

NOTES

BANKRUPTCY ACT: ABUSE OF SECTIONS 14C(3) AND 17A(2) BY SMALL LOAN COMPANIES

The purpose of the Bankruptcy Act¹ is two-fold: to distribute the debtor's assets fairly among his general creditors² and, secondly, to liberate him from his indebtedness and provide for his economic renaissance.³ To accomplish the latter purpose the act provides that the debtor may be released from all his debts which are provable in bankruptcy, except those debts which are specifically made exempt from discharge.⁴ Serious problems are posed by the practice of some small loan companies of inducing the debtors to make false financial statements.⁵ These practices circumvent the spirit of the Bankruptcy Act and nullify the intent of Congress to allow the honest debtor economic regeneration. Further complications arise because of the failure of the federal courts to give sufficient protection to the honest debtor.⁶ A thorough analysis of the problem raised is necessary to arrive at a justifiable solution which not only will afford the creditor with his just share of the debtor's assets, but also will protect the small debtor from infringement upon the protection which the Bankruptcy Act seeks to give.

Section 14 of the Bankruptcy Act provides that the adjudication of a debtor as a bankrupt by the court is deemed an application for discharge from all his debts.⁷ On a date fixed by the court subsequent to adjudication a creditor of the bankrupt may file objections in an attempt to

1. 30 Stat. 544 (1898), as amended, 11 U.S.C. §§ 1-1255 (1952), hereinafter referred to as Bankruptcy Act.

2. *Straton v. New*, 283 U.S. 318 (1931); *State Finance Co. v. Morrow*, 216 F.2d 676 (10th Cir. 1954); *Watts v. Elliathorpe*, 135 F.2d 1 (1st Cir. 1944).

3. The purpose of the Bankruptcy Act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." *Williams v. United States Fidelity & Guarantee Co.*, 236 U.S. 549, 554-55 (1915). See *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934); *State Finance Co. v. Morrow*, *supra* note 2; *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1931). It has been asserted that the primary purpose in approximately 85% of ordinary bankruptcy cases is to obtain a discharge for an employee and allow the debtor to get back on his feet. *Covey, Recent Developments in Bankruptcy Administration*, 31 REF. J. 11, at 13 (1957).

4. The two pertinent sections in the act are § 14, and § 17.

5. See note 18 *infra*, where the practices are fully discussed.

6. See notes 70-83 *infra*, and accompanying text.

7. Bankruptcy Act § 14. "Discharges, When Granted. The adjudication of any person . . . shall operate as an application for a discharge. . . ."

prevent the discharge.⁸ The creditor will be successful in blocking the release by proving to the court⁹ that the bankrupt obtained money or property on credit on the basis of a false financial statement.¹⁰ However, the creditor who has extended credit on the basis of the materially false financial statement made by the debtor has an option.¹¹ If he does not object to discharge under § 14c(3), he may pursue the debtor into a state court by virtue of § 17a(2), because the debtor is still amenable to suit. This section exempts from the operation of discharge the liability for obtaining money or property by false pretenses or false representations.¹²

The right to a discharge¹³ and the effect of a discharge¹⁴ are two distinct matters.¹⁵ Since the inception of the act the general rule has been that the right to a discharge will be determined by the referee.¹⁶ Similarly the proper forum to determine the effect of the discharge de-

8. Bankruptcy Act § 14b. The court is to make "an order fixing a time for the filing of objections, and notice is to be given to all parties in interest. . . ." If no objection is filed the bankrupt will be discharged. If an objection is filed, then the court will hear the evidence of all parties pertaining to the matter.

9. Bankruptcy Act § 1. "Meaning of Words and Phrases . . . (9) 'Court' shall mean the judge or referee of the court of bankruptcy in which the proceedings are pending."

10. Bankruptcy Act § 14c. "The court shall grant the discharge unless satisfied that the bankrupt has . . . (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition. . . ." Once the objection shows to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts that would prevent his discharge the burden of proving he has not committed any such acts is upon the bankrupt. 1 COLLIER ON BANKRUPTCY, ¶ 14.12 (14th ed. 1940). The burden of proving that he has not committed any of the enumerated acts is often difficult for the bankrupt and this, together with the practices, discussed in note 18 *infra*, in relation to this section of the act, makes the situation extremely objectionable.

11. See *In re Hadden*, 142 F.2d 896, 897 (6th Cir. 1944); *In re Barber*, 140 F.2d 727, 729 (3rd Cir. 1944); *Watts v. Elliathorpe*, 135 F.2d 1, 3 (1st Cir. 1943). *But see In re Walton*, 51 F.Supp. 857 (W.D. Mo. 1943), where the court seemed to say that one of the grounds on which it exercised its ancillary jurisdiction to enjoin the creditor from continuing his suit in the state court was that he should have objected in the discharge hearing. However, the court went on to review the merits of the cause [i.e., was there in fact a false financial statement rendered which was relied on?] and decided for the bankrupt.

12. Bankruptcy Act § 17. "Debts Not Affected by a Discharge. A discharge in bankruptcy shall release a debtor from all of his provable debts, whether allowable in full or in part, except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations. . . ."

13. Bankruptcy Act § 14c(3).

14. Bankruptcy Act § 17a(2).

15. *In re Sutton*, 19 F. Supp. 892 (S.D.N.Y. 1937). COLLIER, *op. cit. supra* note 10, ¶ 14.02.

16. Bankruptcy Act § 2a(12). See COLLIER, *op. cit. supra* note 10, ¶ 2.55.

creed has been the forum in which suit is brought on the particular debt.¹⁷ Both of these remedies open to the creditor are fraught with inequities and have been used by creditors to circumvent the spirit of the act. One prevalent practice frequently reported has become practically a stock in trade of some small loan companies. The small loan or personal finance company will often encourage the debtor not to make a full statement of his liabilities or even make it impossible for him to report correctly his complete indebtedness on the loan application.¹⁸ Thus, the financial

17. "The proper time and place for the determination of the effect of a discharge is when the discharge is pleaded or relied upon by the debtor as a defense to the enforcement of a particular claim. The issue upon the effect of a discharge cannot properly arise or be considered in determining the right to a discharge. The right to a discharge does not at all depend upon whether or not the judgment is released by the discharge." *In re Sutton*, 19 F.Supp. 892, 893 (S.D.N.Y. 1937).

18. See Friebohn, *Re-Examination of Section 14(c)*, 39 MINN. L. REV. 673, 686-7 n. 31. Referee Friebohn reports a poll he took of other referees. Their comments concerning the use of the financial statement by small loan companies indicate a specific knowledge of the practice of encouraging false financial statements by debtors. Their contempt for the practice is evident.

In *In re Anderson*, 104 F.Supp. 599, 605-6 (E.D. Wis. 1952), the court said, ". . . the agents of the objecting creditors deliberately contrived to obtain a financial statement that would be incomplete and erroneous for the purpose of using it to prevent the extinguishment of their claim by a discharge in bankruptcy." In the *Anderson* case it was pointed out that the financial statement was small, with a space of one inch in which debtor was obliged to list his indebtedness in his own writing.

For an example of how small loan companies encourage the debtor to file an incomplete statement see BURROUGHS CLEARING HOUSE, March, 1954, where a copy of an application blank of Chicago National Bank's Borrow-by-Mail personal loan program appears. The application blank requests the applicant to attach a list of all references and debts and mail it in. This statement is to be relied on in making the loan.

Also see *Matter of Forgay*, 140 F.Supp. 473, 478 (D. Utah 1956), in which the District Court discussed why it should exercise its power under the doctrine of *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), which gave the federal courts the power under unusual circumstances to enjoin proceedings in state courts against a discharged bankrupt. The court said, "Experience with these bankruptcy matters teaches a judge that the view for which the Loan Co. contends [i.e., that the court had no jurisdiction to enjoin the suit in the state court under § 17a(2) or its enforcement] would put a premium upon the loan companies' carelessness, if not their collusion, in obtaining applications for loans which are improperly or inadequately filled out by borrowers. A loan company manager's job is to get the money out at interest. The more he gets out, the more he gets paid. This affects his efficiency rating for promotion. It affects the financial success of the concern. To be sure, if he has excessive bad debt losses they will reflect against him. But, if the lending agency manager can make loans with assurance that the borrower won't be able to get them discharged in bankruptcy, he need not be so careful about applications. Indeed, in the event the loan turns sour, it will be better for him and his concern if there is an omission or misstatement in the application. At the lending stage of the transaction, with every pressure upon the loan company official to make the loan, there will be an increased temptation for carelessness, and in some cases actual collusion. Unhappily, a judge doesn't have to be on the bench of a bankruptcy court very long before he observes both."

Also see the REPORT OF COMMITTEE ON BANKRUPTCY OF THE AMERICAN BAR ASSOCIATION, June 1, 1956, p. 5, where the practice of encouraging false financial statements is discussed.

On its face the magnitude of this practice does not seem imposing. However, note that in the fiscal year ending June 30, 1955 (for latest figures available see TABLES OF BANKRUPTCY STATISTICS, Administrative Office of the United States Courts, Washing-

statement is prima facie false.

