by the promise to pay the old discharged debt. This new debt was dischargeable. *Shepherd v. McDonald,* 157 F.2d 467 (C.C.A. 9th 1946), cert. denied, 329 U.S. 802 (1947).

The principal case raises the question whether a judgment debt based upon a bankrupt's promise to pay a debt which had been discharged in bankruptcy is itself dischargeable in a later bankruptcy proceeding. It must be kept in mind that the debt sought to be discharged in the second proceeding was a judgment debt, and that in considering the validity of a judgment courts will not inquire into the underlying transaction out of which the judgment was rendered.[2] The solution of the question depends upon the interpretation of the Bankruptcy Act.[3]

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1. In re Shepherd, 61 F.Supp. 948 (D.C.Ore. 1945); Notes, 32 Va. L. Rev. 642 (1946), 46 Col. L. Rev. 293 (1946).
2. See Moore v. Kraft, 179 Fed. 685, 686 (1910): "But when Moore . . . obtained the judgment in question, the original cause of action became merged in the legal evidence of a new debt, for the nonpayment of which a new cause of action would arise." Accord, McAleer v. Clay County, 38 Fed. 707 (N.D.Iowa 1889).
3. 30 Stat. 544 (1898), as amended, 52 Stat. 840 (1938), 11 U.S.C. §§ 1 et seq. (1940).

In considering any petition in bankruptcy, three problems may confront a court as to whether a debt is dischargeable. These will be presented and discussed in relation to the principal case.

1. Whether the claims made are debts "provable in bankruptcy." This problem is solved in the principal case by §63(a)(1) of the Bankruptcy Act, in which a judgment is specifically made a "provable debt" within the meaning of §1(14) which defines "debt" as being any debt provable in bankruptcy. Nothing in the Act nor in its legislative history[4] makes an exception to judgments being provable debts.

2. Whether the debts are within the exceptions of §17 and are therefore not dischargeable. This problem seems clearly answered by §17(a) of the Bankruptcy Act which lists the six statutory exceptions as the debts "not affected by a discharge."[5] These exceptions do not include a judgment based upon a new promise to pay an obligation discharged by a prior bankruptcy. It has been held that §17 must be strictly construed in favor of the bankrupt.[6]

3. Whether, if the debts are not within the exceptions of §17, they are excepted for any other reason. As to this problem, the contention made by the creditor in the principal case was that the bankrupt's waiver of his discharge in the first bankruptcy proceeding operated as a bar to his discharge of the *same obligation* in a second bankruptcy proceeding. Perhaps the best answer to this contention is that the obligations sought to be discharged in the two proceedings were not the same. In the first, the discharged debts were founded upon certain promissory notes. In the second, the debt was founded upon a judgment of a state court.

However, the creditor's contention may also be successfully controverted by a construction of the Bankruptey Act's

4. H. R. Rep. No. 1409, 75th Cong., 1st Sess. (1937).
5. Section 17(a) lists the following six exceptions:
   1. taxes due;
   2. alimony, child support, and liabilities arising from certain torts;
   3. debts not duly scheduled in time for proof and allowance;
   4. debts arising from petitioner's misappropriations while acting in a fiduciary capacity;
   5. wages earned within three months before commencement of the bankruptcy proceedings; and
   6. deposits to secure faithful performance by an employee of the terms of an employment contract.
6. Gleason v. Thaw, 236 U.S. 558 (1914); Lockhart v. Edel, 23 F.2d 912 (C.C.A. 4th 1928).

waiver provisions. Section 14(a) contains the only procedure by which a bankrupt may waive his discharge. It provides that an adjudication of bankruptcy will not operate as a discharge if the bankrupt, before the hearing on his application for a discharge, waives, by writing filed with the court, his right to a discharge.[7] Concededly the bankrupt in the principal case did not comply with the waiver provisions in the Act. Therefore to deny his discharge in the subsequent bankruptcy proceeding would be judicial legislation, *i.e.*, adding a seventh exception to the six listed in §17.

The District Court, in holding that the original debt was revived by means of a waiver, considered the principal case analogous to those cases which hold that where a bankrupt loses his right to a discharge by a failure to prosecute, he cannot in a later proceeding secure a discharge of the debts scheduled in the prior proceeding.[8] The judgment in the first proceeding would be res judicata as to all claims scheduled therein.[9] Therefore, whether or not the doctrine of res judicata has any application to the facts of the principal case depends upon whether the judgment sought to be discharged in the second proceeding and the promissiory note discharged in the first proceeding were the same debt. It is submitted that they were not the same debt, either under the provisions of the Bankruptcy Act,[10] or under the various theories of waiver which obtain in the state courts.[11]

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7. 1 Collier, "Bankruptcy" (14th ed. 1940) § 17.33; 7 Remington, "Bankruptcy" (5th ed. 1939) § 3502. The Bankruptcy Act of 1898 (30 Stat. 544), under which the 1931 discharge in the principal case was granted, contained no provision for waiver of discharge. The Chandler Act, supra n. 3, in 1938 amended the Act of 1898, supplying the waiver provisions.

8. Hill v. Railroad Industrial Finance Co., 92 F.2d 973 (C.C.A. 10th 1937); Pollet v. Cosel, 179 Fed. 488 (C.C.A. 1st 1910); Kuntz v. Young, 131 Fed. 719 (C.C.A. 8th 1904).

9. In re Fiegenbaum, 121 Fed. 69 (C.C.A. 2d 1903).

10. 52 Stat. 873 (1938), 11 U.S.C. § 103 (a) (1940).

