

# SUMMARY JURISDICTION IN BANKRUPTCY: KATCHEN v. LANDY AND QUESTIONS LEFT UNANSWERED

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*This article deals with a complex and conceptually difficult phase of bankruptcy law. It is not written for the beginner, for it does not contain all the background material necessary to effectuate a full understanding of the area. But it is extremely objective, and it exhaustively treats the relevant appellate court decisions. For the informed reader, therefore, it is both thought-provoking and an invaluable research tool.*

UNDER WHAT circumstances and to what extent may a bankruptcy court, in the exercise of its summary jurisdiction, grant an affirmative money judgment against a claimant and in favor of a trustee where the trustee has filed a counterclaim which exceeds, in amount, the claim filed by the creditor? This has been, and remains, one of the most troublesome questions<sup>1</sup> in the administration of the Bankruptcy Act,<sup>2</sup> notwithstanding the recent decision of the Supreme Court in *Katchen v. Landy*.<sup>3</sup> The question has produced a fertile field for litigation,<sup>4</sup> and it will continue to occupy the time of the courts until the Bankruptcy Act is amended<sup>5</sup> or the Supreme Court gives the matter further definitive treatment. As we shall see, different circuits have given different answers to the various facets of the question, and confusion exists even within the same circuit.

Under section 57n of the Bankruptcy Act,<sup>6</sup> claims which are not filed within six months after the first date set for the initial meet-

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<sup>1</sup> "The problem . . . has developed more facets than a dime store ruby." Palmer, *The Supreme Court Speaks on Bankruptcy; A Review of Katchen v. Landy, Segal v. Rochelle, and United States v. Speers*, 40 REF. J. 44 (1966).

<sup>2</sup> 52 Stat. 840 (1938), as amended, 11 U.S.C. (1964).

<sup>3</sup> 382 U.S. 323 (1966).

<sup>4</sup> 4 COLLIER, BANKRUPTCY ¶ 68.20[4] (14th ed. 1964) [hereinafter cited as COLLIER] cites over 50 cases in discussing this relatively narrow point.

<sup>5</sup> It has been argued that the probability of amendment is slight. Comment, 34 FORDHAM L. REV. 469, 481 & n.104 (1966).

<sup>6</sup> Bankruptcy Act § 57n, 52 Stat. 867 (1938), as amended, 11 U.S.C. § 93 (n) (1964).

ing of creditors are not allowed and may not participate in dividends. If a creditor knows or fears that the trustee has a cause of action against him which exceeds his claim, then the creditor is faced with a difficult decision. If he fails to file his claim, he will not receive his share of the bankrupt estate, and if the bankrupt is discharged, the claim may be forever barred.<sup>7</sup> If, however, he files the claim, he lays himself open to the trustee's counterclaim, which may be determined in summary bankruptcy proceedings—without a jury.<sup>8</sup>

The trustee's counterclaim may fall into one of several categories. The trustee may assert that the creditor has received a voidable preference under section 60,<sup>9</sup> or seek to set aside fraudulent transfers under sections 67d<sup>10</sup> or 70e;<sup>11</sup> additionally, the counterclaim could be based on *any* legal right which the estate has against the creditor. In any case, the counterclaim may arise out of the same transaction or occurrence as that which gave rise to the claim, or it may be entirely unrelated to the claim. So long as the trustee's claim is asserted only to reduce or extinguish the creditor's claim, there is no question that the bankruptcy court has jurisdiction to entertain it in any of these situations.<sup>12</sup>

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<sup>7</sup> The choice is thus not so simple as the concurring opinion in *Katchen v. Landy*, 336 F.2d 535, 539 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966), would have us believe: "The decision here is whether to become a moving party and also to submit the adjudication of claims and preferences to the bankruptcy court without a jury, or whether to forego the filing of his claim and wait to become a defendant."

<sup>8</sup> A claimant may also invoke the jurisdiction of the court by filing a reclamation petition or a petition to abandon. A reclamation petition is filed where the trustee has possession of a particular *res* to which the petitioner claims title. A petition to abandon may be filed by a secured creditor who contends that the administration by the court of the particular *res* would be burdensome because valid liens exceed the value of the *res*, and no equity exists for unsecured creditors.

<sup>9</sup> Bankruptcy Act § 60, 52 Stat. 869 (1938), as amended, 11 U.S.C. § 96 (1964). This section defines a preference and provides, in subsection b, that the preference may be avoided by the trustee if the creditor had reasonable cause to believe that the debtor was insolvent at the time when the transfer was made.

<sup>10</sup> Bankruptcy Act § 67d, 52 Stat. 877 (1938), as amended, 11 U.S.C. § 107 (d) (1964). This section makes voidable by the trustee certain transfers within one year prior to the filing of the bankruptcy petition, which were made without fair consideration or with actual intent to hinder, delay, or defraud creditors. This section also enables the trustee to avoid certain transfers made within four months of bankruptcy, and in contemplation of the filing of the bankruptcy petition or with intent to use the consideration to effect a preference.

<sup>11</sup> Bankruptcy Act § 70e, 52 Stat. 882 (1938), as amended, 11 U.S.C. § 110 (e) (1964). This section arms the trustee with all powers of avoidance held by any actual creditor of the bankrupt under applicable state law.

<sup>12</sup> 4 COLLIER ¶ 68.20[4], at 805. The problem here considered arises where the trustee attempts to obtain judgment in the summary bankruptcy proceeding for the excess of his counterclaim over the creditor's claim.

## I

## SUMMARY V. PLENARY JURISDICTION

Usually, proceedings in a bankruptcy court—that is, a federal district court sitting in its bankruptcy capacity<sup>13</sup>—are “summary,” as opposed to proceedings which are “plenary.” It is important, therefore, to distinguish between the two.

A “plenary” suit is a suit of the ordinary character, commenced by complaint or petition filed in a United States district court or in a state court. Juries may be had in proper cases. In a “summary” bankruptcy proceeding, on the other hand, the action is commenced by an application for relief, followed by an order to the respondent to show cause. Trial is to the referee sitting *without a jury*, but the trial is otherwise conducted in the same manner as a similar trial would be conducted before the federal judge—the same Federal Rules of Civil Procedure and the same rules of evidence apply. Appeal from the ruling of the referee is by “petition for review”<sup>14</sup> to the district judge, and thereafter to the court of appeals.

Summary proceedings are most unfortunately named. The very word “summary” brings up visions of “drumhead justice,” but these writers know of no experienced bankruptcy practitioners who would make such a contention.<sup>15</sup> Indeed, the full protection of due process applies to proceedings in the bankruptcy court.<sup>16</sup> If there has been a reluctance on the part of some courts of appeals to extend the summary jurisdiction of bankruptcy courts, it may be traced, in part at least, to long-held prejudices harking back to the years when referees’ compensation was based on a percentage of assets administered.<sup>17</sup>

## II

## APPLICABLE STATUTES AND RULES

To the extent that the bankruptcy courts have been granted jurisdiction to render affirmative money judgments on trustees’ counterclaims, the power has been implied from express jurisdic-

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<sup>13</sup> See Bankruptcy Act § 1(10), 66 Stat. 420 (1952), 11 U.S.C. § 1(10) (1964).

<sup>14</sup> Bankruptcy Act § 39c, 74 Stat. 528 (1960), 11 U.S.C. § 67(c) (1964).

<sup>15</sup> See Treister, *Bankruptcy Jurisdiction: Is It Too Summary?*, 39 So. CAL. L. REV. 78 (1966).

<sup>16</sup> *In re Wood & Henderson*, 210 U.S. 246, 253 (1908) (requiring notice and opportunity to be heard even where statute did not).

<sup>17</sup> For a discussion of misconceptions about summary bankruptcy proceedings, see Rochelle & King, *A Proposal to Raise Bankruptcy Courts to District Court Level*, 13 KAN. L. REV. 391 (1965).

tional grants in certain sections of the Bankruptcy Act. Conversely, the language contained in some of these sections has led some courts to restrict the bankruptcy court in the exercise of such jurisdiction. A familiarity with these provisions is therefore essential to the understanding of the problem.