By threatening to block discharge under § 14c(3) by filing an objection based on the prima facie false financial statement, it is possible for the loan company to coerce payment of the debt in full.¹⁹ The debtor would rather pay this single debt than have none of the debts discharged. Thus, the debtor will promise to pay the debt after discharge. If he fails to pay the loan company still has the option of suing under § 17a(2) on the liability for false representation or a better weapon of suing on the new promise to pay.

The abuse of § 14c(3)²⁰ has been recognized by the National Association of Referees in Bankruptcy, who have recommended that this section be deleted from the act.²¹ House Bill 11543, introduced in the 84th Congress,²² would accomplish this end.²³ This bill was introduced to expedite the administration of the act, "and to avoid the denial of discharge where a loan from a small loan company has been secured as

ton, D. C.) over 50,000 bankruptcy cases, or 84.5% of all cases were filed by employees or others not in business. Also in the same year 85% of all ordinary bankruptcy cases closed were either no-asset or nominal asset cases. Although no statistics are available it is generally conceded that the largest group of those borrowing from the small loan companies or personal finance companies are wage-earners.

19. For a full account of how the creditor coerces payment under these circumstances see Friebolin, *op. cit. supra* note 18 at 683. In a letter from Referee Friebolin to the *Indiana Law Journal*, November 24, 1956, in discussing the forcefulness of the weapon of 14c(3) in the hands of the small loan company, he states, "what I do propose is the removal of the club—Sec. 14c(3)—which induces the bankrupt to renew or pay without a suit because the lender may by outright threat or by mere suggestion, bring home to the bankrupt that, if he doesn't renew or pay, the lender has the power, not only to bring suit under Sec. 17a(2), but to object to his discharge entirely.

"But, of course, it is seldom that a lender will make an outright threat that he will object to a discharge unless the bankrupt pays his debt. If the referee hears of an express proposal of that kind, he will certify the facts to the District Attorney for prosecution. A wise lawyer for the bankrupt will know what the lawyer for the lender has in mind when he examines the bankrupt about the inaccurate statement and then announces that he (the lender) has a discharge, and he expects to be paid. He need go no further. Bankrupt's lawyer will know what the lender can do under Sec. 14c(3): object to his client's entire discharge. So he advises his client to pay rather than take the chance that the lender will object to the bankrupt's discharge and lose the entire benefit of the bankruptcy."

20. This problem is important considering that the large majority of all objections filed recently have been based on § 14c(3), and the largest percentage of these objections have been based on false financial statements issued to small loan companies by individuals not in business. The loans involved are usually small, and are seldom over \$300. Friebolin, *op. cit. supra* note 18, at 682.

21. See *Summary Report of the Committee on Improvements in Bankruptcy Law*, 25 REF. J. 43 (1951).

22. The bill was sponsored by Representative Emanuel Celler of New York. Introduced on May 31, 1956, it subsequently died in committee.

23. Section 3 of House Bill 11543 provided that § 14c(3) be deleted. See *infra* note 89.

a result of false or incomplete financial statements."²⁴ Another objection to this section is directed at the inequity that exists whereby all debts are denied discharge including those debts created without knowledge of the existence of a false financial statement.²⁵ This bestows a windfall upon those creditors who are in no way affected by the false financial statement. Further, the use of this section is far beyond the scope originally intended.²⁶

If the loan companies lose the remedy of being able to object to discharge and the apparent beneficial consequences, the result will undoubtedly be to shift emphasis to the remedy afforded under § 17a(2), i.e. suit in the state court on the nondischargeable claim. This avenue of redress is open to criticism. The individual who goes to these small loan companies more often than not is the small debtor who, because of his recent insolvency, can least afford to answer suit in the state court. The debtor, furthermore, is often under the impression that his discharge in bankruptcy did release him from this particular obligation, and he will fail to answer the suit.²⁷ The result is often a default judgment which becomes *res judicata*.²⁸ In none of these cases do the federal courts offer relief.²⁹ Consequently, there has been a general practice among loan companies and other creditors of ignoring the discharge decrees and suing in the state courts; quite frequently they have recovered debts that were discharged in bankruptcy or debts that would be discharged but for their own sharp practice in creating the obliga-

24. In a letter from Representative Celler to *Indiana Law Journal*, October 16, 1956, explaining his reason for deleting § 14c(3), Congressman Celler stated, however, "I have no knowledge of loan companies using this section to coerce small debtors into making full payments to loan companies."

25. The sanction imposed by § 14c(3) is extremely severe in relation to the harm. But where the creditor acts without subterfuge, the particular obligation created by the false financial statement should not, in fairness, be discharged.

26. Section 14c(3), as it was originally adopted in 1903, was aimed primarily at financial statements given by businessmen to mercantile agencies such as Dun and Bradstreet, and was not intended to apply to a debtor not engaged in business. For an excellent discussion of the intent of Congress in relation to the object of congressional intent see Friebolin, *op. cit. supra* note 18 at 688-91. *Contra*, COLLIER, *op. cit. supra* note 10, ¶ 14.34, p. 1341. Collier indicates that neither the language nor the history of § 14c(3) restricts its application to merchants, rather, that the section applies to all who ask a discharge in bankruptcy.

27. See note 80 *infra*.

28. See note 79 *infra*.

29. See notes 70-72, 79-83 *infra* and accompanying text. *But see* Gore v. Gorman's Inc., 143 F.Supp. 9 (W.D. Mo. 1956). In this case punitive damages for malicious prosecution were granted bankrupt (Gore) in light of creditor's attempt to pursue him in the state court after discharge in bankruptcy where the creditor (Gorman) knew the debt had been discharged. The remedy offered by the district court in this case, if used more often, might serve as a deterrent to the loan companies and others who have been the most flagrant in this type of abuse.

tion.³⁰ Even more despicable is the practice of those persons in metropolitan areas who have made a business of buying claims known to be discharged and subsequently suing on them in the state courts knowing that default judgment or quick settlement will follow.³¹

30. It is the usual practice of creditors having an alleged false financial statement to let the discharge be issued, and then sue in the state court claiming that their debt was not one included in the discharge decree. Covey, *op. cit. supra* note 2, at 14.

Many bankrupt wage-earners have small loan companies as creditors. The small loan company will often bring suit in the state court knowing full well that their claim is discharged, but hoping to bring the bankrupt in line thereby. Often in these cases the bankrupt does not know that he has adequate legal remedy, being ignorant of the necessity of pleading discharge, and he will often be unable to employ counsel. Note, 2 OKLA. L. REV. 505, 507 (1949).

"The average bankrupt is a layman who has been advised that a discharge in bankruptcy releases him from his debts and who has faith in the dignity, the force and effect of a decree of a federal court. He has surrendered his property and has no means to defend himself against further litigation. It has become a custom for greedy creditors to take advantage of this situation by ignoring the bankruptcy proceedings and the order of discharge and suing on their debts in the state courts hoping that the bankrupt, because of this ignorance and faith in this order of discharge or because he is unable to employ counsel, will fail to appear and plead the discharge or otherwise defend. And unfortunately this frequently happens. Usually these suits are brought before inferior state courts, such as justices of the peace, many who are laymen; and even when the bankrupt appears and pleads his discharge these justices, without legal training or experience in interpretation of the Bankruptcy Act, undertake to pass upon the effect of the discharge as affecting the particular debts—usually reaching erroneous conclusions and usually adverse to the bankrupt. Every court which deals with any considerable number of bankruptcy cases is familiar with the difficulties which bankrupts have in protecting themselves from rapacious creditors even after discharge." Dissenting opinion of Justice Paul in *Helms v. Holmes*, 129 F.2d 263, 269 (4th Cir. 1942). This case held that a judgment rendered in the state court became *res judicata* upon the federal courts in re: the effect of discharge on a particular debt, and the court refused to enjoin enforcement of judgment even where there was an erroneous decision of law.

One writer has indicated that those courts which have exercised ancillary jurisdiction to enjoin suits in the state courts or to declare the effect of a discharge decree frequently have pointed out the plight of the bankrupt, unable to protect himself, being coerced into paying already discharged debts. He indicates that the courts are aware of the misunderstanding the bankrupt has in regard to the necessity of pleading discharge in the state court in defense of the creditor's action. Smedley, *Bankruptcy Courts as Forums for Determining the Dischargeability of Debts*, 39 MINN. L. REV. 651, 666 (1955).

"Many creditors . . . follow the practice of ignoring the bankruptcy court and virtually annulling its orders of discharge by coercive measures, taken after discharge, in the nature of suits in state courts on dischargeable debts, or threats of garnishment proceedings against, or of notices to employees of bankrupts which would result in loss of employment; by harassing them in many other ways. These discharged bankrupts are in many cases induced to renew such debts or pay them off rather than risk the danger of losing their employment or undergo the expense, which they cannot afford, of defending numerous cases in the state courts. In many instances, too, these debtor's are ignorant of the law, and unable to employ counsel to defend them in the state courts; and, relying on the efficacy of the judgments of discharge in the bankruptcy court, allow their cases to go by default in the state courts." *In re Cleapor*, 16 F.Supp. 481, 483-4 (N.D. Ga. 1936).

