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Bankruptcy--Counterclaims Arising Under Section 57(g)--Implied Consent to Summary Jurisdiction [*Katchen v. Landy*, 382 U.S. 323 (1966)]

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Recent Decisions

BANKRUPTCY — COUNTERCLAIMS ARISING UNDER SECTION 57(g) — IMPLIED CONSENT TO SUMMARY JURISDICTION

Katchen v. Landy, 382 U.S. 323 (1966).

Bankruptcy courts, established by act of Congress,¹ are courts which have legal and equitable jurisdiction to settle bankruptcy matters through summary proceedings.² Frequently, suits before bankruptcy courts involve the validity of preferences which occur when an insolvent debtor makes payment on a claim of one of his creditors to the exclusion of the others.³ The trustee in bankruptcy may avoid such preferences if it can be shown that the preferred creditor had "reasonable cause to believe that the debtor was insolvent."⁴ Some interesting questions have arisen concerning the extent of the jurisdiction of bankruptcy courts in the establishment of preferences under section 57(g) of the Bankruptcy Act.⁵ The courts of appeals have been divided as to whether a creditor who submits a claim against the trustee impliedly consents to the jurisdiction of the bankruptcy court and its summary proceedings in determining section 57(g) matters or unrelated counterclaims.⁶

¹ Bankruptcy Act of 1898, 30 Stat. 544, as amended, 11 U.S.C. §§ 1-1255 (1964) [hereinafter cited as 1898 Act]. The authority for this act comes directly from the Constitution. U.S. CONST. art. I, § 8. See also Note, *Implied Consent to Summary Jurisdiction in Bankruptcy: The Forgotten Right to Jury Trial*, 114 U. PA. L. REV. 256 (1965).

² 1898 Act § 2, 30 Stat. 545, as amended, 11 U.S.C. § 11 (1964); *Pepper v. Litton*, 308 U.S. 295, 304 (1939); see Moore, *Res Judicata and Collateral Estoppel in Bankruptcy*, 68 YALE L.J. 1, 33 (1958); Treister, *Summary Jurisdiction*, 36 J. OF THE S.B. OF CAL. 1085, 1086 (1961); cf. Note, *supra* note 1.

³ BLACK, LAW DICTIONARY 1342 (4th ed. 1951). MacLachlan lists the eight elements of a preference required by § 60 of the Bankruptcy Act. They are (1) a transfer, (2) by the bankrupt, (3) of the bankrupt's property, (4) made within four months of bankruptcy, (5) to a creditor or for his benefit, (6) for or on account of an antecedent debt, (7) while the debtor was insolvent, (8) with the effect of giving the transferee a greater percentage of his debt than some other creditor of the same class. MACLACHLAN, BANKRUPTCY § 248 (1956); 1898 Act § 60, 30 Stat. 562, as amended, 11 U.S.C. § 96 (1964).

⁴ MACLACHLAN, *op. cit. supra* note 3, § 267; 1898 Act § 60(b), 30 Stat. 562, as amended, 11 U.S.C. § 96(b) (1964).

⁵ 1898 Act § 57(g), 30 Stat. 560, as amended, 11 U.S.C. § 93(g) (1964): The claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this title, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments, or encumbrances. *Ibid.*

⁶ *Katchen v. Landy*, 382 U.S. 323 (1966); *Interstate Nat'l Bank v. Luther*, 221

In *Katchen v. Landy*,⁷ the Supreme Court has clarified the rule as to the extent of the power of bankruptcy courts to grant affirmative relief in summary proceedings involving section 57(g) matters. Katchen, the petitioner, had been an accommodation maker on two corporate notes made by the bankrupt. Following a costly fire, all of the funds and collections of the corporation were placed in a trust fund under petitioner's control. The payments on the corporate notes were made to petitioner out of this trust fund within four months of bankruptcy. In the subsequent bankruptcy proceeding, petitioner filed two claims — one for rent owed him by the bankrupt, and a second for payments made on the notes out of his personal account. The trustee in bankruptcy claimed the payments from the trust fund were voidable preferences and therefore demanded affirmative relief for the amount of these preferences. In addition, he demanded money from an unpaid stock subscription owed by petitioner.