11. The Circuit Court's decision that the new debt is based on the debtor's moral obligation to pay after discharge has been attacked by a leading writer. 1 Collier, "Bankruptcy" (Supp. 1946) §§ 17.33, 17.38. More recent authority holds that promises to pay once legally enforceable debts such as those barred by a discharge in bankruptcy are enforceable without consideration. 1 Williston, "Contracts" §§ 147, 158 (Rev. ed. 1936); Restatement, "Contracts" § 85 (1932). However, contrary to this position are numerous cases holding that while a discharge releases a bankrupt from legal liability to pay a provable debt, it leaves him under a moral duty which is sufficient to support a new promise to pay. Zavelo v. Reeves, 227 U.S. 625 (1913); In re Cox, 33 F.Supp, 796 (W.D.Ky.

Moreover, even if the two debts could be reasonably held identical, the correct application of the doctrine of res judicata would seem to require a result exactly contra to that reached by the District Court. For, if the 1934 judgment of the state court was based upon the original debt that had been discharged in the first bankruptcy proceeding, then the doctrine of res judicata would require such judgment to be held dischargeable in the second proceeding.[12] Obviously, a denial of the discharge of a debt in a prior bankruptcy proceeding is res judicata that such debt is within the exceptions of §17. Therefore, a discharge of a debt in a prior bankruptcy proceeding is res judicata that such debt is not within the exceptions of §17 and is dischargeable.

The Circuit Court of Appeals reached the correct result, although the Court was somewhat confused in its legal reasoning. The Court laid great emphasis on the creditor's allegation that the bankrupt's new promise was made *after* discharge, notwithstanding that it is overwhelmingly settled that whether the promise is made before or after discharge is immaterial.[13] Collier approves the District Court's decision, on grounds that the waiver did not create a new debt, but merely renewed the old one, and that the judgment merely changed the form of the original debt.[14] The essence of the Circuit Court's opinion was that the bankrupt was an "honest debtor" as demonstrated by his "recognition of his moral obligation to pay his discharged indebtedness"; and that as

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1940); Needham v. Matthewson, 81 Kan. 340, 105 Pac. 436 (1909). The majority of cases likewise hold that a discharge in bankruptcy merely affords a complete legal defense to a claim without extinguishing the debt itself. In re Weisburg, 253 Fed. 833 (E.D.Mich. 1918); Butler Bros. v. Twineham, 134 Kan. 547, 7 P.2d 531 (1932); Federal National Bank v. Koppel, 253 Mass. 157, 148 N.E. 379 (1925); contra: Needham v. Matthewson, 81 Kan. 340, 105 Pac. 436 (1909); Kravitz v. Povlotsky, 335 Pa. 75, 3 A.2d 922 (1939). It is generally agreed that the bankrupt may waive this defense. Hays v. Cyrus, 252 Ky. 435, 67 S.W.2d 503 (1934); Harrington v. Davitt, 220 N.Y. 162, 115 N.E. 476 (1917). However, the courts are in conflict as to whether the cause of action should be brought on the original obligation supported by a new promise: Fierce v. Fleming, 205 Iowa 1281, 217 N.W. 806 (1928); Parker v. Smith, 143 Wash. 677, 255 Pac. 1026 (1927); or on the new promise supported by the older liability: Needham v. Matthewson, 81 Kan. 340, 105 Pac. 436 (1909); McDermott v. Sulkin, 154 Pa. Super. 81, 35 A.2d 556 (1944).

12. Shepherd v. McDonald, 157 F.2d 467, 469 (C.C.A. 9th 1946), cert. denied, 329 U.S. 802 (1947).

13. 1 Collier, "Bankruptcy" (Supp. 1946) § 17.38, and cases cited.

14. Ibid.

a matter of policy to refuse a discharge would penalize the bankrupt and prevent him from starting afresh from his business misfortunes. It is true that one of the avowed purposes of the Bankruptcy Act is to discharge the indebtedness of the honest debtor so that he will be permitted to start afresh in his economic pursuits.[15] Courts have held that the Act is to be sensibly construed in favor of the honest bankrupt and his release.[16] However, it is submitted that the result reached by the Circuit Court in the principal case is the only tenable interpretation under the Bankruptcy Act, wholly apart from matters of policy.

CONFLICT OF LAWS

WORKMEN'S COMPENSATION

An employee of an Illinois Corporation, hired in Illinois, was injured in the course of his employment in Wisconsin. The employee received a Workmen's Compensation award from his employer under the Illinois statute. This award contained a specific provision that no rights were to be affected which the employee might have under the Workmen's Compensation Act of Wisconsin. Then the employee applied for compensation under the Wisconsin Act. The Wisconsin Supreme Court[1] under the authority of *Magnolia Petroleum Co. v Hunt*[2] set aside the Wisconsin order allowing compensation, finding that under the full faith and credit clause[3] of the Federal Constitution that the Wisconsin proceedings were barred by the Illinois awad. On certiorari to the Supreme Court the Wisconsin judgment was reversed; since the Illinois award was not intended to be conclusive of the employee's rights in Wisconsin, the Wisconsin award was not barred by the Illinois award. *Industrial Commission of Wisconsin v. McCartin*, 330 U.S. 622 (1947).

The requirement of the Constitution for one state to

15. H. R. Rep. No. 1409, 75th Cong., 1st Sess. 3 (1937).
16. Williams v. U.S. Fidelity Co., 236 U.S. 549 (1915).
1. 248 Wis. 570, 22 N.W.2d 522 (1946).
2. 320 U.S. 430, 150 A.L.R. 413 (1943).
3. U.S. Const. Art. IV, §1: "Full Faith and Credit shall be given in each state to the Public Acts, Records, and Judicial Proceedings of every State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and Effect thereof."