31. Their *modus operandi* is to ascertain that the bankrupt is employed once more, and then proceed to procure an assignment of an account from a discharged creditor with the understanding to split the proceeds. At that point they proceed to bring suit in the justice of the peace court, and harass the debtor. Covey, *op. cit. supra* note 3, at 14.

The problem raised by the *modus operandi* of certain small loan companies and other unscrupulous creditors requires an investigation of the legal structure of § 17a(2).³² The act states that "(a) a discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations. . . ." The act enumerates those debts considered to be proved under § 63a.³³ The suit in the state court under § 17a(2) is oftentimes on a note,³⁴ which is considered a provable debt.³⁵ The suit on the liability³⁶ for obtaining money or property by false pretenses or representations also comes within the scope of a "provable debt." The debtor's obligation on the note is absolutely owing at the time of the filing of the petition. The conditions under which the loan was given exempt it from the discharge. Even though it is a claim sounding in tort, the debt is liquidated and is not contingent, therefore avoiding the pitfalls of § 57d,³⁷ which requires that in order for a claim to be provable and allowable it must be liquidated.³⁸

There seems to be some controversy over the nature of the cause of action pleaded in the state courts.³⁹ It is generally conceded that since

32. Bankruptcy Act § 17a. Regardless of whether the plaintiff recovers a proportionate amount of his claim on the note in the distribution of bankrupt's assets under the act, he is not prohibited from suing in the state court under 17a(2) for the deficiency remaining. *Wheeler & Motter Mercantile Co. v. Green*, 97 Okla. 96, 222 Pac. 965 (1924). Also, if a creditor objects to discharge and the objection is denied, he may still sue in the state court.

33. Bankruptcy Act § 63a.

34. See the discussion on pleading, notes 39-42 *infra* and accompanying text.

35. Bankruptcy Act § 63a. "Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether payable or not with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest: . . ."

36. Liability in this sense includes every obligation to pay money whether evidenced by judgment or note. *Personal Finance Co. of New York v. Crowley*, 30 N.Y.S.2d 645 (1941).

37. Bankruptcy Act § 57d.

38. Section 57d states that ". . . an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceeding under this Act." *Ibid.* It is held a liquidated debt on the ground that the amount recoverable is the amount of the obligation evidenced by the note.

39. See *Elaine v. Richards*, 296 Ky. 283, 176 S.W.2d 697, 699 (1944) (dictum) and *COLLIER, op. cit. supra* note 10 ¶ 17.16, at p. 1607-8. In a recent case, *Matter of Forgay*, 140 F.Supp. 473 (D. Utah 1956), the court exercised ancillary jurisdiction to enjoin enforcement of a judgment rendered in a state court on the grounds that the action in the state court had been on the note and not on the fraud. Forgay, (petitioner) had obtained a loan from the loan company on November 21, 1953. On May 18, 1954 he filed a voluntary petition in bankruptcy scheduling the debt to the loan company. Though notified, the creditor did not appear at the creditor's meeting. Between adjudi-

the debt on the note is discharged, only the liability for fraud survives the discharge, and therefore the suit must be on the fraud.⁴⁰ Although the action must sound in tort to avoid the discharge,⁴¹ the cases seem to indicate that the complaint may set forth the note without mention of the tort claim.⁴² Seeing a suit on the note which he deems discharged by virtue of the decree puts the bankrupt off guard, and often will result

cation and discharge, creditor commenced action on the note in city court, alleging that the bankrupt made a false financial statement to induce the loan. A default judgment was rendered and attachment of wages followed. At this point, on petition of bankrupt who had by now been discharged, the court enjoined the creditor on above mentioned grounds. Note that in this case it would be impossible for the court to determine whether the judgment was for a debt on the note or the false pretenses, and it would be presumably on the former. This might be an entirely different situation than the one where the fraud is merged in the judgment or it is clear from the allegations that the suit and judgment were on the fraud. See *Consolidated Plan of Conn. Inc. v. Bonitatibus*, 130 Conn. 199, 33 A.2d 140 (1943), where the judgment sued upon by the plaintiff after discharge was based on a contract, the court held that in plaintiff's attempt to come within § 17a(2) after formerly receiving a contract judgment he could not introduce evidence to show that the cause of action came within 17a(2). However the court indicated that it might look at the pleadings in the original suit where the character of the judgment is not clear from the record. This is different from the situation in *State Loan v. Morrow*, 216 F.2d 676 (10th Cir. 1954), where the circuit court of appeals granted an injunction to enjoin enforcement of a state court judgment. There the cause was filed in the justice of the peace court after discharge of the bankrupt, the bankrupt not appearing to plead discharge. Suit was on the promissory note scheduled in the proceedings, however counsel for the loan company asserted that the suit in the state court was based on the liability for obtaining money by false pretenses with a false financial statement, and therefore not discharged. The circuit court took the position, however, that since this was a justice of the peace court where issues are loosely cast, they would be unable to determine whether the judgment is on the debt (note) or on the fraud when judgment issues.

40. *Zimmern v. Blount*, 238 Fed. 740 (5th Cir. 1917); *Ohio Finance v. Greathouse*, 110 N.E.2d 805 (Ohio App. 1947); *Elaine v. Richards*, 296 Ky. 283, 176 S.W.2d 697 (1944); *Gregory v. Williams*, 106 Kan. 819, 189 Pac. 932 (1920); *Personal Finance Corp. of Waterbury v. Robinson*, 27 N.Y.S.2d 6 (1941).

41. *Elaine v. Richards*, 296 Ky. 283, 176 S.W.2d 697 (1944); *Spier v. Westmoreland*, 149 S.E. 423 (Ga. App. 1929).

42. In *Ohio Finance v. Greathouse*, 110 N.E.2d 805, 807 (Ohio App. 1947), the court said, ". . . plaintiff in the municipal court was not required to anticipate that defendant would assert defense of discharge of a non-dischargeable debt. Having asserted such discharge, plaintiff need only deny the same in its reply, which it did and alleged the reasons for such denial. Defendant cannot decide for plaintiff the nature of the cause of action. Nor can defendant change plaintiff's cause of action by alleging matters of defense thereto." See *Gregory v. Williams*, 106 Kan. 819, 189 Pac. 932 (1920) and *Personal Finance Corp. of Waterbury v. Robinson*, 27 N.Y.S.2d 6 (1941). It has been held that the plaintiff in a suit on a promissory note under § 17a(2) cannot allege the debt on the note, and then assert bankrupt's discharge alleging that the debt was a liability for obtaining money under false pretenses and therefore the debt was exempt from the decree. In *Personal Finance Co. v. Schwartz*, 170 S.W.2d 701 (Mo. App. 1943), it was held in such circumstances that by anticipating the defense of discharge in bankruptcy in an action on contract, plaintiff pleaded a bar to his own action on the ground that there couldn't be an allegation of fraud and contract in the same petition. *Contra*, *Personal Finance Co. v. Lillie*, 129 Conn. 290, 27 A.2d 794 (1942). This rule of pleading probably is avoided in those states using federal rules or other forms of liberal pleading. Also see *Spier v. Westmoreland*, 149 S.E. 423 (Ga. App. 1929).

in the bankrupt disregarding the suit. The debtor must allege his discharge in bankruptcy, which is an affirmative defense, and if it is not pleaded it is waived.⁴³ If the discharge is pleaded the creditor may then reply asserting those facts which sustain the cause of action for the fraud.⁴⁴

An analysis of the elements of the fraud must be made in terms of the burden of proof or burden of persuasion. This burden is shifted several times during the trial. The important elements from this standpoint are that the statement was materially false, that the bankrupt intended to deceive, and that the creditor relied on the statement in granting the loan.⁴⁵ The presumption is that the bankrupt is discharged from all of his debts;⁴⁶ therefore the generalization may be made that a creditor contending that the debt is excepted from the operation of the discharge by virtue of the false representation has the burden of proof.⁴⁷ However, the plaintiff may enter in proof the financial statement given to him by the bankrupt. This coupled with the list of indebtedness filed with the bankruptcy court forms a prima facie case of fraud.⁴⁸ When a prima facie case is established from the facts the intent to deceive is presumed, and the burden of removing the presumption is on the bank-

43. Helms v. Holmes, 129 F.2d 263 (4th Cir. 1942); Beneficial Loan Co. v. Noble, 129 F.2d 425 (4th Cir. 1942).

44. See cases cited *supra* notes 41 and 42.

45. To recover by alleging this fraud the plaintiff must plead either in his complaint or in his reply: (1) materially false financial statement made by the bankrupt (2) that at the time the loan was given the plaintiff did not know that the statement was false (3) that at the time the statement was made the bankrupt did know that the statement was false (4) that the bankrupt made the statement with the intent to deceive the creditor (5) that the plaintiff relied on the statement (6) to his injury. In Watts v. John J. Ward, 7 Mass. App. 303, 327 (1942) the court stated that "every element of fraud is required"; also see Wheeler & Motter Mercantile Co. v. Green, 97 Okla. 96, 222 Pac. 965 (1924) where the court required that all facts must be proved with reasonable degree of certainty. Failure to prove any one is fatal. Zimmern v. Blount, 238 Fed. 240 (5th Cir. 1917); *In re* Lundberg, 272 Fed. 107 (7th Cir. 1920); Morris Plan Bank of Richmond, Virginia v. Henderson, 57 F.2d 326 (M.D. N.C. 1932). Note that the latter three cases were under § 14c(3), but that the elements of the tort are the same.