Section 2a (2)<sup>18</sup> empowers the bankruptcy court to "allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates," and section 2a (7) provides, in part:

where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the Court of Bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court, or fixed or extended by order of court for the filing of an answer to the petition, motion, or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction.<sup>19</sup>

This latter section probably does not apply to claims filed by creditors.<sup>20</sup>

The bankruptcy court does not have jurisdiction in all situations, however. Section 23a provides:

The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.<sup>21</sup>

The traditional test of the dividing line between the summary jurisdiction of the bankruptcy court and this plenary jurisdiction of the district court, especially in turnover-order situations, has been possession of the property in dispute. If the bankrupt on the date of bankruptcy had possession, either actual or constructive, or if an

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<sup>18</sup> Bankruptcy Act § 2a (2), 52 Stat. 842 (1938), 11 U.S.C. § 11 (a) (2) (1964).

<sup>19</sup> Bankruptcy Act § 2a (7), 66 Stat. 420 (1952), 11 U.S.C. § 11 (a) (7) (1964).

<sup>20</sup> This provision was enacted to clarify and limit the effect of *Cline v. Kaplan*, 323 U.S. 97 (1944), and apparently applies only where the adverse party is *involuntarily* brought into court. *Continental Cas. Co. v. White*, 269 F.2d 213, 216 (4th Cir. 1959); *Inter-State Nat'l Bank v. Luther*, 221 F.2d 382, 387 (10th Cir. 1955), *cert. dismissed per stipulation*, 350 U.S. 944 (1956).

<sup>21</sup> Bankruptcy Act § 23a, 52 Stat. 854 (1938), 11 U.S.C. § 46 (a) (1964).

"adverse" claimant's possession is merely colorable, then summary jurisdiction will lie. One court, at least, has utilized the possession test to deny summary jurisdiction even when a counterclaim on a preference was in issue.<sup>22</sup>

Section 23b limits the coverage of section 23a:

Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, *unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act.*<sup>23</sup>

By its terms, this section involves consent to jurisdiction by a *defendant*, and hence appears inapplicable where a creditor has become the moving party by filing a claim.<sup>24</sup> Nevertheless, some courts have considered section 23b to be the basis for the theory that a creditor who files a claim in a summary proceeding consents to adjudication of counterclaims raised by the trustee.<sup>25</sup>

Identical provisions in sections 60b,<sup>26</sup> 67e,<sup>27</sup> and 70e (3)<sup>28</sup> vest concurrent jurisdiction in state and federal courts for the recovery and avoidance of preferences and fraudulent conveyances. The language used is the following: "For the purpose of any recovery or avoidance under this section, *where plenary proceedings are necessary*, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."<sup>29</sup> The italicized portion of this provision has caused some difficulty, but it is now clear that this wording authorizes both plenary and summary proceedings for the recovery and avoidance of fraudulent transfers and preferences.<sup>30</sup>

Section 57 deals with the proof and allowance of claims, and subsection g provides:

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<sup>22</sup> See *B. F. Avery & Sons v. Davis*, 192 F.2d 255, 259 (5th Cir. 1951), *cert. denied*, 342 U.S. 945 (1952).

<sup>23</sup> Bankruptcy Act § 23b, 52 Stat. 854 (1938), 11 U.S.C. § 46(b) (1964). (Emphasis added.)

<sup>24</sup> *Katchen v. Landy*, 382 U.S. 323, 332 n.9 (1966); Seligson & King, *Jurisdiction and Venue in Bankruptcy*, 36 REEF. J. 73, 79 (1962).

<sup>25</sup> *E.g.*, *Gill v. Phillips*, 337 F.2d 258, 262 (5th Cir. 1964); see notes 94-99, 105-06, 118-20 *infra* and accompanying text.

<sup>26</sup> Bankruptcy Act § 60b, 52 Stat. 870 (1938); 11 U.S.C. § 96(b) (1964).

<sup>27</sup> Bankruptcy Act § 67e, 52 Stat. 878 (1938), 11 U.S.C. § 107(e) (1964).

<sup>28</sup> Bankruptcy Act § 70e (3), 52 Stat. 882 (1938), 11 U.S.C. § 110(e) (3) (1964).

<sup>29</sup> Emphasis added. The wording of the introductory clause is slightly different in § 70e (3).

<sup>30</sup> *Katchen v. Landy*, 382 U.S. 323, 331 (1966).

The claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this Act, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments, or encumbrances.<sup>31</sup>

Thus, the trustee may object to and prevent allowance of a claim unless preferences are first returned to the estate. Whether this section permits the trustee to *compel* surrender of a preference is, of course, a different matter.

Section 68 deals with set-offs and counterclaims, and subsection a provides: "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."<sup>32</sup> This section seems to give some support to allowing counterclaims by trustees. It expresses the idea of "clearing the books" between the bankrupt and the creditor.

General Order 37<sup>33</sup> makes the Federal Rules of Civil Procedure applicable to proceedings in bankruptcy insofar as they are not inconsistent with the act. Rule 13 (a) defines a compulsory counterclaim as one which "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction."<sup>34</sup> Rule 13 (b)<sup>35</sup> provides for the assertion of permissive counterclaims.<sup>36</sup> If the claim filed by a creditor can be analogized to a complaint under the Federal Rules, then does rule 13 (a) compel a bankruptcy court to adjudicate compulsory counterclaims? And does rule 13 (b) provide a jurisdictional basis for summary adjudication of permissive counterclaims?

### III

#### ALEXANDER V. HILLMAN

*Alexander v. Hillman*<sup>37</sup> is the progenitor of *Katchen*. It was not a bankruptcy case, but rather involved an equity receivership filed

<sup>31</sup> Bankruptcy Act § 57g, 52 Stat. 866 (1938), 11 U.S.C. § 93 (g) (1964).

<sup>32</sup> Bankruptcy Act § 68a, 52 Stat. 878 (1938), 11 U.S.C. § 108 (a) (1964).

<sup>33</sup> 305 U.S. 698 (1939), 11 U.S.C. App. Order 37 (1964).

<sup>34</sup> FED. R. CIV. P. 13 (a).

<sup>35</sup> FED. R. CIV. P. 13 (b).

<sup>36</sup> Unfortunately for the solution of the problem under discussion, it is not always easy to determine, in a given fact situation, whether a counterclaim is "compulsory" or "permissive." See 3 MOORE, FEDERAL PRACTICE ¶ 13.13 (2d ed. 1964).

<sup>37</sup> 296 U.S. 222 (1935).

in West Virginia to liquidate the assets of a West Virginia corporation. Pennsylvania stockholder-officers filed claims in the West Virginia proceedings, and were met by the receivers' counterclaims alleging fraud by the claimants. Other counterclaims by the receivers were later asserted—including a charge that excessive salaries had been paid—and an accounting was sought for misappropriated assets. The claimants contested the jurisdiction of the court, arguing that they were entitled to a plenary determination of the counterclaims against them in the state of their residence.<sup>38</sup>

Mr. Justice Butler, speaking for the Court, held that by filing their claims in the receivership proceeding, the respondents submitted themselves to the court's jurisdiction in respect to all defenses that might be made by the receivers.<sup>39</sup> The right given by section 51 of the Judicial Code<sup>40</sup> to be sued in the district of the defendant's residence was construed by the court to be merely a "personal privilege that may be waived,"<sup>41</sup> and the privilege was said not to affect the general jurisdiction of the court.<sup>42</sup>

The respondent's contention was construed to mean

that, while invoking the court's jurisdiction to establish their right to participate in the distribution, they may deny its power to require them to account for what they misappropriated. In behalf of creditors and stockholders, the receivers reasonably may insist that, before taking aught, respondents may by the receivership court be required to make restitution. That requirement is in harmony with the rule generally followed by courts of equity that having jurisdiction of the parties to controversies brought before them, they will decide all matters in dispute and decree complete relief.<sup>43</sup>

The court of appeals had held that the district court had jurisdiction to pass on all defenses against the claims, but denied affirmative relief to the receivers. The Supreme Court reversed on this point, sanctioning the jurisdiction of the equity court to grant

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<sup>38</sup> *Id.* at 230-36.

<sup>39</sup> *Id.* at 241.