The trial court granted affirmative relief to the trustee on both of these counterclaims.⁸ The Tenth Circuit affirmed the decision but denied the counterclaim for the unpaid stock subscription.⁹ The court held that the stock subscription did not arise out of petitioner's claim and thus he had not impliedly consented to the court's jurisdiction.¹⁰ As the trustee did not contest the adverse ruling with respect to the stock subscription, the Supreme Court was concerned only with the procedure used in establishing the preference. Petitioner argued that the bankruptcy court had been given no authority by Congress to determine such matters in a summary manner. Further, he argued, if the Court affirmed the summary proceedings in this case, future creditors would be denied their right to a jury trial. After presenting the problem and thoroughly discussing the development of the case law in the area, the court held "that the Act does confer summary jurisdiction to compel a claimant to surrender preferences that under § 57(g) would require disallowance of the claim."¹¹

F.2d 382 (10th Cir. 1955), *appeal dismissed*, 350 U.S. 944 (1956); Seligson & King, *Jurisdiction and Venue in Bankruptcy*, 36 REF. J. 73 (1962); Note, *Bankruptcy: Section 23 Consent and the Extension of the Hillman Doctrine*, 49 VA. L. REV. 571, 579 (1963).

⁷ 382 U.S. 323 (1966).

⁸ *Ibid.*

⁹ *Katchen v. Landy*, 336 F.2d 535 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966).

¹⁰ *Ibid.*

¹¹ *Katchen v. Landy*, 382 U.S. 323, 335 (1966). It is interesting to note that in

The *Katchen* Court had three alternatives open to it as had been previously set forth in *Interstate Nat'l Bank v. Luther*.¹² The first solution would have been to reject the theory of implied consent to summary jurisdiction in all cases — the position which was initially taken by many courts.¹³ While the Court rejected this solution in *Katchen*, most courts have adhered to this view with respect to counterclaims which are entirely unrelated to the creditor's claim.¹⁴

A second approach would give summary jurisdiction in the establishment of preferences under section 57 (g), but would deny the courts' authority to grant affirmative relief on the trustee's counterclaim.¹⁵ However, this type of reasoning would lead to an impractical result. If a court finds a valid preference, it would then be necessary for the trustee to institute a subsequent plenary action to recover the funds paid in the voidable preference. Since principles of *res judicata* apply to bankruptcy proceedings, the court in the subsequent plenary action would be bound by the referee's decision with respect to the voidable preference.¹⁶ The only possible function of the jury would be to establish the amount of damages. This method would delay a final settlement of the bankruptcy action because the trustee would have to await the longer and more involved proceedings of a plenary suit to completely determine this claim.

The third and most recent view is the one adopted by the Su-

a footnote, Mr. Justice White calls attention to the exact language of §57(g) with the following observation:

The language of this section, it will be observed, is concerned with *creditors* rather than *claims* and thus contemplates that allowance of a claim may be conditioned on surrender of preferences received with respect to transactions unrelated to the claims. The exact reach of § 57(g) is not entirely settled.

Id. at 330 n.5.

¹² 221 F.2d 382 (10th Cir. 1955), *appeal dismissed*, 350 U.S. 944 (1956).

¹³ See, e.g., *Louisville Trust Co. v. Comingor*, 184 U.S. 18 (1901); Moore, *supra* note 2, at 34.

¹⁴ *Daniel v. Guaranty Trust Co.*, 285 U.S. 154 (1932); *In the Matter of Majestic Radio & Television Corp.*, 227 F.2d 152 (7th Cir. 1955), *cert. denied*, 350 U.S. 995 (1956); *B. F. Avery & Sons Co. v. Davis*, 192 F.2d 255 (5th Cir. 1951), *cert. denied*, 342 U.S. 945 (1952). *Contra*, *Katchen v. Landy*, 336 F.2d 535 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966); *Interstate Nat'l Bank v. Luther*, 221 F.2d 382 (10th Cir. 1955), *appeal dismissed*, 350 U.S. 944 (1956); *In re Nathan*, 98 F. Supp. 686 (S.D. Cal. 1951).

¹⁵ *Kleid v. Ruthbell Coal Co.*, 131 F.2d 372 (2d Cir. 1942). The court considered the issue of a voidable preference as purely a matter of defense and not a counterclaim requiring affirmative relief. *Id.* at 373, Moore, *supra* note 2, at 34-35; Note, *supra* note 6, at 579.