46. Frangos v. Frangos, 157 Pa. Super. 87, 41 A.2d 416 (1945).

47. *In re* Noble, 42 F.Supp. 684 (D.C. Colo. 1941), reversed on other grounds, 129 F.2d 425 (10th Cir. 1942).

48. With the prima facie case, the plaintiff must show more. "It is not sufficient to show that the statement is incorrect in fact, it must be materially false." Morris Plan Bank of Richmond, Virginia v. Henderson, 57 F.2d 326, 327 (M.D. N.C. 1932). In that case it was held that the statement was not materially false because the creditor did not request the bankrupt to list his unsecured debts. When a debtor asserts that his list of indebtedness is approximate, "the information which is represented to be approximately correct . . . the variance between such information and the actual fact must be relatively slight if such information is to be regarded as an approximation." Rustuen v. Apro, 40 Wash. 395, 243 P.2d 479, 482 (1952).

rupt.⁴⁹ In those instances where the false financial statement is, in effect, induced by the creditor, the bankrupt will be hard pressed to prove what transpired in the interview and counteract the allegations of intent to deceive and reliance on the false financial statement.⁵⁰ Although the courts in many cases have looked with a jaundiced eye on the plaintiff's plea of reliance,⁵¹ in those cases where there have been no prior dealings between the parties the prima facie case carries much weight for the reliance plea.⁵²

The bankrupt is at a decided disadvantage when suit is brought in the state court because of the prima facie case built up against him, even when he answers and asserts his discharge as an affirmative defense. Matters are much worse when the bankrupt, laboring under the misapprehension that his discharge is a bar without pleading it, ignores the state court proceeding. A default judgment is rendered⁵³ which becomes

49. *Morris Finance & Loan Co. v. Dickerson*, 57 So.2d 786 (La. App. 1952); *Personal Finance Co. of Providence v. Nichols*, 71 R.I. 213, 43 A.2d 315 (1945); *Watts v. Ward*, 7 Mass. App. 303 (1942); *Underwood v. Ajax Rubber Co., Inc.*, 296 S.W. 964 (Tex. Civ. App. 1927); *In re Perlmutter*, 256 Fed. 862 (D. N.J. 1919). This latter case was decided under § 14c(3), at that time 14(b). In the *Watts* case, *supra* at 306, the court said, ". . . the plaintiffs have shown a state of facts which creates a presumption which the defendant must rebut if he is to prevail. . . . 'The bankrupt's mere statement that he had no intent to deceive or defraud is insufficient to overcome the presumption.'"

50. In the *Morris Finance* case, *supra* note 49, plaintiff contended that he went out of the room while the bankrupt made out the statement. Bankrupt claims that the plaintiff knew of additional obligations then owed by the bankrupt, but he further contended that the loan company official said that it was unnecessary to list them, and that the loan was rendered on the basis of previous experience with the applicant. Reversing the trial court, which held for the bankrupt, the court said it could not understand why any loan company would want to have the debtor list only a portion of his debts. Bankrupt failed in his burden of proof regarding lack of intent and lack of reliance by the creditor in the statement. A similar result was reached in *Personal Finance Co. of Providence v. Nichols*, *supra* note 49, where the bankrupt testified that he told the loan company manager of all his indebtedness, and the manager in effect told him that he did not need to list all of his obligations, for it was a mere formality.

51. See *Household Finance Corp. v. Grosco*, 230 F.2d 608 (6th Cir. 1956) (a case under 14c(3)); *Helms v. Holmes*, 129 F.2d 263, 268-73 (4th Cir. 1942) (dissenting opinion); *Matter of Forgy*, 140 F.Supp. 473 (D. Utah 1956) (a case under 14c(3)); *In re de Gopper*, 138 F. Supp. 928 (W.D. Mich. 1956) (a case under 14c(3)); *In re Anderson*, 104 F.Supp. 599 (E.D. Wis. 1952) (a case under 14c(3)); *In re Noble*, 42 F.Supp. 684 (D.C. Colo. 1941), reversed on other grounds, 129 F.2d 425 (4th Cir. 1942); *Commonwealth Loan Company v. Coleman*, Municipal Ct. of Barbeton, Ohio, 133 N.E.2d 677 (1955); *Underwood v. Ajax Rubber Co., Inc.*, 296 S.W. 964 (Tex. Civ. App. 1927). Even though the lending institution claims reliance on the financial statement many times these organizations have their own system of checking the authenticity of the statement and do not use the debtor's application as a basis on which to judge the reliability of the applicant or the soundness of financial condition. In the "home improvement" business (siding, storm windows, etc.) the product for sale is not only the home improvement, but money as well. These people will often use a financial statement to see how much the purchaser can conceivably afford and then charge him accordingly.

52. This may be drawn by inference from those cases cited in note 51 *infra*.

53. See note 80 *infra*.

res judicata in both the state and federal courts.⁵⁴

The protection offered by the federal courts is in the form of an injunction against the creditor pursuing a course in the state court. The efficacy of the remedy proffered must be measured in terms of the circumstances under which the remedy is exercised. This protection is negligible. Two sections of the act⁵⁵ vest in the federal courts the power to enjoin the creditor from proceeding in the state court. Section 11a⁵⁶ gives the federal court the power to enjoin a suit against the bankrupt pending in the state forum prior to the filing of the petition in the bankruptcy court until there is an adjudication or dismissal of the petition. The purpose of this section is to protect the bankrupt from being harassed in both the state court and the bankruptcy court at the same time. If the debtor is adjudged a bankrupt the court at its discretion may stay the proceedings in the state court until there has been a determination of the question of the bankrupt's right to a discharge. The dischargeability of the debt under § 17a is made the basis of jurisdiction under § 11a.⁵⁷ A stay will be denied if the debt is exempt from the operation of discharge. The burden of proof rests with the party opposing the stay to show that the claim is within § 17a and not discharged.⁵⁸ The jurisdiction of the court under this section terminates with the discharge hearing, and the stay will thereafter be dissolved.⁵⁹ The determination at this stage of the proceedings that a claim is discharged in bankruptcy has no effect if, after the discharge is granted, the creditor subsequently sues in the state court.⁶⁰

However, another fountainhead of authority exists for the federal

54. See note 79 *infra*.

55. Bankruptcy Act § 2a(15), and § 11a.

56. Bankruptcy Act § 11. "Suits By and Against Bankrupts. a. A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition by or against him, shall be stayed until an adjudication or the dismissal of the petition; if such person is adjudged a bankrupt, such action may be further stayed until the question of his discharge is determined by the court after a hearing, or by the bankrupt's filing a waiver of, or having lost, his right to discharge. . . ." *Ibid*.

57. Unless the debt or claim involved would be discharged under the Act, no stay should be granted. COLLIER, *op. cit. supra* note 10, ¶ 11.04 n. 1. Under § 11a the court is required to pass on the dischargeability of a particular claim. If the suit in the state court has not reached a judgment, the court may look to the pleadings in that suit. If the suit is on a judgment the court may look to the nature of the judgment in an effort to determine the facts and nature of the cause of action upon which judgment is based. COLLIER, *supra* at p. 1147.

58. COLLIER, *op. cit. supra*, note 10, ¶ 11.04 n. 3.

59. COLLIER, *op. cit. supra* note 10, ¶ 11.07 and n. 7.

60. The dischargeability of the claim is conclusive upon the parties until discharge is granted or denied. Thereafter the finding is not binding in a subsequent suit in the state court. COLLIER, *op. cit. supra* note 10, ¶ 11.04.

court whereby relief might be granted to the bankrupt. Section 2a(15)⁶¹ is a blank check to the court to make orders and enter judgments that may be necessary for the enforcement of the act. However, prior to 1934 the Supreme Court had ruled that the bankruptcy court, having determined the bankrupt's right to discharge, had no residuary power to determine the effect of the discharge upon a claim pursued after discharge.⁶² In 1934, in the famous *Local Loan v. Hunt*⁶³ case, the Supreme Court declared that the bankruptcy court did have ancillary jurisdiction in equity to permanently enjoin a creditor's suit in a state court and thereby determine the effect of its own discharge decree.⁶⁴ Section 2a(15) has been used as a source of power for the courts when they care to exercise their ancillary jurisdiction under *Local Loan v. Hunt*.⁶⁵ Prior

61. Bankruptcy Act § 2a(15). This section gives the bankruptcy court power to "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. . . ."