<sup>40</sup> Judicial Code § 51, as amended, ch. 345, 42 Stat. 849 (1922), as amended (now 28 U.S.C. § 1391 (1964)): "no civil suit shall be brought in any district court against any person by any original process or proceeding in any other district than that whereof he is an inhabitant . . ."

<sup>41</sup> 296 U.S. at 240.

<sup>42</sup> *Ibid.*

<sup>43</sup> *Id.* at 241-42.

affirmative relief in the West Virginia proceeding without requiring the receivers to seek relief in a plenary Pennsylvania suit.<sup>44</sup>

Prior to *Hillman*, the bankruptcy cases had held that a bankruptcy court's jurisdiction over counterclaims was effective only to the extent necessary to offset the creditor's claim, and that a plenary suit was necessary to collect any excess due the estate.<sup>45</sup> As we shall see, several courts seized upon *Hillman* to extend the summary jurisdiction of bankruptcy courts.

#### IV

##### INTER-STATE V. LUTHER

Before examining the summary jurisdiction cases in detail, and in order to better understand *Katchen*, let us look at *Inter-State Nat'l Bank v. Luther*,<sup>46</sup> a decision of the Tenth Circuit Court of Appeals. Prior to this case, extension of summary jurisdiction had been limited to compulsory counterclaim situations, where both the claim and the counterclaim arose out of the same transaction. In giving relief to the trustee for a permissive counterclaim, *Luther* thus constituted the most liberal decision in this area.<sup>47</sup>

In *Luther*, the bank filed its claim in the bankruptcy proceeding based on a certain promissory note in the amount of 50,000 dollars. The trustee counterclaimed on the ground that the bank had received a 150,000-dollar voidable preference from the payment of two prior notes. The referee found for the trustee and decreed that the trustee recover the excess from the bank. The district judge affirmed.<sup>48</sup>

One of the bank's principal defenses in the court of appeals was that the notes forming the basis for the counterclaim were separate and distinct transactions from the note on which the claim was based and that the court had no jurisdiction to render an affirmative judgment on a permissive counterclaim.<sup>49</sup> Judge Murrah,

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<sup>44</sup> *Id.* at 242-43.

<sup>45</sup> *In re Vadner*, 17 F.2d 721 (9th Cir. 1927); *Fitch v. Richardson*, 147 Fed. 197 (1st Cir. 1906); *In re Patterson-MacDonald Shipbuilding Co.*, 284 Fed. 281 (W.D. Wash. 1922), *aff'd on other grounds*, 293 Fed. 192 (9th Cir. 1923), *cert. denied*, 264 U.S. 582 (1924).

<sup>46</sup> 221 F.2d 382 (10th Cir. 1955), *cert. dismissed per stipulation*, 350 U.S. 944 (1956).

<sup>47</sup> *Luther* was later modified by the Tenth Circuit in *Katchen*. See text accompanying notes 53-55 *infra*.

<sup>48</sup> See 221 F.2d at 385-86.

<sup>49</sup> *Id.* at 389-90.

writing for the majority of an en banc court, held that the bank had impliedly consented to jurisdiction by filing the claim, and affirmed the district judge and the referee. Rule 13 of the Federal Rules of Civil Procedure was considered as a grant of *jurisdiction*, and since the bank had consented to jurisdiction, the distinction between compulsory and permissive counterclaims was said to be of no consequence.<sup>50</sup>

Chief Judge Phillips, joined by Judge Pickett, vigorously dissented, urging that the traditional tests for summary jurisdiction—whether the *res* is in the actual or constructive possession of the bankrupt on the date of bankruptcy, and whether the adverse claim is real and substantial or merely colorable—should be applied. The Chief Judge would have relegated the trustee to a plenary suit to recover the preference.<sup>51</sup>

## V

### KATCHEN v. LANDY

In *Katchen v. Landy*,<sup>52</sup> an officer of the bankrupt corporation had become an accommodation maker on notes given to two banks for indebtedness owed by the bankrupt. The officer filed two claims in the bankruptcy proceeding, one for rent due from the bankrupt and the other for the recovery of a payment made from his personal funds on one of the notes. The trustee counterclaimed, asserting that certain prior payments to the bank, made with funds of the bankrupt, had served to reduce the officer's personal liability on the notes and were, therefore, preferential as to him. Another counterclaim of the trustee was based on an unpaid stock subscription. The officer made timely objection to the exercise of summary jurisdiction, but the referee overruled the objection and rendered judgment for the trustee on both the preferences and the stock subscription. The district court sustained the referee.<sup>53</sup>

The Court of Appeals for the Tenth Circuit, again sitting en banc, reconsidered its opinion in the *Luther* case and said:

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<sup>50</sup> *Id.* at 390.

<sup>51</sup> *Id.* at 401 (dissenting opinion). This was the approach taken by the Fifth Circuit in *B. F. Avery & Sons v. Davis*, 192 F.2d 255 (5th Cir. 1951), *cert. denied*, 342 U.S. 945 (1952), discussed in text accompanying notes 135-37 *infra*. Judge Phillips distinguished other cases on the ground that they involved compulsory counterclaims.

<sup>52</sup> 336 F.2d 535 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966).

<sup>53</sup> 336 F.2d at 535-36.

[I]n the light of subsequent decisions and commentary, we have decided to adhere to its [*Luther's*] pronouncements. But, we decline to extend the summary jurisdiction of the court by implied consent to counterclaims which do not involve a preference, set-off, voidable lien, or a fraudulent transfer, and which are wholly unrelated to the creditor's claim.<sup>54</sup>

Thus, the Tenth Circuit took back its apparent former blessing on summary jurisdiction of permissive counterclaims. It affirmed the lower court for the amount of the voidable preferences, but reversed the judgment for the amount of the stock subscription.

The trustee did not seek review in the Supreme Court of the adverse decision on the stock subscription.<sup>55</sup> The Supreme Court granted certiorari on the officer's request because of the conflict between the tenth and other circuits, and the Fifth Circuit.<sup>56</sup>

Mr. Justice White, writing for the majority of the Court, conceded that the Bankruptcy Act does not expressly confer summary jurisdiction to order claimants to surrender preferences, but pointed out that Congress has often left the exact scope of summary proceedings to be determined by the courts.<sup>57</sup> The Court referred to congressional committee reports in which special attention was given to the necessity for inexpensive and expedient administration of bankrupt estates,<sup>58</sup> and then noted the express power of the trustee to allow claims and inquire into their validity and his concurrent duty under section 47a (8)<sup>59</sup> to inquire into the claims and make objections in proper cases.<sup>60</sup>

Special emphasis was laid on section 57g of the act<sup>61</sup> which was said to be "part and parcel of the allowance process."<sup>62</sup> Objections thereunder were "subject to summary adjudication by the bankruptcy court. This is the plain import of § 57 and finds support in the same policy of expedition that underlies the necessity for sum-

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<sup>54</sup> *Id.* at 537.

<sup>55</sup> This was tragic. If the trustee had taken up the permissive counterclaim issue, we might now have a definitive pronouncement from the Supreme Court on the whole area of affirmative judgments on trustees' counterclaims.

<sup>56</sup> 382 U.S. at 326.

<sup>57</sup> *Id.* at 328.

<sup>58</sup> *Id.* at 328-29.

<sup>59</sup> Bankruptcy Act § 47a (8), 52 Stat. 861 (1938), 11 U.S.C. § 75 (a) (8) (1964).

<sup>60</sup> 382 U.S. at 329-30.

<sup>61</sup> 52 Stat. 866 (1938), 11 U.S.C. § 93 (g) (1964).

<sup>62</sup> 382 U.S. at 330.

mary action in many other proceedings under the Act."<sup>63</sup> As to affirmative relief in favor of the trustee, section 57g was made the foundation of the Court's ruling by the following language:

[O]nce it is established that the issue of preference may be summarily adjudicated . . . it can hardly be doubted that there is also summary jurisdiction to order the return of the preference. This is so because in passing on a § 57g objection a bankruptcy court must necessarily determine the amount of preference, if any, so as to ascertain whether the claimant . . . has satisfied the condition imposed by § 57g on allowance of the claim. . . . Thus, once a bankruptcy court has dealt with the preference issue nothing remains for adjudication in a plenary suit. The normal rules of *res judicata* and collateral estoppel apply . . . . More specifically, a creditor who offers a proof of claim and demands its allowance is bound by what is judicially determined . . . . To require the trustee to commence a plenary action in such circumstances would be a meaningless gesture, and it is well within the equitable powers of the bankruptcy court to order return of the preference during the summary proceedings . . . .<sup>64</sup>

The Court then quoted the *Hillman* language set out above<sup>65</sup> to the effect that equity will decide all matters in dispute and decree complete relief.