¹⁶ Moore, *supra* note 2, at 2.

preme Court in *Katchen*.¹⁷ This line of authority grants *complete relief* to the trustee by a summary proceeding in cases under section 57(g). Supporters of this modern trend argue that since bankruptcy is primarily an equity proceeding, once the court accepts jurisdiction, it may hear all aspects of the suit. Many courts, including the *Katchen* Court, have used the doctrine of *Alexander v. Hillman*¹⁸ in holding that a creditor impliedly consents to summary jurisdiction of all phases of the suit when he submits a claim for adjudication. Mr. Justice White based the majority opinion on the underlying principle of the Bankruptcy Act which seeks rapid and inexpensive settlements.¹⁹ In dismissing petitioner's argument that he was being deprived of a jury trial, the majority used the *Hillman* doctrine pointing out that such a trial would be wasted since the referee's determination of the issues is *res judicata*.²⁰

Since the Court has relied so heavily on the policy of expedient settlements in relation to jury trials, it is necessary to examine the soundness of this balance and its significance in future cases involving counterclaims which are totally unrelated to the creditor's claim. Commentators call attention to a number of provisions of the Bankruptcy Act which they consider examples of a congressional intention to provide for efficient and complete settlement of bankruptcy matters.²¹ The argument is that this policy is best effected by a summary disposition of all claims against the estate. A summary proceeding dispenses with formal pleadings and often utilizes affidavits rather than the testimony of witnesses. Also, the court may fix the date of the hearing and shorten the statutory time requirements of plenary suits. It is thus the short and informal character

¹⁷ Other cases which have followed this view are: *Peters v. Lines*, 275 F.2d 919 (9th Cir. 1960); *Continental Gas. Co. v. White*, 269 F.2d 213 (4th Cir. 1959); *Interstate Nat'l Bank v. Luther*, 221 F.2d 382 (10th Cir. 1955), *appeal dismissed*, 350 U.S. 944 (1956); *Columbia Foundry Co. v. Lochner*, 179 F.2d 630 (4th Cir. 1950); *In re Nathan*, 98 F. Supp. 686 (S.D. Cal. 1951).

¹⁸ 296 U.S. 222 (1935). While this original case involved an equitable receivership, the theory was brought into the bankruptcy area in *Florence v. Kresge*, 93 F.2d 784 (4th Cir. 1938). See also Note, *supra* note 6.

¹⁹ *Katchen v. Landy*, 382 U.S. 323 (1966). See also Seidman, *Summary Jurisdiction of the Referee: Some Recent Developments*, 39 REF. J. 100 (1965); Seligson & King, *supra* note 6.

²⁰ *Katchen v. Landy*, *supra* note 19.

²¹ 1898 Act § 2, 30 Stat. 545, as amended, 11 U.S.C. § 11 (1964); see Gendel, *Summary Jurisdiction in Bankruptcy Related to Possible Referee Disqualification*, 51 CALIF. L. REV. 755 (1963); Jenkins, *Controversies in Bankruptcy: Summary vs. Plenary Jurisdiction*, 51 ILL. B.J. 792, 799 (1963); Seidman, *supra* note 19; Seligson & King, *supra* note 6; Note, *supra* note 6.

of a summary proceeding which makes it so desirable in bankruptcy cases.²²

Although creditors invariably complain that they are being deprived of their right to a jury trial, one writer suggests that perhaps the underlying factor is the attorney's desire to argue the case in the familiar surroundings of a plenary suit.²³ The same author contends that a referee would be "more expert in the intricacies of bankruptcy law and the field of creditor's remedies than . . . a less specialized judge."²⁴ In examining all of the factors which go into balancing the right to a jury trial against the policy of expediency found in the Bankruptcy Act, one may easily be convinced that a summary proceeding is not so arbitrary and unjust as to deprive the creditor of his basic rights. It is generally agreed that the basic distinctions between summary and plenary suits are merely procedural in nature.²⁵ In discussing this very point, Seligson and King say:

The courts must weigh the advantages of expedition in the administration of bankrupt estates against the inconvenience and procedural rights of claimants. If that is done the former should prevail for, in the last analysis, while the claimant may be deprived of his procedural rights to a plenary trial in a more convenient forum, there will be *no denial of due process of law*.²⁶

Although *Katchen v. Landy*²⁷ deals exclusively with compulsory counterclaims, it will be interesting to see if the policy of expediency

²² Central Republic Bank & Trust Co. v. Caldwell, 58 F.2d 721 (8th Cir. 1932).