62. Glenn contends that the effect of discharge could only be determined in the court where the suit upon the claim was brought. He said further that this determination could not be made in any collateral proceeding. Glenn, *Effect of Discharge in Bankruptcy: Ancillary Jurisdiction of Federal Courts*, 30 VA. L. REV. 531, 532 (1944). *Contra*, Smedley, *op. cit. supra* note 30, at 654 n. 17 & 18.

63. 292 U.S. 234 (1934).

64. In 1930, Hunt borrowed \$300 from Local Loan, and as security executed an assignment of wages. In 1931, Hunt filed a voluntary petition in bankruptcy in the Illinois federal court, and included in his schedule the debt owed Local Loan. He was adjudicated a bankrupt and subsequently discharged, on October 10, 1932. On October 18, 1932, the creditor sued in the Municipal Court of Chicago to enforce the assignment of wages earned after adjudication. Hunt petitioned for an injunction to the court that granted the discharge. A permanent injunction was granted and affirmed in the Supreme Court. The court reasoned that the federal courts of equity have jurisdiction to entertain a petition ancillary to a proceeding in the same court "to secure or preserve the fruits and advantages of a judgment or decree rendered therein"; that the bankruptcy courts are courts of equity; and therefore a bankruptcy court may so entertain a petition to protect its decree or order of discharge. The court pointed out that the petitioner had a legal remedy in the state courts when the creditor attempted to enforce the wage assignment in an action against the employer, but the court pointed out further that it would necessitate a long and expensive course of litigation through ultimate courts of appeal. Furthermore the Illinois Supreme Court had already held that the assignment of future wages constituted an enforceable lien, in counterposition to the lower federal court position now adopted by the United States Supreme Court that adjudication and discharge in bankruptcy nullify the effect of the lien created by an assignment of wages as security for a loan. These factors together induced the exercise of the announced jurisdiction to enjoin the state court proceedings.

65. "While such power is probably inherent in the bankruptcy court as a court of equity, clause (15) gives it express legislative sanction." COLLIER, *op. cit. supra* note 10, ¶ 2.61. Note that some writers think there is a mistake in using this section as a source of power in the cases coming within the *Local Loan v. Hunt* doctrine. See Reich, *Injunctive Relief under the Bankruptcy Act*, 19 BROOKLYN L. REV. 222, 223 (1953). Preceding *Local Loan v. Hunt*, *supra*, an almost identical case arose in the 4th Circuit, the often cited *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1931). Petitioner was an employee of a railroad. He borrowed \$50 from Seaboard Loan, giving as security a deed of trust on some personalty and he also executed an assignment of 10 per cent of his wages over a 40 month period. A clause of the assignment contract

to considering the substantive law involved the Supreme Court first had to justify the assumption of jurisdiction by the lower court in the case. It did so by asserting that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity."⁶⁶ However, the court said that whether the lower courts should exercise that power was within the discretion of the court and admonished that it should be exercised only under "unusual circumstances."⁶⁷ The writers are divided as to how far this jurisdiction should extend. Glenn was very adamant in his opposition to the ancillary jurisdiction of the court through a supplemental bill in equity. To Glenn the concept of this equity

provided that no copy of the assignment would be served upon the railway company as long as payments were met. After 4 monthly payments were met, petitioner still owing a balance of \$30, Ottinger went into voluntary bankruptcy. Thereafter the loan company filed a copy of the assignment with the railroad company and demanded that 10 per cent of the wages due petitioner be retained. Petitioner then moved in the federal court to enjoin the enforcement of the assignment. The loan company challenged the jurisdiction of the court and asserted its lien notwithstanding the adjudication and discharge that might be granted. Before the injunction was granted petitioner was discharged in proceedings under the act. The court held the assignment ineffective after discharge, and stated that the lower court did have and should exercise the jurisdiction to enjoin proceedings in a state court when ever the remedy there afforded is inadequate in an equitable sense to the wage earner, involving trouble, embarrassment, excessive expense, and possible loss of employment.

"In view of this purpose of the act and of the express provision that the bankrupt shall be released from all provable debts, it would be indeed a strange situation if the court vested with jurisdiction to enforce the act were without power to stay the hand of a creditor whose debt has been discharged by bankruptcy, but who nevertheless persists in harassing the bankrupt with efforts to collect it. It will not do to say that the bankrupt has an adequate remedy at law by pleading the discharge in case of suit, or by suing an employer if the latter withholds wages under an order such as that here. Such remedy is not adequate because its assertion involves trouble, embarrassment, expense, and possible loss of employment. A laboring man who had availed himself of the benefits of the act would in many cases prefer to pay a debt discharged by bankruptcy rather than hazard his employment by bringing suit for wages withheld under notice like that with which we are dealing. And an employer in many cases would prefer to discharge an employee against whom a claim has been filed rather than engage in litigation with the claimant. The demand under an assignment order, in an effort to collect a debt discharge by bankruptcy, is nothing less than an attempt to circumvent the order discharging same and to deprive the bankrupt of the benefit of that order. It was to meet situations such as this that the bankruptcy court was vested with the general power under section 2 subsection 15, of the Bankruptcy Act to "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 title." *Id.* at 859.

Seaboard Loan was followed by *Sims v. Jamison*, 67 F.2d 409 (9th Cir. 1933), a case involving a question of the validity of a mortgage on crops in futuro, in the face of discharge. Exercising its jurisdiction, the court pointed out that the bankruptcy court could exercise or refuse to exercise its jurisdiction according to the exigencies of the case. Thereafter came the development of the straight-jacket of the *Local Loan*, "unusual circumstances."

66. 292 U.S. at 240. The correct procedure for the bankrupt to follow in order to invoke the court's equity jurisdiction is through a supplemental bill in equity praying for the exercise of the ancillary jurisdiction of the court. *Id.* at 240.

67. 292 U.S. at 241, "It does not follow, however, that the court was bound to exercise its authority. And it probably would and should not have done so except under unusual circumstances."

jurisdiction is “. . . contrary to the history and theory of bankruptcy jurisdiction. . . .”⁶⁸ It is generally conceded, however, that although the jurisdiction to determine the effect of a discharge in “unusual circumstances” is recognized by the lower federal courts, it is rare indeed when the power is exercised,⁶⁹ because “unusual circumstances” has become the “straight-jacket” of *Local Loan*.

As time went on, although more vehemently affirming their possession of the power to enjoin or declare the effect of discharge, the federal courts became extremely conservative in the actual employment of the authority.⁷⁰ The “unusual circumstances” prompting such exercise have never been clarified by the courts, but seem to synthesize into the generalization that the power will be asserted when there might be extreme embarrassment to the parties,⁷¹ inadequate remedy in the state forum, or where there would be a conflict in interpretation of state law with bankruptcy law. Yet it should be noted that even when these circumstances do exist a federal court generally will not exercise its authority.⁷²

When the creditor petitions the court to declare the effect of the discharge on the debt, the cases indicate overwhelmingly that the petition will be denied, but in a very few cases jurisdiction is exercised. The usual fact situation eliciting assertion of jurisdiction is one where the creditor is suing on a prior judgment in which the nature of the judgment or the record clearly falls within the exceptions of § 17a(2).⁷³ In deny-

68. Glenn, *op. cit. supra* note 62, at 537 n. 26.

69. The ancillary jurisdiction envisioned by *Local Loan v. Hunt* and subsequent cases has been strictly limited to the situation where insufficient remedy exists in order to invoke equitable relief. It is contended that this jurisdiction does not extend to a general jurisdiction in the bankruptcy court to determine the dischargeability of claims or the injunction of proceedings in state courts regardless of the bankrupt's remedy. COLLIER, *op. cit. supra* note 10 ¶ 2.62 at p. 291. Also see Glenn, *op. cit. supra* note 62; Smedley, *op. cit. supra* note 30; Ogelbay, *Some Developments in Bankruptcy Law Regarding Summary Jurisdiction and the Determination of the Effect of Discharge*, 21 REF. J. 18, 24 (1946); Twinem, *Discharge—What Court Determines the Effect Thereof*, 21 REF. J. 33, 34 (1946).

70. Ogelbay, *op. cit. supra* note 69; Twinem, *op. cit. supra* note 69; Glenn, *op. cit. supra* note 62.

71. The circumstances considered to be sufficiently embarrassing to warrant an injunction of the state court proceedings are those similar to the fact situation in *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1931), discussed in note 65 *supra*. It is to be noted that the terminology “extreme embarrassment” is an intangible standard which is hard to evaluate.

72. The only way to discern which fact situation will stimulate the court to act is through a case by case analysis. In many instances the same general problem that the court deems adequate to warrant use of the injunctive power in one situation will be deemed inadequate on similar facts in another case. For an excellent discussion and analysis by case method, see Smedley, *op. cit. supra* note 62 at 655-69. Also see 141 A.L.R. 1380 (1942).