Mr. Justice White then turned to the question of the respondent's right to a jury trial under the seventh amendment. The Bankruptcy Act, passed pursuant to constitutional authority, was said to convert the creditor's legal claim into an equitable claim to a pro rata share of the *res*, and the right of trial by jury does not extend to cases of equity jurisdiction.<sup>66</sup> Petitioner had urged the *Beacon* and *Dairy Queen* doctrine,<sup>67</sup> which was said to be that "where both legal and equitable issues are presented in a single case, "only under the most imperative circumstances . . . can the right to a jury trial of legal issues be lost through prior determina-

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<sup>63</sup> *Id.* at 330-31. This policy of expedition via summary proceedings was not negated, said the Court, by any other section of the act. The language of section 60b, 52 Stat. 870 (1938), 11 U.S.C. § 96(b) (1964), conferring concurrent jurisdiction on state courts and federal district courts to entertain plenary suits for the recovery of preferences, was said to contemplate nonplenary recovery proceedings as well because the language "where plenary suits are necessary" could be interpreted in no other way. 382 U.S. at 331.

<sup>64</sup> *Id.* at 333-35.

<sup>65</sup> See text accompanying note 43 *supra*.

<sup>66</sup> 382 U.S. at 336-37.

<sup>67</sup> *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959); *Dairy Queen, Inc. v. Wood*, 369 U.S. 469 (1962).

tion of equitable claims." "68 These cases were distinguished by the fact that in neither of them was there involved a specific statutory scheme contemplating the prompt trial of a disputed claim without the intervention of a jury.<sup>69</sup> Finally, the Court concluded that "to implement congressional intent, we think it essential to hold that the bankruptcy court may summarily adjudicate the § 57g objection; and . . . the power to adjudicate the objection carries with it the power to order surrender of the preference."<sup>70</sup> Justices Black and Douglas dissented for the reasons stated by Judge Phillips in his dissenting opinion in the court of appeals.<sup>71</sup>

The Supreme Court opinion is as important for what it does not say as for what it says. The Court refused to pass on the consent theory—that by filing a claim a creditor consents to summary adjudication of counterclaims—upon which several courts of appeals had predicated jurisdiction. No mention was made of rule 13 of the Federal Rules. This will cause considerable speculation on what the Court's holding might have been if a permissive counterclaim had been involved. That the preferences here considered were compulsory counterclaims was not stated to be a determining factor in the Court's decision.<sup>72</sup> No hint was given as to the form which the referee's order should have taken, although in its brief statement of the facts, the Court referred to the referee's order as a "judgment."<sup>73</sup>

The opinion is carefully written with what appears to be a studied effort to restrict the holding to the narrow facts of the case. It is difficult to see any illumination in the still dark area of non-57g counterclaims.<sup>74</sup> However, for those who favor the extension of summary jurisdiction, some comfort can be obtained from the fact that the Court laid great stress on what it considered to be a congressional intention to favor inexpensive and expedient bankruptcy

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<sup>68</sup> 382 U.S. at 338.

<sup>69</sup> *Id.* at 339.

<sup>70</sup> *Id.* at 340.

<sup>71</sup> *Ibid.*

<sup>72</sup> See *id.* at 326 n.1.

<sup>73</sup> *Id.* at 325.

<sup>74</sup> *But see* Macey, *Katchen vs. Landy: A Milestone Along the Summary Jurisdiction Road*, 71 *COM. L.J.* 68, 69 (1966): "It can hardly be doubted that all circuits will exercise summary jurisdiction to render affirmative judgments on offsets and counterclaims arising out of the subject matter of the proof of claim, as well as to determine Section 57 (g) objections."

administration, even at the sacrifice of the respondent's claim to trial by jury.

## VI

### THE SITUATION IN THE CIRCUITS

*Katchen* has merely sharpened rather than solved the inquiries in this area. Lower court opinions must be re-examined in the light of *Katchen*, of course, but most of them seem either unaffected by or distinguishable from *Katchen's* narrow coverage. What follows here is an attempt to analyze, circuit by circuit, the holdings of the various courts of appeals on these problems. Space limitations have prohibited the discussion of many of the district court decisions. The varied and complex theories which have been suggested and developed should become clearer to the reader as he progresses through the ensuing discussion.

#### A. First Circuit

The First Circuit has had no opportunity to reconsider the problem since many years before the Supreme Court's *Hillman* decision. It therefore continues to be represented, speaking strictly if not realistically, by its early decision in *Fitch v. Richardson*,<sup>75</sup> a typical pre-*Hillman* holding that a bankruptcy court could not enter an affirmative judgment on a trustee's counterclaim, even though the counterclaim arose out of the same subject matter as the original claim.

#### B. Sixth Circuit

The problem has never been before the Sixth Circuit. A Kentucky district court in *In the Matter of Scott-Frederick Motor Co.*<sup>76</sup> has relied on cases from other circuits to hold that a referee has jurisdiction to grant affirmative relief to a trustee on a related counterclaim because the creditor consents to such jurisdiction when he files his claim. One Ohio district court case is in accord<sup>77</sup> and another appears contra.<sup>78</sup>

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<sup>75</sup> 147 Fed. 197 (1st Cir. 1906).

<sup>76</sup> 177 F. Supp. 758 (E.D. Ky. 1959).

<sup>77</sup> *In the Matter of Morrison-Barnhart Motors, Inc.*, 142 F. Supp. 845 (N.D. Ohio 1956).

<sup>78</sup> *In re Poston Const. Corp.*, 115 F. Supp. 323, 330-31 (N.D. Ohio 1953) ("it may well be that a plenary suit . . . will be required to set aside the alleged preferential transfer").

### C. Eighth Circuit

In *Floro Realty & Inv. Co. v. Steem Elec. Corp.*,<sup>79</sup> a chapter X proceeding,<sup>80</sup> a petitioner in the bankruptcy court alleged breach of a lease under which the debtor held certain property and prayed surrender of the leased premises. It was held that the petitioner had invoked the court's jurisdiction and was hence subject to the trustee's counterclaim for return of a security deposit made by the debtor under the lease. The court made no careful distinction between compulsory and permissive counterclaims, although the claim in issue seems clearly to be the former.

*Floro* is one of the pioneering post-*Hillman* decisions. Its reasoning is general at best, and the Eighth Circuit has not clarified its position to date.<sup>81</sup> It is thus difficult to predict how the Eighth Circuit today would handle a permissive—or even a compulsory—counterclaim. We know at least, however, that the Eighth Circuit's earlier decisions in *Atwood-Larson Co. v. Hasvold*<sup>82</sup> and *Triangle Elec. Co. v. Foutch*,<sup>83</sup> both of which held that a trustee could not assert a voidable transfer or preference against a claimant in bankruptcy court but instead had to resort to a plenary suit, have been overruled by *Katchen*.

### D. Third Circuit

The case of *In re Solar Mfg. Corp.*,<sup>84</sup> a chapter X matter, concerned the trustee's counterclaims on both preferential payments under section 67 and other causes of action related to the creditor's claim. Holding that the reorganization court had summary jurisdiction over the subject matter of the trustee's counterclaims, the court stated:

In *Hillman* [and other cases] . . . , as in this appeal, the subject matter of the counterclaim arose out of the same transaction as the claim. This is important because in those circumstances, as we have above indicated, the trustee may have a summary

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<sup>79</sup> 128 F.2d 338 (8th Cir. 1942).

<sup>80</sup> Bankruptcy Act ch. X, 52 Stat. 883 (1938), as amended, 11 U.S.C. §§ 501-676 (1964). Chapter X provides means for a near-bankrupt to resolve its financial difficulties and continue in business in a reorganized form.

<sup>81</sup> In fact, the waters were muddied somewhat by *Solomon v. Allied Bldg. Credits, Inc.*, 209 F.2d 828 (8th Cir. 1954) (no consent to summary jurisdiction implied by mere filing of claim).