The main characteristic differences between a summary proceeding and a plenary suit are: The former is based upon a petition, and proceeds without formal pleadings; the latter proceeds upon formal pleadings. In the former, the necessary parties are cited in by order to show cause; in the latter, formal summons brings in the parties other than the plaintiff. In the former, short time notice of hearing is fixed by the court; in the latter, time for pleading and hearing is fixed by statute or by rule of court. In the former, the hearing is quite generally upon affidavits; in the latter, examination of witnesses is the usual method. In the former the hearing is sometimes *ex parte*; in the latter, a full hearing is had. *Id.* at 731. See also Treister, *supra* note 2, at 1086.

²³ Treister, *supra* note 2.

²⁴ *Id.* at 1091.

²⁵ Seidman, *supra* note 19; Treister, *supra* note 2. *But see* Note, *supra* note 6, in which the author says:

[R]egardless of the persuasive reasons that may be called to bear, fundamental principles cannot be lightly set aside. . . . Although the results obtained are highly desirable and quite reasonable, the area appears to be one which requires statutory change rather than expansion through loose construction in the courts. *Id.* at 590.

²⁶ Seligson & King, *supra* note 6, at 78. (Emphasis added.)

²⁷ 382 U.S. 323 (1966).

and the equitable nature of the proceedings are strong enough to outweigh the right to a jury trial in cases of unrelated counterclaims.

It is obvious that in dealing with unrelated counterclaims the equitable argument used in the above cases does not apply. Although a creditor who presents a claim may give implied consent to a full adjudication of that claim, it is questionable whether he consents to summary jurisdiction of all unrelated matters.²⁸ In addition, section 23(b) of the act provides that where a trustee brings suit, it must be brought in a court where the bankrupt could have brought the action.²⁹ For example, if the trustee has a large counterclaim arising in tort, having no connection with section 57(g), he must bring the suit in a court where the bankrupt would have sued prior to bankruptcy. In such a case, a jury would determine the issues of fact.³⁰ Assuming the "equity argument" to be in valid, the only justification which the courts have in denying a creditor his right to a jury trial is the policy of the Bankruptcy Act for quick and final settlements.

A noted authority on bankruptcy urges that the Federal Rules of Civil Procedure give a trustee "the right to allege any counterclaim which is included in 13(b)."³¹ An article published in a periodical distributed to referees in bankruptcy considers the underlying policy of the act sufficient to outweigh the right to a jury trial even in the area of unrelated counterclaims.³² It is also significant

²⁸ The equity court has jurisdiction to adjudicate all matters before it, but an unrelated claim against the creditor is not before it. As a practical matter, this might convince a creditor who is subject to a large counterclaim not to file a claim against the estate to avoid a summary proceeding on the matter.

²⁹ 1898 Act § 23(b), 30 Stat. 552, as amended, 11 U.S.C. § 46(b) (1964). If the equity courts have jurisdiction over all matters, then what is the purpose of this section?

³⁰ It should be noted that Treister's argument for summary jurisdiction based on the judge's superior knowledge of bankruptcy law and creditor's remedies might work against extension of the summary jurisdiction of the bankruptcy court to include a permissive counterclaim based on tort. See text accompanying note 19 *supra*.

³¹ 2 COLLIER, BANKRUPTCY § 23.08 at 555 (1964). FED. R. CIV. P. 13 (b) states: "A pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim."

³² The article states:

Resolution of all issues in a single litigation is a most desirable objective and makes efficient use of judicial machinery. Where the aid of the bankruptcy court is invoked, whether by the filing of a proof of claim or otherwise, and a counterclaim, compulsory or permissive is pleaded by the trustee, the bankruptcy court should exercise the power to grant affirmative relief. . . . The trial of all issues by the bankruptcy court avoids multiplicity and circuity of action. Seligson & King, *supra* note 6, at 83.

The Tenth Circuit Court of Appeals has taken the lead in abandoning any distinc-