73. *In re Tamburo*, 82 F.Supp. 995 (D.Md. 1949); *In re Ellman*, 48 F.Supp. 518 (W.D. N.Y. 1942); *In re Zitzmann*, 46 F.Supp. 315 (E.D. N.Y. 1942); *In re Kubinec*, 2 F.Supp. 632 (W.D. N.Y. 1932). It is to be noted that all these cases were for causes of action other than one for obtaining money on false pretenses or false representations.

ing jurisdiction for the benefit of the creditor, the court will usually recognize first that it has jurisdiction but that its exercise is purely discretionary with the court;⁷⁴ that no special circumstances warrant use of the jurisdiction;⁷⁵ that exercise of the power will delay proceedings;⁷⁶ that it will be detrimental to the bankrupt because it would deprive him of a jury trial;⁷⁷ and most important that the creditor's remedy in the state court is adequate.⁷⁸

When denying the bankrupt's prayer for exercise of jurisdiction to determine the effect of a discharge, within their discretion, the federal courts have denied the existence of "unusual circumstances" on the grounds that the judgment already entered in the state courts is *res judicata*.⁷⁹ This course will be followed regardless of under what circumstances judgment was obtained, including default, even where the bankrupt received erroneous advice as to the necessity of answering suit in the state court after discharge,⁸⁰ and where the state court made an

74. *Ciaverilla v. Salituri*, 153 F.2d 343 (2d Cir. 1946); *In re Briscoe*, 45 F.Supp. 422 (D. Mass. 1942); *In re Anthony*, 42 F.Supp. 312 (E.D. Ill. 1941).

75. *Ciaverella v. Salituri*, *supra* note 74; *In re Barber*, 140 F.2d 727 (3rd Cir. 1944); *In re Hadden*, 142 F.2d 897 (6th Cir. 1944); *In re Marshall*, 24 F.Supp. 1012 (S.D. N.Y. 1938).

76. *Watts v. Elliathorpe*, 135 F.2d 1 (1st Cir. 1944); *In re Barber*, *supra* note 75; *In re Hadden*, *supra* note 75; *In re Briscoe*, 45 F. Supp. 422 (D. Mass. 1942).

77. *Watts v. Elliathorpe*, *supra* note 76; *In re Briscoe*, *supra* note 76; *In re Anthony*, 42 F.Supp. 312 (E.D. Ill. 1941).

78. *Watts v. Elliathorpe*, *supra* note 76; *In re Hadden*, 142 F.2d 897 (6th Cir. 1944); *In re Lowe*, 36 F.Supp. 772 (W.D. Ky. 1941).

79. *Cstari v. General Finance Corp.*, 173 F.2d 798 (6th Cir. 1949); *Walters v. Wilson*, 142 F.2d 59 (9th Cir. 1944); *Beneficial Loan Co. v. Noble*, 129 F.2d 425 (10th Cir. 1942); *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942); *In re Deveraux*, 76 F.2d 522 (2d Cir. 1935); *Otte v. Cooks, Inc.*, 113 F.Supp. 861 (D. Minn. 1953); *In re Kornblum*, 22 F.Supp. 245 (D. Minn. 1938). *Contra*, *State Finance Co. v. Morrow*, 216 F.2d 676 (10th Cir. 1954), which might indicate a reversing trend. There judgment was rendered in the state justice of the peace court and subsequently the federal court exercised its injunctive power regardless of the prior state court proceeding. The ground given for exercising its authority was that it was not recognizable from the judgment in the state court whether it was on the prior loan or whether it was a liability incurred for obtaining money under false representations. However, the stronger rationale for the decision is contained in these passages: "The question whether that debt now asserted in the state court was discharged by the decree is drawn in issue and it is to be determined by the federal court on equitable principles fashioned in the image of the needs of the occasion." *Id.* at 680. "But it is important to bear in mind that the remedy afforded to the bankrupt by federal law is not merely a legal remedy in the form of burdensome litigation with successive appeals to reach a court of record. It is a remedy adequate to meet the full requirements of justice—a remedy which comports with the spirit and purpose of the bankruptcy act to secure to the bankrupt the full and complete benefits of discharge." *Ibid.* ". . . for all practical purposes the bankrupt was defenseless. It is these practical considerations which prompt bankruptcy courts to exercise their equitable protective powers. Indeed, it is these considerations which impose upon them the inescapable duty to vouchsafe the integrity of their decrees." *Ibid.*

80. *Beneficial Loan Co. v. Noble*, 129 F.2d 425 (10th Cir. 1942). In *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942), the bankrupt neglected to answer the suit in the state court, explaining that he thought the discharge in bankruptcy was an automatic

erroneous decision of a matter of law.⁸¹ The court will further deny jurisdiction on the grounds that the remedy in the state court of either answer, using the discharge decree as a defense, or appeal, is adequate,⁸² disregarding the fact that the insolvent is already without funds⁸³ and is seriously handicapped in attempting to make an appeal or an answer.

In the face of sharp practices of creditors and the bankrupt's general attitude regarding the efficacy of the discharge decree, the view of the courts toward exercise of jurisdiction seems highly inequitable and short-sighted, and the negligible remedy offered to the bankrupt is all but valueless.

Once it is recognized that the lower federal courts have severely limited their own jurisdiction under the *Local Loan v. Hunt* doctrine, and thus practically eliminated that protection which is offered the bankrupt; and once the worrisome problem of the conniving creditor taking advantage of the weakened position of the debtor is appreciated, it is submitted that remedial steps should be taken. Glenn⁸⁴ and others⁸⁵ have called for

defense to any subsequent action brought against him by a creditor on a claim which came within the discharge proceedings, i.e. one of the scheduled debts. The court denied the bankrupt's petition, and the state court proceeding was held *res judicata*. The conception of the efficacy of the discharge decree in the Noble case is not unusual nor unwarranted. This difficulty arises from the language used in the discharge decree. See Form No. 45, Official Bankruptcy Forms.

81. *In re Devereaux*, 76 F.2d 522 (2nd Cir. 1935); *In re Epstein*, 48 F.Supp. 436 (S.D. N.Y. 1942).

82. *Gathany v. Bishopp*, 177 F.2d 567 (4th Cir. 1949); *Otte v. Cooks, Inc.*, 113 F.Supp. 861 (D. Minn. 1953); *In re Grover*, 63 F.Supp. 644 (D. Minn. 1945); *In re Harris*, 28 F.Supp. 487 (E.D. Ill. 1939); *In re Cox*, 33 F.Supp. 796 (W.D. Ky. 1939); *In re Stoller*, 25 F.Supp. 226 (S.D. N.Y. 1938). In some states, e. g. California, CAL. CODE CIV. PROC. § 675b (Deering 1953), and Minnesota, MINN. STAT. ANN. § 548.18 (1947), a statute exists as part of the debtor-creditor law that allows the discharge of a judgment rendered on petition one year subsequent to adjudication. In *In re Grover*, *supra*, a petition by bankrupt to the jurisdiction of the federal court was denied on the ground that there was an adequate remedy in the state court. One reason for the court's denial of jurisdiction was that one year had elapsed between adjudication and the petition to the court, and therefore the bankrupt could have the debt discharged. The decision of the court is questionable where immediately subsequent to adjudication the creditor sues on the prior judgment and the bankrupt cannot avail himself of the state statutory discharge. In the face of the current decisions the bankrupt is helpless. Note, however, that this state remedy is good, but not if the alert creditor proceeds with the judgment to collect the indebtedness before the statute applies, or if the state court would be unwilling to enjoin creditor until the year had lapsed.

83. Note, however, that in *In re Connors*, 93 F.Supp. 149 (N.D. Ind. 1950) an injunction was granted on the grounds of the practical inadequacy of bankrupt's remedy at law because of costs of appeal. In those cases where an injunction has been granted the cost factor is weighed, but it is conceivable that it should be a factor more widely recognized when a petition for injunction is considered. Denying jurisdiction on the grounds that an adequate remedy exists in the state court does not reflect a realistic view of the economics of bankruptcy. Also see *In the Matter of Zilliox*, a decision written by Referee Brink appearing in 28 REF. J. 92 (1954).

84. Glenn, *op. cit. supra* note 62, at 538. Glenn further asserts that the wage-earner debtor needs protection because he is most likely to be persecuted.

85. Twinem, *op. cit. supra* note 69.

the Supreme Court either to accept or deny the limitations chiseled out by the lower courts. The proper place to determine the effect of the discharge decree is in the bankruptcy proceedings.⁸⁶ The contention is that if the bankrupt is legally deserving of a discharge he ought to be set forth with a complete and final release against his discharged creditors. Additionally, the bankruptcy court is not doing its full job if it turns the bankrupt out of court with a naked discharge in his hand, expecting him to defend himself in all forums and against all who would sue him there.⁸⁷ Either Congress must act, or the Supreme Court must review the cases since *Local Loan*, and reappraise the application of jurisdiction of the courts in these cases.