<sup>82</sup> 280 Fed. 385 (8th Cir. 1922).

<sup>83</sup> 40 F.2d 353 (8th Cir. 1930).

<sup>84</sup> 200 F.2d 327 (3d Cir. 1952), *cert. denied*, 345 U.S. 940 (1953).

adjudication of the issues upon which his counterclaim depends by raising these issues in his answer to the claim. Appellant offers no reason for compelling the trustee to institute a plenary action in order to obtain affirmative relief where, as here, the issues adjudicated as defenses to the claim would be *res judicata* in the plenary suit.<sup>85</sup>

While it is doubtful that the preferences in *Solar* were compulsory counterclaims under Federal Rule 13 (a),<sup>86</sup> the opinion does indicate the position of the Third Circuit on compulsory counterclaims. So far as the case indicates permissive counterclaims could not under any circumstances be summarily adjudicated, even for an alleged section 67 preference, *Katchen* casts doubt on its authority.

The *res judicata* point raised in the quoted portion above has, of course, been approved by the Supreme Court in *Katchen*.<sup>87</sup>

#### E. Seventh Circuit

Judge Swaim brought the problems of our subject into good focus in his opinion in *In the Matter of Majestic Radio & Television Corp.*<sup>88</sup> The claimant, a former director of the bankrupt corporation, filed his proof of claim in the amount of 1,482 dollars for goods sold the bankrupt, and the trustees filed an offset and counterclaim in the amount of 442,067 dollars based on alleged breaches of fiduciary duty by the claimant while he had been a director of the bankrupt and its subsidiary.<sup>89</sup> Upon motion of the claimant, the trustees' objection, set-off, and counterclaim were dismissed by the district court, sitting as the bankruptcy court, on the ground that mere filing of a proof of claim did not constitute implied consent to adjudication of counterclaims arising out of transactions *different from* the one on which the claim was based.<sup>90</sup> The Court of Appeals for the Seventh Circuit affirmed on the same ground.

The trustees contended that section 68a commanded all mutual

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<sup>85</sup> *Id.* at 331.

<sup>86</sup> The trustee alleged dereliction of duty by the creditor in its capacity as indenture trustee of some outstanding bonds of the bankrupt. Yet none of the creditor's claims concerned these bonds. It is therefore questionable whether a compulsory counterclaim arose. Nonetheless, the court felt the counterclaim was "related" to the claim, and the holding of the case is clearly limited to such "related" counterclaims.

<sup>87</sup> See text accompanying note 64 *supra*; *cf.* Comment, 34 FORDHAM L. REV. 469, 477 n.64 (1966).

<sup>88</sup> 227 F.2d 152 (7th Cir. 1955), *cert. denied*, 350 U.S. 995 (1956).

<sup>89</sup> 227 F.2d at 154.

<sup>90</sup> *Ibid.*

debts to be set off against each other. The court agreed, but denied that a bankruptcy court could determine whether there *were* mutual debts.<sup>91</sup> The reference to "account . . . stated" in section 68a was held to refer not to a claim for unliquidated damages but to "an agreement between the parties to an account based upon prior transactions between them."<sup>92</sup> The trustees further argued that Federal Rule 13 (b), relating to permissive counterclaims, impliedly conferred jurisdiction on bankruptcy courts to try such counterclaims. The court answered that no federal rule could enlarge bankruptcy jurisdiction, and that rule 13 (b) was inconsistent with the Bankruptcy Act (apparently referring to section 23).<sup>93</sup>

Quoting sections 23a and 23b, the court held that section 23b, absent consent of the claimant, took jurisdiction of the trustee's counterclaim away from the bankruptcy court, since the claim was not one on a preference or other void or voidable transfer arising under sections 60, 67, or 70, the sections excepted from the operation of section 23b.<sup>94</sup> The court went on to hold that the claimant had not consented to the jurisdiction of the bankruptcy court to determine the trustees' permissive counterclaim or waived his right to object to such jurisdiction. It distinguished *Luther, Solar*, and another case, pointing out that in them the trustees' counterclaim had arisen under one of the sections excepted from the operation of section 23b.<sup>95</sup> Thus, it appears that the court would have held otherwise had the trustees' counterclaim been on such a void or voidable transfer, even if permissive—a position in accord with the Tenth Circuit's recent holding in *Katchen*.<sup>96</sup> The court pointed out that while many cases have held that filing a proof of claim constitutes consent to be sued in bankruptcy court on related counterclaims (and indicated that it would hold likewise in an appropriate situation), there was no authority to uphold summary jurisdiction so acquired on a permissive counterclaim.<sup>97</sup> *Hillman*

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<sup>91</sup> *Id.* at 156.

<sup>92</sup> *Id.* at 157.

<sup>93</sup> *Ibid.*

<sup>94</sup> *Id.* at 155.

<sup>95</sup> *Ibid.*

<sup>96</sup> See text accompanying note 54 *supra*.

<sup>97</sup> The court reasoned as follows on the subject of the bankruptcy court's jurisdiction to determine compulsory and permissive counterclaims:

"It is obvious that filing a claim in a Bankruptcy Court is an implied consent to summary adjudication by that court of any counterclaims based upon the subject matter of that claim. A litigant could hardly claim a recovery on the basis of a certain

was said to be not in point, because section 23 of the Bankruptcy Act did not apply in the equity receivership proceeding there before the Supreme Court.<sup>98</sup>

The reliance of the *Majestic* court on section 23b seems unwarranted. Although the court indicates it would have reached the same result on a preference counterclaim as did the Supreme Court in *Katchen*, it should be noted that the opinion of the Supreme Court in *Katchen* indicated that section 23b is inapplicable where preference counterclaims are in issue.<sup>99</sup> Nonetheless, the decision in *Majestic* can stand on the theory that consent gives jurisdiction notwithstanding any statutory provision—a theory fully supportable by the court's language quoted in footnote 97.

#### F. Fourth Circuit

The Court of Appeals for the Fourth Circuit, in *Florance v. Kresge*,<sup>100</sup> became the first court to apply the rule of *Alexander v. Hillman* to a proceeding under the Bankruptcy Act. There, one Kresge filed his claim (and an intervention petition) in a bankruptcy proceeding. He asserted a claim accruing under a contract with the bankrupt for the subletting of certain property. The court upheld the right of the bankruptcy court to grant affirmative relief on the trustee's counterclaim, which in fact arose from the same transaction as the claim, and quoted with approval the language in *Hillman* that the court could hear and determine *all* objections *and* defenses to a claim.<sup>101</sup> The court emphasized that the creditor had made himself a party to the proceeding by filing his unsecured claim, and stated:

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fact situation without permitting the court to decide all of the legal consequences of that situation. No party can invite summary adjudication on only part of the relevant evidence relating to the subject matter of the claim. If all of such evidence shows that each party is liable to the other the court will set off one claim against the other and render judgment for only any balance found to be due. In other words, if you invite a Bankruptcy Court to review a set of facts for your benefit, you invite it to review all pertinent related facts even though they should tend to prove your opponent's case. But it does not follow that by filing a claim a litigant has impliedly consented to the summary adjudication in the Bankruptcy Court of a counterclaim arising out of subject matter which has no relation to his claim. Here Franklin did not consent to the adjudication of the trustees' counterclaim; he objected to it, and the trial court upheld his objection." 227 F.2d at 156.

<sup>98</sup> *Ibid. Contra*, Chase Nat'l Bank v. Lyford, 147 F.2d 273, 276-77 (2d Cir. 1945).

<sup>99</sup> *Katchen v. Landy*, 382 U.S. 323, 332 n.9; see Seligson & King, *Jurisdiction and Venue in Bankruptcy*, 36 REF. J. 73, 79 (1962). Compare text accompanying notes 105-06 and 118-20 *infra*.

<sup>100</sup> 93 F.2d 784 (4th Cir. 1938).

<sup>101</sup> *Id.* at 786.

