1929

Bankruptcy, Partnership, Voidable Judgment Liens

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COMMENT ON RECENT CASES

BANKRUPTCY—PARTNERSHIP—VOIDABLE JUDGMENT LIENS.—[United States] At length another cause of action[1] has come to rest and the law of bankruptcy as it involves the field of partnership has been clarified at one point. The Liberty National Bank over eight years ago secured a judgment against the Roanoke Provision Company, a partnership, and the two partners individually. They were insolvent at that time. This judgment became a lien upon the real estate of the judgment debtors. Within four months the partnership was adjudicated a bankrupt upon an involuntary petition which alleged insolvency. More than eight months thereafter the two partners separately and individually were adjudged bankrupts. The bank filed its claim, based on the judgments, against the separate estates of the two partners and asserted that it was entitled to priority by virtue of its lien. The trustee opposed this claim upon the theory that the adjudication of the partnership as bankrupt—as distinguished from the adjudication of the two partners individually—within four months after the judgment was secured caused the judgment lien to be "null and void" under sec. 67f of the Bankruptcy Act. The Supreme Court of the United States held in the case under review that the claim of the bank to priority was well founded and rejected the argument of the trustee.[2]

To state the decision in other terms the adjudication of the partnership as an entity is one thing and the adjudication of the partners individually is something different. The first ad-

1. *Liberty National Bank* v. *Bear* (1928) 48 Sup. Ct. Rep. 252. See also *Bear* v. *Liberty Natl. Bank* (1922) 285 Fed. 703; s. c. 265 U. S. 365, 44 Sup. Ct. Rep. 499, 68 L. Ed. 1057; s. c. 4 Fed. (2d) 240; 18 Fed. (2d) 281. No reference was made to *Ft. Pitt, etc., Co.* v. *Diser* (1917) 239 Fed. 443. It seems fundamentally to be opposed to the opinion under review.

2. Contrast these two points of view:

"It cannot be that the bankruptcy of the partnership carries the partners into the proceeding with their assets and liabilities for the purpose of proving debts, adjusting equities, preventing preferences generally, and distributing to creditors the individual as well as partnership assets, and yet does not carry them in for the two other main purposes of the bankruptcy statute, namely, protecting creditors against the preference of liens acquired within four months of bankruptcy, and discharging the debtor from his debts." 285 Fed. 705.

"We cannot believe that Congress intended to limit and weaken the broad provision of Sec. 5a permitting a partnership to be adjudged a bankrupt, by making it essential to such an adjudication that the partners should also be adjudged bankrupts individually. So to hold would make it impossible, in an involuntary proceeding, to adjudge bankrupt a partnership as a separate entity, although it was insolvent and had committed an act of bankruptcy, if any of the partners could not be adjudged a bankrupt because he had not committed an individual act of bankruptcy or was a person exempt from such an adjudication, or for any other adequate reason." 48 Sup. Ct. Rep. 252.

judication does not carry with it the adjudication of the partners individually for the purpose of setting a zero hour in the process of invalidating liens.

Thus it comes to pass that the United States Supreme Court has recognized the entity theory of a partnership under the Bankruptcy Act. So much is expressly avowed by Mr. Justice Sanford who wrote the opinion.

The law of partnership is made intricate because there is no agreement as to the fundamental theory underlying this sort of a business association. The conflict between the entity theory and the aggregate theory seems to be as sharp as ever. There seems to be a tendency to explain that this court or that court adheres to one theory or the other.[3] The writer has thought it more accurate to say that most, if not all, courts make use of both theories when convenient as devices for rationalizing results which they seek to reach. If the courts would only frankly avow what seems to be the truth probably there would be less confusion than there is today.

It has been frequently stated that section five of the Bankruptcy Act was written with a view of handling a partnership as an entity. But time is a great leveller of hopes and the results have not been what may have been expected.

It may be regarded as definitely settled that now a partnership may be adjudicated a bankrupt without regard to an adjudication of the partners individually.[4] The reverse is also true.[5] This partakes of the entity theory.