To some extent, Congressional leaders⁸⁸ have recognized these problems and several amendments have been introduced within the past year.⁸⁹

86. Smedley, *op. cit. supra* note 30, at 668-69. It is peculiar that a decree of discharge must be taken to a state court to be interpreted. Twinem, *op. cit. supra* note 69, at 33. Referee Coleman contends that having the discharge decree interpreted in the state court equates the referee to a machine. His contention is that the referee lives with the case, and thereby becomes familiar with the bankrupt's business and financial matters and more competent to determine the effect of the discharge. Further, he asserts, by giving the referee this authority there would be an end to litigation. In addition Referee Coleman points to the fact that in many cases the attorneys do not follow up the cases in the state court, and as a result there is hardship to the bankrupt. Coleman, *A Plea for "One Stop Service" in Bankruptcy* 25 REF. J. 31 (1951).

87. In the Matter of Zilliox, appearing 28 REF. J. 92 (1954).

88. Particularly the late Senator Kilgore, and currently Representative Emanuel Celler.

89. House Bill 9866, introduced by Representative Winfield K. Denton on March 12, 1956, subsequently died in committee.

A BILL

To amend the Bankruptcy Act to provide that a discharge in bankruptcy will release a bankrupt from liability from certain debts if the creditor fails to object to such discharge.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That clause (2) or section 17 of the Bankruptcy Act (11 U.S.C. sec. 35) is amended by inserting immediately after "or false representations," the following: "unless the creditor with notice or actual knowledge of the bankruptcy proceeding in which the discharge was granted failed to object to such discharge."

House Bill 11543, introduced by Representative Emanuel Celler on May 31, 1956, subsequently died after reference to the House Judiciary Committee. This bill has been reintroduced in the 85th Congress as House Bill 106.

A BILL

To amend the Bankruptcy Act to authorize courts of bankruptcy to determine the dischargeability or nondischargeability of provable debts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That subsection (a) of section 2 of the Bankruptcy Act, as amended (11 U.S.C. 11 (a)), is amended by adding at the end thereof the following:

"(22) Determine the dischargeability or nondischargeability of all provable debts. If a case is reopened solely for the purpose of determining such dischargeability or nondischargeability, no additional filing fees shall be collected."

House Bill 9866, introduced by Representative Denton, would have provided that a discharge in bankruptcy will release a bankrupt from liability for certain debts if the creditor fails to object to such discharge. The Denton proposal has been criticized on the grounds that it is too broad.⁹⁰ Some criticism has been leveled at the proposal because of the burden placed on the creditor and because legislation of this type complicates the administration of the act.⁹¹ A more valid criticism is that it places more emphasis on the evils inherent in § 14c(3), and would therefore serve

Sec. 2. That subsection a of section 11 of the Bankruptcy Act, as amended (11 U.S.C. 29a) is amended to read as follows:

"a. A suit which is founded upon a claim from which a discharge would be or is claimed to be a release, and which is pending against a person at the time of the filing of a petition by or against him, shall be stayed until an adjudication or the dismissal of the petition; if such person is adjudged bankrupt, such action may be further stayed until the question of his discharge and the question of the dischargeability or nondischargeability of the claim are determined by the court after a hearing, or by the bankrupt's filing a waiver of, or having lost, his right to a discharge, or, in the case of a corporation, by its failure to file an application for a discharge within the time prescribed under this Act: Provided, however, That such stay shall be vacated by the court if, in a proceeding under this Act commenced within six years prior to the date of the filing of the petition in bankruptcy, such person has been granted a discharge, or has had a composition confirmed, or has had arrangement by way of composition confirmed, or has had a wage earner's plan by way of composition confirmed."

Sec. 3. Subsection (c) of section 14 (11 U.S.C. 32c) of the Bankruptcy Act, as amended, is amended by striking the word "or" preceding the figure 3 in parentheses and by striking all of clause (3). The succeeding clauses of subsection (c) are renumbered as follows: Clause (4) is renumbered clause (3), clause (5) is renumbered clause (4), clause (6) is renumbered clause (5), and clause (7) is renumbered clause (6).

90. "It is believed that this bill is intended to strike at small loan companies that have indulged in the practice of seeking to enforce their claims against the bankrupt after he has procured a discharge, claiming the issuance of a false financial statement. While there is agitation for some relief to be afforded against the practices of the small loan companies in encouraging the issuance of financial statements that do not fully set forth all the liabilities of the applicant and then seeking to enforce their claims against the bankrupt after his discharge on the ground that the bankrupt obtained loans or property by false pretenses, the proposed legislation is regarded as too broad particularly where the false pretenses bear no relation to, and are not founded upon, the issuance of the false financial statement. Your committee disapproves the bill." REPORT OF THE COMMITTEE ON BANKRUPTCY OF THE AMERICAN BAR ASSOCIATION, June 1, 1956.

91. "That a burden should not be placed upon an individual creditor to object to the discharge of the bankrupt, on a nondischargeable debt." "There is little practical purpose to be achieved by passage of this enactment and that such legislation would tend to complicate the administration of the Bankruptcy Act." "There is no reason why a creditor of the type referred to in House Bill 9866 should be compelled to file objections to a bankrupt's discharge in order to maintain the nondischargeability of his claim." Comments from correspondence received by the American Bar Association in reply to an inquiry concerning various proposed amendments to the Bankruptcy Act. The correspondence was obtained from former Referee John K. Rickles on October 10, 1956.

no real purpose.⁹²

House Bill 11543, introduced by Representative Celler, would delete § 14c(3)⁹³ from the act and give the court jurisdiction in every instance to determine the dischargeability or nondischargeability of all provable debts.⁹⁴ The Celler proposal has elicited both unfavorable⁹⁵ and favorable⁹⁶ comment. Disapprobation has taken the following approach. The jurisdiction granted the courts by the amendment is not limited to debts claimed to be incurred by reason of a false financial statement, but to all classes of liabilities in § 17a, including alimony, wilful and malicious injuries, etc., beyond the scope of the particular problem.⁹⁷ It would cause great inconvenience to the creditor when forced to plead in a federal court possibly on the other side of the country. There would be added expense and trouble to the creditor, who, having only the effect of discharge determined, must still sue on the liability in the state court. It would greatly increase the burden on the already overloaded calendars of the federal courts.⁹⁸ It would deprive the parties of a right to a trial by jury. Finally, opponents urge that adequate protection exists under the law in state courts for both debtor and creditor. Although the criticism is not totally without merit, it is not enough to warrant disregard of a needed change if the advantages eclipse the disadvantages inherent in

92. By requiring the creditor to object to discharge the implied threat to use the objection and block discharge will gain prominence, with the creditor attempting to extract a new promise to pay. See discussion note 19 *supra*. The new promise to pay is outside the operation of the Act; see *In re Harris*, 28 F. Supp. 487 (E.D. Ill. 1939). By forcing a creditor to object to discharge, emphasis is placed on the inequity present where all debts are denied discharge. It is to be remembered that it is not all classes of creditors who were to be allowed use of § 14 at its original enactment. See note 26 *supra*.

93. Section 3, *op. cit. supra* note 89.

94. Section 1, *op. cit. supra* note 89.

95. Letter from Referee Carl Friebolin to the *Indiana Law Journal*, October 23, 1956.

96. Lynch, *Congressman Celler's Proposed Amendment to the Bankruptcy Act*, 10 PERSONAL FINANCE LAW QUARTERLY REPORT 121 (1956). This article fully discusses criticisms made of the Celler proposal.

97. "That means that if the creditor (a divorced wife) has a provable debt for what she claims is 'alimony' or for 'maintenance or support of herself or children' she could, in the Bankruptcy Court try out that domestic relations problem." "It would mean that a creditor with a provable debt by a suit pending for damages for negligence in which he also alleges that it was wilful and malicious, he could try out that law suit which would—with or without a jury—require days of trial. . . ." Letter from Referee Friebolin, *op. cit. supra* note 95. Those debts made exempt from the operation of discharge by § 17a(2) besides the liability for obtaining money or property by false pretenses include, *inter alia*, liability for alimony, support, and seduction. Other exceptions to the operation of discharge under § 17 include taxes and wages owed employees.

98. Lynch, *op. cit. supra* note 96 at 124. Conversation with former Referee John K. Rickles of Indianapolis concerning possible objections to the Celler proposal on October 10, 1956. The writer is indebted to Mr. Rickles for his timely help and consideration in the preparation of this note.

the proposal. The first three criticisms are technicalities,⁹⁹ and the latter three dissolve under close scrutiny.