We see no reason why the court of bankruptcy should not pass upon the claims in favor of the bankrupt estate and set them off against the claims filed against the estate and its receivers; and, under the recent decision of the Supreme Court in *Alexander v. Hillman* . . . we see no reason why the court, which is a court of equity even though exercising special statutory powers, should not proceed to render judgment against Kresge for any balance found to be due by him.<sup>102</sup>

In 1950, in *Columbia Foundry Co. v. Lochner*,<sup>103</sup> the Fourth Circuit again held that a creditor, by submitting his proof of claim, consented to the jurisdiction of the bankruptcy court to enter an affirmative judgment against him on a counterclaim arising out of the same transaction as the claim. There, the creditor's unsecured claim was asserted for certain merchandise sold the bankrupt, and the trustee's counterclaim, unrelated to section 57 of the Bankruptcy Act, was for damages caused by defects in the merchandise. It was held that the filing of a claim by a creditor constituted consent to the bankruptcy court's summary jurisdiction for related counterclaims.<sup>104</sup>

The Court's treatment of section 23 of the act, the section relied on in *Majestic* to limit the jurisdiction of the bankruptcy court, is

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<sup>102</sup> *Ibid.*

<sup>103</sup> 179 F.2d 630 (4th Cir. 1950).

<sup>104</sup> The court relied on *Hillman* and on its earlier opinion in *Florance v. Kresge*, 93 F.2d 784 (4th Cir. 1938). Quoting 4 COLLIER ¶ 68.20[4], at 805-10, the court said: "In respect to the filing of proofs of claim in bankruptcy, as consent to the jurisdiction of the court, Collier . . . says:

"It is clear that where the plaintiff's petition is of such a nature that he submits his cause to the bankruptcy court, and manifests a willingness that the court fully determine his rights therein, such as in a reclamation petition, he consents to the court's jurisdiction and cannot complain thereafter of the court's power to render a judgment against him upon a proper set-off or counterclaim asserted by the trustee. On the other hand, the mere filing of a proof of claim for allowance is not such a clear expression of consent. It has been held in some cases that such a claim, without more, does not constitute consent . . . . In *Florance v. Kresge*, however, the court held [the opposite] . . . . In the light of expeditious administration of bankrupt estates, and an avoidance of multiplicity of litigation, this decision has much to recommend it. It would further serve to reduce the operation of the "absurdity of making A pay B when B owes A."

"One who files a proof of claim should be held to acquiesce in the adjudication of any proper set-off or counterclaim even to the extent of a judgment thereon, since . . . the claimant puts himself in a position, should his interests warrant, to challenge the receiver's or trustee's acts and the demands of others claiming as creditors. He should not be permitted to claim the benefits of such a position, and yet maintain a favored advantage as against the trustee or receiver, compelling that officer to resort to a plenary action to collect on a claim that is a proper subject of set-off or counterclaim.'" 179 F.2d at 632.

an important aspect of the opinion. In speaking of the apparent conflict between section 23 and section 68 relative to set-off and counterclaim, Judge Soper characterized section 23 as primarily a venue provision whose purpose it was to protect a defendant from the inconvenience of defending a suit away from his home. The court said that section 23 should apply only where the trustee brings suit, not where a claim is filed against the trustee in the bankruptcy court.<sup>105</sup> Proceeding to section 68, the court stated:

There is naught in the text of the section which manifests an intention to subject the trustee to any restriction in the use of a set off that would not have applied to the bankrupt if sued before his adjudication; and since in such an event the bankrupt could have had an affirmative judgment against his adversary under the ordinary rules of procedure, the trustee should be entitled to the same advantage in winding up the estate. The creditor would not be injured thereby, since the burden of opposing the counterclaim is the same whether it is used as an offensive or defensive weapon, and both parties are advantaged by disposing of both claims in a single suit.<sup>106</sup>

In *Continental Cas. Co. v. White*,<sup>107</sup> the Fourth Circuit in 1959 again held that a court of bankruptcy could adjudicate a trustee's counterclaim and enter an affirmative judgment against a creditor who had filed a claim. The counterclaim was based on a preference and was raised by way of a 57g objection. The trustee argued that even permissive counterclaims could be summarily adjudicated under the consent theory, but the court reserved judgment on the point, having found that the counterclaim arose out of the same transaction as the claim filed by the creditor.<sup>108</sup>

### G. Ninth Circuit

In 1960, the Ninth Circuit decided *Peters v. Lines*,<sup>109</sup> in which a creditor filed a claim alleging damages for breach of contract by the bankrupt, and the trustee counterclaimed for breach of the same contract. The bankruptcy court granted an affirmative judgment to the trustee on his counterclaim, and was affirmed by the district court.<sup>110</sup> The Ninth Circuit, agreeing with the principle of the

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<sup>105</sup> *Id.* at 633.

<sup>106</sup> *Id.* at 633-34.

<sup>107</sup> 269 F.2d 213 (4th Cir. 1959).

<sup>108</sup> *Id.* at 215.

<sup>109</sup> 275 F.2d 919 (9th Cir. 1960).

<sup>110</sup> In the Matter of Snow Camp Logging Co., 168 F. Supp. 420 (N.D. Cal. 1958).

judgment below although reducing its amount, held that the creditor, by filing his proof of claim, consented to the summary jurisdiction of the bankruptcy court to render an affirmative money judgment for the trustee on a counterclaim arising out of the same transaction on which the claim was based.<sup>111</sup> The court emphasized that to force the trustee to split his cause of action in order to obtain affirmative relief would be illogical, and pointed out that the same reasoning underlies Federal Rule 13 (a).<sup>112</sup>

The opinion of U. S. District Judge Mathes in *In re Nathan*<sup>113</sup> has become a landmark in this area. Witness the laudatory language of Charles Elihu Nadler:

The reasoning of . . . the Referee, and sustaining opinion of . . . Judge Mathes, both following the pioneer approach of . . . Judge Yankwich (*In re Mercury Engineering Co.*), are examples of scholarly research, keen analysis, and courageous departure from antiquated traditional thinking. Anyone interested in this area of summary jurisdiction must read *In re Nathan*.<sup>114</sup>

There, the trustee, in response to a creditor's claim for 13,000 dollars based on the bankrupt's promissory note, filed a counterclaim to recover preferences in the amount of 54,000 dollars. In reviewing the question of whether the creditor should be allowed to withdraw his claim, Judge Mathes was faced with the problem of deciding whether the bankruptcy court had jurisdiction to entertain the trustee's affirmative counterclaim.<sup>115</sup> He held, in part, that since an adjudication of the defenses and set-off to the claim would be res judicata in a plenary suit, the legal result of allowing a plenary suit on the counterclaim would be the same as if consent had been given the bankruptcy court to entertain the affirmative counter-

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<sup>111</sup> 275 F.2d at 925. The court quoted with approval the distinction made in *In the Matter of Majestic Radio & Television Corp.*, 227 F.2d 152 (7th Cir. 1955), *cert. denied*, 350 U.S. 995 (1956), concerning the difference between counterclaims arising from the same and from separate transactions. 275 F.2d at 925 & n.4.

<sup>112</sup> The court cited with approval (275 F.2d at 925) the opinion in *In the Matter of Farrell Publishing Corp.*, 130 F. Supp. 449, 453-54 (S.D.N.Y. 1955), concerning the interrelation of the consent theory with rule 13 (a).

<sup>113</sup> 98 F. Supp. 686 (S.D. Cal. 1951).

<sup>114</sup> Nadler, *Summary Jurisdiction to Render Affirmative Judgment on Counterclaims, Setoffs and Reclamations*, 29 REF. J. 39, 42 (1955). (Footnote omitted.)

<sup>115</sup> "If the bankruptcy court does not have such jurisdiction, then . . . that court could not properly permit the claim to be withdrawn because the trustee's counterclaim for the preference would not 'remain pending for independent adjudication'—the prerequisite to withdrawal provided in Rule 41 (a) (2) of the Federal Rules of Civil Procedure." 98 F. Supp. at 691.

claim.<sup>116</sup> Additionally, the policy of the Bankruptcy Act, said Judge Mathes, is to effect a quick and summary disposal of questions arising in the case, and no substantial right of the creditor would be impinged by allowing summary adjudication.<sup>117</sup> Therefore, filing a claim was held to constitute consent to jurisdiction.