However if a partnership as an entity is made bankrupt the trustee may draw unto himself the individual assets of partners.[6] The decision which announced this has been something of a storm center. It is hardly consistent with an unadulterated entity theory.[7]

3. For example, see 41 Harv. Law Rev. 1044, 1046, reviewing the case here noted.

4. See the long list of decisions cited for this in the opinion under review.

5. In re *Mercur* (1903) 122 Fed. 384.

6. *Francis* v. *McNeal* (1913) 228 U. S. 695, 33 Sup. Ct. Rep. 701, 57 L. Ed. 1029, L. R. A. 1915-E, 706. In 41 Harv. Law Rev. 1045, it is stated: "It is settled in the federal circuit courts that a partner may be required to file a schedule of his individual assets and liabilities and that these assets may be administered in the partnership bankruptcy even though the partner is not bankrupt." This is followed by a note: "It is not clear whether the Supreme Court has directly decided this question. See *Francis* v. *McNeal* (1913) 228 U. S. 695. In this case the court assumed that the partner had consented to filing a schedule and so could not complain. The reasoning of the case, however, would render consent immaterial, and the lower courts treat it as an authority for their procedure."

The basis of this refinement seems to be a statement in the opinion that "Francis has consented and agreed to hand over his property according to the order of the court." One may doubt whether such an agreement means anything in particular. Most of us have to obey the orders of court whether or not we consent to them. Furthermore it would seem as if Francis resisted the order and thus the matter was taken into the U. S. Supreme Court.

7. Notice this language of Mr. Justice Holmes: "Finally it would be a third incongruity to grant a discharge in such a case from the debt consid-

Other steps in the process of administration in bankruptcy where a partnership is involved probe more deeply into partnership theory with resulting confusion and speculation. Some of the questions which have arisen are listed: (1) Does the adjudication of a partnership alone necessarily mean that the individual assets of a partner or partners are to be administered by the trustee for the creditors of the partnership? Or does he have choice?; (2) If, upon the adjudication of a partnership alone, the individual assets of a partner or partners are taken by the trustee for the creditors of the partnership, do creditors of partners individually have an opportunity to participate in the administration? Or will the assets which should be appropriated to the creditors of individual partners be turned back to the partners personally?; (3) If a partnership alone is adjudicated, no individual assets are handled, and then it is discharged, are the partners individually discharged from (*a*) partnership debts; (*b*) individual debts?; (4) Suppose in (3) that individual assets were handled, then what?; (5) If a partnership alone is adjudicated are the partners individually discharged from partnership or individual debts unless the order so states?; (6) If a partnership alone is adjudicated do the partners have to file schedules of individual creditors under sec. 17 (3)[8] in order to obtain a discharge from individual debts? Perhaps it is not too much to suggest that even though there have been some decisions[9] and considerable debate,[10] final answers have not been given to these questions excepting the answer given in *Myers* v. *International Trust Co.*[11]

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ered as joint but to leave the same persons liable for it considered as several. We say the same persons, for however much the difference between firm and members under the statute be dwelt upon, the firm remains at common law a group of men, and will be dealt with as such in the ordinary courts for use in which the discharge is granted."

8. Notice that by Sec. 17 of the Bankruptcy Act "a discharge . . . shall release a *bankrupt*. . . ." Such textual difficulties probably will be ignored.

9. *Nashville Saddlery Co.* v. *Green* et al. (1921) 127 Miss. 98, 89 So. 816; *Wm. R. Moore Dry Goods Co.* v. *Ford* (1920) 146 Ark. 227, 225 S. W. 320, 226 S. W. 139; *Ellet-Kendall Shoe Co.* v. *Miller* et al. (1923) 215 Pac. 417; *Abbott* v. *Anderson* (1914) 265 Ill. 285, 106 N. E. 782, L. R. A. 1915-F, 668; *Myers* v. *International Trust Co.* (1927) 273 U. S. 380. Cf. the effect of a discharge granted to a partner who alone has been adjudicated a bankrupt: *Jarecki Mfg. Co.* v. *McElwaine* (1901) 107 Fed. 249; In re *Kaufman* (1905) 136 Fed. 262; *Wagner Grocery Co.* v. *Dodd-Cooner Merc. Co.* (1921) 206 Ala. 627, 91 So. 487; 20 Harv. Law Rev. 569; *Lansing, etc.*, v. *Heinze* (1918) 184 App. Div. 129.

10. See note in L. R. A. 1915-F, 669, which argues that under *Francis* v. *McNeal*, "a court cannot legally adjudicate in bankruptcy and discharge the partnership as an entity apart from the members of the partnership"; 5 Minn. Law Rev. 309; 1 *Collier* "Bankruptcy" (13th ed.) p. 250; 5 Texas Law Rev. 400; 37 Harv. Law Rev. 614, critical of *Abbott* v. *Anderson* (1914) 265 Ill. 285; 21 Col. Law Rev. 290; 20 Harv. Law Rev. 589; 22 Col. Law Rev. 348; 10 Mich. Law Rev. 215; 35 Yale Law Jour. 362.

11. (1927) 273 U. S. 380.