The following advantages of the Celler amendment must be weighed against these criticisms. Under present law one creditor, by his objection to discharge, may block discharge in toto. By deleting § 14c(3) and adding jurisdiction to determine the dischargeability of a claim, the referee could grant a discharge and declare a particular debt nondischargeable. This would protect the debtor from further harassment, for armed with the discharge decree he is fully protected if he answers a suit in the state court; or he may invoke the injunctive power successfully against the creditor if the latter attempts to circumvent the act and sue in the state forum.¹⁰⁰ Although protection is offered the creditor who claims his loan was induced by fraud, it would work no hardship upon the creditor to whom the bankrupt made no misrepresentations. The bankrupt can no longer be harassed in the state court before tribunals not cognizant of the problems inherent in the relations between bankrupt debtors and their creditors. Issues will be decided by courts familiar with bankruptcy problems, the facts of the particular case, and the problems of this particular debtor. Furthermore, the court will proceed on an already complete record, saving time and effort for creditor and debtor.¹⁰¹ Deciding the issue before the bankruptcy court saves added expense to the bankrupt, who because of his recent insolvency is least able to afford extra litigation and the necessary appeals under present law.¹⁰²

Two criticisms directed toward the Celler proposal should not obstruct the change. The contention that the jurisdiction tendered by the amendment is too broad may be met by diminishing the jurisdiction proffered by the amendment to handle the specific problem which is the source of real difficulty, i.e., obtaining money under false pretenses. This may be done since the other exemptions under § 17 need neither the familiarity of the bankruptcy courts with the financial matters of the debtor in relation to his creditors, nor their familiarity with this particular class of creditors, specifically loan companies. However, it should

99. Lynch, *op. cit. supra* note 96 at 124.

100. The amendment forces the creditor to utilize the procedure of the bankruptcy court. At present many creditors' attorneys are unwilling to enter the bankruptcy forum because of the specialized practice and their unfamiliarity with and fear of the bankruptcy court.

101. Lynch, *op. cit. supra* note 96 at 125.

102. *Ibid.* Furthermore, under the Celler proposal, § 1, the \$45 filing fee for reopening a case to have the dischargeability of a particular debt declared is done away with. This is to meet the exigency where a creditor's claim is not scheduled or has not been viewed in relation to the discharge provision. It is contended that the present \$45 fee has been a deterrent to the bankrupt for asking further relief from the court. Covey, *op. cit. supra* note 3, at 14.

be recognized that a broad basis of jurisdiction over all provable debts most certainly handles the problem of the unscrupulous creditor who would sue after discharge in the hope of collecting on an already discharged debt or one not coming within the exception to discharge. The inconvenience to the creditor inherent in the possibility that he might have to plead in a court many miles from him is not a tenable argument. Particularly in the case of the small loan company or other lending institution, the debtor and the creditor are in the same locale. Armed with the unequivocal decree of the court, suit in the state court will proceed quickly, since the bankrupt has no defense. If the change adequately promotes the objectives in view of the need, condemnation of the amendment because the court calendars are overloaded loses sight of the very purposes of the act. An attempt to discredit adoption of a proposal which places the determination of the effect of discharge in the bankruptcy courts because adequate protection exists under the law in state courts does not reflect cogent analysis, for adequate protection in the state forum, realistically does not exist for the debtor.¹⁰³

The one possibly valid objection to the Celler proposal is that the jurisdiction in the bankruptcy court to determine the dischargeability or nondischargeability of a particular debt deprives the parties of a right to trial by jury. However this argument may be met in several ways. Nothing in the proposal indicates that there would not be a jury determination made of the crucial issues. The bankruptcy statute provides for a right to trial by jury only in certain instances.¹⁰⁴ There is no trial by jury as a matter of right of all issues tried under bankruptcy proceedings because such proceedings are equitable in nature.¹⁰⁵ At present, determination of the dischargeability of a particular debt is made by the court without a jury under § 11a.¹⁰⁶ The hearing to determine the bank-

103. Adequate protection for the debtor does not exist in the state court because (1) usually the debtor is financially unable to answer litigation or appeal; (2) the burden of proof in removing the presumption of fraud is difficult in regard to the *prima facie* case built against him; (3) the state courts are not cognizant of bankruptcy problems and the practices of unscrupulous creditors, and therefore the bankrupt's burden is increased.

104. Bankruptcy Act § 19, provides that an involuntary bankrupt has the right to a jury trial only to the matter of his insolvency, and whether or not he committed an act of bankruptcy. Otherwise the right to jury trial of matters in controversy or an offense under the act is determined by federal law. See 2 COLLIER, *op. cit. supra* note 10, ¶ 19.02 at pp. 224-5. "Matters in Controversy" include plenary suits, which are independent actions brought in the federal courts by the trustee in bankruptcy or receiver against third persons having an adverse claim in regard to property outside the possession of the bankruptcy court. 2 COLLIER, *supra*, ¶ 23.02. In these suits a trial by jury is required. However a determination of the effect of discharge on a particular debt is not within this class of plenary suits.

105. 2 COLLIER, *op. cit. supra* note 10, ¶ 19.07 n. 4 and 5.

106. See note 57 *supra*.

rupt's right to a discharge is made without a jury, because it is held to be a trial in equity, and a jury cannot be demanded.¹⁰⁷ In a hearing under § 14c(3) one of the issues to be decided by the court is whether or not there are reasonable grounds for believing that the bankrupt did issue a materially false statement.¹⁰⁸ The issue to be decided by the court under the proposed amendment is whether or not the debt in question is discharged under the provisions of the act, and particularly in relation to this problem, whether or not the bankrupt did obtain money on false pretenses and that the creditor relied on this statement. The determination of whether or not fraud with all its elements did exist under § 17a(2), is a mixed question of law and fact.¹⁰⁹ On the basis of past experience with this class of creditors¹¹⁰ referees have not been able to place much faith in the testimony, nor, in many instances, in the prima facie nature of the evidence submitted by the lending institutions.¹¹¹ This factor coupled with the equitable nature of the jurisdiction exercised when they do determine the dischargeability of the particular debt under the *Local Loan v. Hunt* doctrine leads to two conclusions. One, that being an equitable proceeding, a jury trial cannot be claimed as a matter of right. Two, that a jury trial might in fact be undesirable. If it were determined that this issue between the parties must be decided by a jury adequate provision is made within the act for the summoning of a jury, if specific provision is not made.¹¹²

Of all the remedies proposed to date to answer the need created by the practices of the small loan company in order to protect the honest debtor, the Celler proposal is the most adequate. Section 14c(3) is deleted, and all the inequitable results from allowing the creditor in those situations to go outside the bankruptcy court are eliminated. Yet adequate protection is offered to the honest creditor, for he too, once and for all, will have the effect of the discharge declared in the federal court, and armed with this decree may go to the state court and get speedy judgment.

107. COLLIER, *op. cit. supra* note 10, ¶ 14.10. In that hearing the referee or the court may administer oaths, call parties as witnesses, may rule on evidence, and then order the discharge granted or denied.

108. COLLIER, *op. cit. supra* note 10, ¶ 14.12 and ¶ 14.13.

109. COLLIER, *op. cit. supra* note 10, ¶ 2.62, at 292.

110. See discussion in notes 18, 19, and 30 *supra*. Also conversation with former Referee John K. Rickles, note 98 *supra*.

111. See note 18 *supra*.

112. See FED. R. CIV. P. 39(c) discussed in 2 COLLIER, *op. cit. supra* note 10, ¶ 1904. It has been suggested that if a bankrupt or a creditor requests a trial by jury in an instance involving the dischargeability or nondischargeability of a debt, the judge of the district court could assign the case to a jury docket. The discharge would in turn recite the verdict of the jury. Lynch, *op. cit. supra* note 96, at 124 n. 22.

Thus, certain lending institutions have thwarted the intent of Congress in the Bankruptcy Act to allow the honest debtor economic rehabilitation. At present, the lower federal courts have so limited their jurisdiction that they have not been able to ameliorate the situation. Furthermore, the act itself, thus interpreted by the courts, cannot solve the problem adequately, nor give sufficient protection to the honest debtor and creditor. There are two solutions available. The Supreme Court can refuse to recognize the limitations placed on its announced doctrine of "unusual circumstances," or Congress may recognize the problem and intelligently amend the act to give the federal courts adequate power to handle the problem. The latter solution seems most desirable.

THE ROLE OF JOB CLASSIFICATION IN COLLECTIVE BARGAINING AGREEMENTS*

Job classification to management experts is a system for relating jobs to each other using a set of elements inherent in varying degrees in all jobs. To employers, job classification means a system for categorizing certain duties into certain jobs and paying wage rates for those jobs in relation to profit gained from such jobs. To the union and the employee, job classifications are merely the particular duties the employee performs and the pay he receives for them. A unique difficulty, which stems from conflicting notions as to the proper function of such systems, is injected therefore into labor-management relations by job classification.

Job classifications are established by weighing a set of elements which exist to a certain extent in all jobs. Difficulty of work, volume of work, responsibility of the employee, supervision required, supervision of others, knowledge and experience necessary, and conditions under which the work is performed, are typical elements considered.¹ These factors are the crux of systems which must establish inter-plant equality in wage rates for similar jobs, establish correct differentials for all jobs within a plant, bring new jobs into proper relativity with existing ones, and accomplish these goals to the satisfaction of management, the union, and the individual employee.

The problem of maintaining wage differentials comparable to differentials in job content is a continuing one for most industries. Because

* This paper was completed as part of the requirements in 3rd year Labor Law by Gene E. Wilkins, A.B. 1956, Indiana University.

1. For a discussion of a job classification plan using these seven elements, see 60 Mech. Eng. No. 12 (1948).