#### H. Second Circuit

In *Chase Nat'l Bank v. Lyford*,<sup>118</sup> a section 77<sup>119</sup> railroad reorganization, the Court of Appeals for the Second Circuit, relying on *Hillman*, upheld the bankruptcy court's right to consider an affirmative money judgment against the claimant bank. The court disposed of the bank's contention that section 23 of the Bankruptcy Act rescued it from the summary jurisdiction of the bankruptcy court by holding that the filing of a claim by the bank waived the *venue* provisions of section 23. The court said:

The bank contends that, under section 23 . . . no summary proceedings as to the bank balance can be brought against the bank over its objection, because it is, in that respect, an adverse claimant. That contention (which of course relates not to "jurisdiction" but to venue) we consider untenable.

. . . The Supreme Court [in *Alexander v. Hillman*] . . . said: "By presenting their claims respondents subjected themselves to all the consequences that attach to an appearance . . ." We think that the doctrine of that case is not limited to a case where claims are filed by wrong-doing officers and directors (or the like). And we see no reason why that doctrine is not applicable to proceedings under section 77, no reason why the venue provisions of section 23 were not waived when the bank filed its claim against the debtor here.<sup>120</sup>

A New York district court in *In the Matter of Farrell Publishing Corp.*<sup>121</sup> in 1955 also held that the *Hillman* doctrine applied to a bankruptcy proceeding. The court stated that filing of a claim implied consent to the exercise of the bankruptcy court's summary jurisdiction to grant affirmative relief on the trustee's "compulsory" counterclaim.<sup>122</sup> The filing of a claim was likened to institution

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<sup>116</sup> *Id.* at 691-92.

<sup>117</sup> *Id.* at 692.

<sup>118</sup> 147 F.2d 273 (2d Cir. 1945).

<sup>119</sup> Bankruptcy Act § 77, 49 Stat. 911 (1935), as amended, 11 U.S.C. § 205 (1964).

<sup>120</sup> 147 F.2d at 276-77. (Footnotes omitted.)

<sup>121</sup> 130 F. Supp. 449 (S.D.N.Y. 1955).

<sup>122</sup> *Id.* at 452.

of an action in federal court, where a defendant must assert his compulsory counterclaim or lose it.<sup>123</sup>

The dictum of Judge Learned Hand in *Conway v. Union Bank of Switzerland*,<sup>124</sup> a chapter X proceeding, sheds further light on the thinking of the Second Circuit. The court noted that a creditor or stockholder, by intervening to assert his interest in the assets, becomes a party to the proceeding and "exposes himself to every defence that the insolvent may have to his claim, including set-offs or counterclaims . . ." <sup>125</sup> Judge Hand reasoned that "any counterclaim" should be enforced in its entirety in that a debtor would otherwise be "forced to split his claim, recovering enough of it in the insolvency proceeding to cancel the claim, but being obliged to seek out the creditor where he could get personal jurisdiction over him in order to recover the remainder."<sup>126</sup> He noted further that the plenary suit would raise only a "formal obstacle" to affirmative recovery on the claim, since the decision on the set-off in the insolvency proceeding would conclusively settle all the facts.<sup>127</sup>

In *Nortex Trading Corp. v. Newfield*,<sup>128</sup> the Second Circuit recently upheld an order of the district court allowing the referee to enter an affirmative money judgment on the trustee's order to show cause alleging a preference of 118,000 dollars. The court, while not specifically referring to the Federal Rules, held that the filing of a claim by a creditor is analogous to the commencement of an action,<sup>129</sup> and relying on *Inter-State Bank v. Luther*, *Conway v. Union Bank*, *In re Solar Mfg.*, and *In re Nathan* the court stated that counterclaims by a trustee are within the bankruptcy court's summary jurisdiction, and the claimant is deemed to consent to this summary jurisdiction upon filing its proof of claim.<sup>130</sup> Since the trustee's order to show cause was in the nature of an answer with request for affirmative relief and thus within the jurisdiction of the bankruptcy court, personal service was held not to be necessary.<sup>131</sup>

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<sup>123</sup> *Id.* at 452-53.

<sup>124</sup> 204 F.2d 603 (2d Cir. 1953), cert. dismissed per stipulation, 350 U.S. 978 (1956).

<sup>125</sup> 204 F.2d at 607.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*

<sup>128</sup> 311 F.2d 163 (2d Cir. 1962).

<sup>129</sup> *Id.* at 164 (citing *In the Matter of American Anthracite & Bituminous Coal Corp.*, 22 F.R.D. 504 (S.D.N.Y. 1958)).

<sup>130</sup> 311 F.2d at 164.

<sup>131</sup> *Ibid.*

The *Nortex* court did not distinguish between compulsory and permissive counterclaims, and it does not appear from the opinion which was involved.<sup>132</sup> It would appear that the door has thus been left open for summary jurisdiction over permissive counterclaims.

A review of Second Circuit cases would not be complete without some mention of *Kleid v. Ruthbell Coal Co.*,<sup>133</sup> one of a number of cases which held that an objection of the trustee under section 57g could only be a defense and not a counterclaim, and that a plenary suit would be necessary to invalidate a preference or voidable transfer.<sup>134</sup> Obviously, these cases have been overruled by *Katchen*.

### I. Fifth Circuit

Until recently, the Fifth Circuit has exhibited great reluctance to extend summary jurisdiction. In *B. F. Avery & Sons v. Davis*<sup>135</sup> the court of appeals in a 57g proceeding held that the bankruptcy court may not grant any money judgment on the trustee's counterclaim on a preference, but must hold the claim until a plenary suit is prosecuted. This has clearly been overruled by *Katchen*, but the decision nevertheless may shed some light on the Fifth Circuit's attitude toward non-57g objections and counterclaims. However, it is submitted that *Avery* should not be regarded as impinging upon the *Hillman* doctrine, since the court failed to face the consent question arising from the case's facts. The court erroneously likened the trustee's action to a turnover order and then applied the usual test of possession to hold that the bankruptcy court lacked jurisdiction.<sup>136</sup> In that the court failed to discuss the consensual aspect of the creditor's claim, it is difficult to accord *Avery* great authority on the question at hand. Regrettably, however, the case has been considered controlling by some courts.<sup>137</sup>

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<sup>132</sup> The character of the counterclaim is not apparent from the lower court opinion either. In the Matter of Kaunitz & O'Brien, 205 F. Supp. 259 (S.D.N.Y. 1962).

<sup>133</sup> 131 F.2d 372 (2d Cir. 1942).

<sup>134</sup> E.g., Triangle Elec. Co. v. Foutch, 40 F.2d 353 (8th Cir. 1930); Atwood-Larson Co. v. Hasvold, 280 Fed. 385 (8th Cir. 1922) (by implication).

<sup>135</sup> 192 F.2d 255 (5th Cir. 1951), cert. denied, 342 U.S. 945 (1952).

<sup>136</sup> This same contention was made in *Nortex Trading Corp. v. Newfield*, 311 F.2d 163 (2d Cir. 1962), but was there properly rejected.

<sup>137</sup> *In re Houston Seed Co.*, 122 F. Supp. 340 (N.D. Ala. 1954), is a holding disallowing permissive counterclaims upon the "controlling" authority of *Avery*. See also *In re Tommie's Dine & Dance*, 102 F. Supp. 627 (N.D. Tex. 1952). It should be noted that the counterclaims in both these cases arose from different transactions than the claim.

Perhaps more important is the Fifth Circuit's recent decision in *Gill v. Phillips*,<sup>138</sup> in which the court noted that most circuits have now adopted the proposition that the filing of a proof of claim constitutes consent to the bankruptcy court's jurisdiction on matters arising out of the same transaction upon which the proof of claim was based. Since *Avery* involved an unrelated counterclaim, said the court, the position of the Fifth Circuit on related counterclaims is "not clear."<sup>139</sup> *Gill* appears prophetic of the attitude of the Fifth Circuit. On rehearing, the court said:

[O]n the remand the referee is free to allow appropriate amendments to the pleadings and conduct further proceedings on this point [whether the counterclaim arose out of same transaction] if it is procedurally feasible to do so. As we pointed out in our opinion, it would not necessarily be inconsistent with *B. F. Avery & Sons, Inc. v. Davis* . . . to premise summary jurisdiction on such a theory.<sup>140</sup>

#### J. Tenth Circuit

The Tenth Circuit opinions in *Katchen* and *Inter-State* have already been discussed.

### VII

#### WHERE DO WE GO FROM HERE?

We still have no Supreme Court pronouncement on non-57g compulsory counterclaims, on permissive counterclaims generally, and on the validity of the consent theory. Nor do we know whether the claimant may, if he carefully and expressly does so in his claim, preserve his right to a plenary suit on any subsequent counterclaim the trustee may raise. Additionally, even where a 57g counterclaim is raised, we do not know what form the referee's order should take, or how it will be enforced.

#### A. Non-57g Compulsory Counterclaims

The *Katchen* counterclaims were said by the Tenth Circuit to arise out of the same transaction on which the claim was based.<sup>141</sup> They were, therefore, compulsory counterclaims within the meaning of rule 13 (a), but, being preference claims, they were included under

<sup>138</sup> 337 F.2d 258 (5th Cir. 1964), rehearing denied *per curiam*, 340 F.2d 318 (5th Cir. 1965).

<sup>139</sup> 337 F.2d at 264.

<sup>140</sup> *Gill v. Phillips*, 340 F.2d 318 (5th Cir. 1965) (denying rehearing *per curiam*).

<sup>141</sup> See *Katchen v. Landy*, 336 F.2d 535 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966).

section 57g. As previously pointed out, the Supreme Court bot-tomed its decision on section 57g, and made no mention of rule 13 (a) nor of section 68.

However, since there is practically no dissent among the circuits on the question of compulsory counterclaims arising out of the same transaction,<sup>142</sup> it would come as the greatest surprise if the Supreme Court reversed the trend in this area. The precise theory by which they would be upheld is, however, open to question. The commonest ground employed by the courts of appeals has been, as we have seen, that a creditor by filing a claim impliedly consents to summary jurisdiction in the bankruptcy court. The fact that it is difficult to find express statutory authority for such jurisdiction does not seem to have caused much hesitation. The use of section 23 to establish jurisdiction appears improper, and the courts have been reluctant to rely heavily on Federal Rule 13 (a). Nevertheless, the policies of expedient administration and, especially, avoidance of multiple suits, and the flexibility inherent in the equitable nature of bankruptcy courts<sup>143</sup> all militate toward adjudication of compulsory counterclaims in summary fashion. *Katchen* certainly tends in that direction.

#### B. *Permissive Counterclaims*

Those who advocate the extension of summary jurisdiction to permissive counterclaims can derive considerable comfort from *Katchen*. The Supreme Court relied heavily on *Hillman* and quoted it at length, and the counterclaims in *Hillman* were permissive and sounded in tort, whereas the claims sounded in contract. *Katchen* also placed great emphasis on the need for inexpensive and expeditious bankruptcy administration. Obviously, to the extent that the trustee might be relegated to a plenary suit to recover a permissive counterclaim, these needs would not be effectuated. Furthermore, the Supreme Court's reasons for denying a jury trial seem equally applicable to a permissive counterclaim as to a 57g situation.

It has been argued that if the referee had jurisdiction to entertain permissive counterclaims, he might "find himself trying hotly

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<sup>142</sup> Even the Fifth Circuit in *Gill v. Phillips*, 337 F.2d 258 (5th Cir. 1964), *re-hearing denied per curiam*, 340 F.2d 318 (5th Cir. 1965), left the door open on compulsory counterclaims in its opinion on rehearing.

<sup>143</sup> *Katchen v. Landy*, 382 U.S. 323, 327 (1966); *Pepper v. Litton*, 308 U.S. 295, 304 (1939); *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934).

contested slander cases, personal injury matters, or, indeed, any cause of action known to the law."<sup>144</sup> This argument overlooks the fact that section 70a (5) provides that, "rights of action ex delicto for libel, slander, injuries to the person . . . , seduction, and criminal conversation shall not vest in the trustee" unless subject to legal process under state law.<sup>145</sup> Certainly, the permissive counterclaim, to be entertainable by a bankruptcy court, would have to fall into the category of causes of action passing to the trustee under section 70.<sup>146</sup>

If, as *Katchen* would indicate, economy and expediency in administration are overriding and dominant considerations, then, if given the opportunity, the Supreme Court may give its blessing to the extension of summary jurisdiction to the area of permissive counterclaims.

### C. *May a Claimant Protect Himself by Careful Phrasing of His Claim?*

May a creditor file a proof of claim and reserve his right to a plenary suit with respect to any counterclaim which the trustee may register against him? There are cases which suggest that such an effort might be successful.<sup>147</sup>

Probably such a tack would not succeed where a 57g objection is at issue. The rationale of *Katchen* could lead to no other conclusion. No definite answer can be given, however, to situations outside of section 57g. Had the Supreme Court grounded its decision in *Katchen* upon the claimant's implied consent to counterclaims by invoking the court's summary jurisdiction, then those cases noted above and the reasoning behind them would have validity—consent could not be found where the claimant expressly conditioned his appearance on non-consent. However, *Katchen* indicates that an attempted reservation in a proof of claim would not be permitted to defeat congressional intent. If *Katchen* is extended to non-57g areas

<sup>144</sup> Palmer, *The Supreme Court Speaks on Bankruptcy; A Review of Katchen v. Landy, Segal v. Rochelle, and United States v. Speers*, 40 REF. J. 44, 45 (1966).

<sup>145</sup> Bankruptcy Act § 70a (5), 52 Stat. 880 (1938), 11 U.S.C. § 110 (a) (5) (1964).

<sup>146</sup> "The trustee . . . shall . . . be vested . . . with the title . . . to all of the following kinds of property . . . (5) . . . rights of action . . . *Provided*, That [see text accompanying note 145 *supra*] . . ." Bankruptcy Act § 70a, 52 Stat. 879 (1938), 11 U.S.C. § 110 (a) (1964).

<sup>147</sup> See *In re Eakin*, 154 F.2d 717 (2d Cir. 1946); *Glens Falls Ins. Co. v. Strom*, 198 F. Supp. 450, 458-59 (S.D. Cal. 1961); *In the Matter of Industrial Associates*, 155 F. Supp. 866, 871 (E.D. Pa. 1957); *In re G. L. Odell Const. Co.*, 119 F. Supp. 578 (D. Colo. 1954).

on the theory that congressional intent favors expediency and inexpensiveness, then an attempted reservation would probably be deemed ineffective.

D. *What Should Be the Form of the Referee's Order?*

Where the referee grants affirmative relief, should it be in the form of a money judgment, reciting that the trustee "have and recover . . . for all of which let execution issue," or should the referee certify the matter to the district judge for the entry of a money judgment by him? Or should the referee expressly *direct* the payment of money to the trustee by the claimant? If so, how would such an order be enforced? Normally, where orders of the referee are disobeyed, as in a turnover order situation, the recalcitrant respondent is certified to the district judge and contempt proceedings are held.

The reported decisions give us no help in answering these questions. In *Katchen*, Judge Seth, in his concurring opinion, merely said, "repayment of the total of such payments was ordered."<sup>148</sup> The Supreme Court opinion stated only that "judgment was rendered."<sup>149</sup>

Certainly, no language in the Bankruptcy Act gives express authority to the referee to enter a money judgment. This is a knotty procedural problem, which can be easily settled and should be. Since the passage of section 2075 of the Judiciary Code on October 3, 1964,<sup>150</sup> the Supreme Court has had the authority to prescribe by general rules "the forms of process, writs, pleadings, and motions, and the practice and procedure under the Bankruptcy Act."<sup>151</sup> The Supreme Court is empowered, by this law, to amend the Bankruptcy Act in any procedural respect. Much work is being done in this area by the Advisory Committee on Bankruptcy Rules under the chairmanship of Judge Philip Forman. It is to be hoped that this problem area, at least, can be quickly clarified.

The wheels of legislative change grind slowly. It will be several years before the problems left unresolved by *Katchen* can expect to be solved by Congress. Perhaps, in the interim, appropriate cases will come to the attention of the Supreme Court and will result in corrective judicial legislation.

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<sup>148</sup> 336 F.2d at 538.

<sup>149</sup> 382 U.S. at 325.

<sup>150</sup> 28 U.S.C. § 2075 (1964).

<sup>151</sup> *Ibid.*