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Bankruptcy - Discharges - Reasons for Denial

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BANKRUPTCY—DISCHARGES—REASONS FOR DENIAL.—One of the main objects of the Bankruptcy Act is to release the honest, though insolvent, debtor from the burden of his obligations in the interests of his family and the general public.[1] In the early bankruptcy acts the discharge of the bankrupt may have been incidental to the more important function, the providing for an equal distribution of his goods among the bankrupt's creditors, but in many of the voluntary cases arising under the present Bankruptcy Act, the administration or distribution of the bankrupt's estate is completed before the debtor files his petition for a discharge, and the sole object of the debtor in originally filing a petition in bankruptcy is that he may be relieved of the burden of his debts.[2] The grounds upon which a discharge may be denied are set out specifically in the present Act.[3] These provisions are to be liberally construed in the bankrupt's interest, and all implications and doubts are to be resolved in his favor.[4] Since it was the purpose of the law to relieve honest debtors the privilege of discharge is not to be denied by a construction both harsh and at variance with the general policy of the statute.[5]

Application for the discharge may be made by the bankrupt at any time after the expiration of one month from the date of adjudication and within twelve months thereafter.[6] This time limit may be extended six months if the bankrupt can show that he was unavoidably prevented from filing the application within the usual time.[7] When the application for discharge is not filed until more than eighteen months after the adjudication the bankruptcy court no longer has the power to pass upon it.[8] There is no obligation on the referee to notify the bankrupt or his attorney of the expiration of the time for filing the application; the bankrupt and his attorney must keep themselves informed of that to their own peril.[9]

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[1] "The determination of the *status* of the honest and unfortunate debtor by his liberation from encumbrance on future exertion is a matter of public concern * * * ." *Hanover Nat. Bank* v. *Moyses,* 186 U.S. 181, 192, 22 Sup. Ct. 857, 46 L.ed. 1113 (1902). "It is the purpose of the Bankrupt Act to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh from the obligations and responsibilities consequent upon business misfortunes." *Williams* v. *U. S. Fidelity Co.,* 236 U.S. 549, 555, 35 Sup. Ct. 289, 59 L.ed. 713 (1915).

[2] *Hardie* v. *Swafford Bros. Dry Goods Co.,* 165 Fed. 588, 20 L.R.A. (N.S.) 785 (C.C.A. 5th, 1908).

[3] Section 14(b), 30 STAT. 550 (1898), 32 STAT. 797 (1903), 36 STAT. 839 (1910), 44 STAT. 663 (1926), 11 U.S.C.A. 32(b) (1934).

[4] See *Webb* v. *Lynchburg Shoe Co.,* 107 Va. 807, 60 S.E. 130 (1908), and also *Hardie* v. *Swafford Bros. Dry Goods Co.,* 165 Fed. 588, 20 L.R.A. (N.S.) 785 (C.C.A. 5th, 1908).

[5] *Gilpin* v. *Merchants Nat. Bank,* 165 Fed. 607, 20 L.R.A. (N.S.) 1023 (C.C.A., 3rd, 1908).

[6] Section 14(a), 30 STAT. 550 (1898), 11 U.S.C.A. 32(a) (1934).

[7] Section 14(a), *supra* note 6. What amounts to unavoidable prevention lies within the discretion of the trial judge. *In re Waller,* 249 Fed. 187 (C.C.A. 7th, 1918). Misunderstanding between the bankrupt and his attorney or a mistake of law on the part of the attorney has been held to be excusable. *In re Churchill,* 197 Fed. 111 (E.D. Wis. 1912).

[8] *In re Wagner,* 139 Fed. 87 (D. C. Nev. 1905).

[9] *In re Knauer,* 133 Fed. 805, (N. D. Iowa 1904).

If the bankrupt has sought a release from his debts within the prescribed time, the release can be denied him only for the reasons set out in the Bankruptcy Act.[10] There is nothing in the Act which expressly precludes the debtor's getting a discharge affecting obligations listed once before with a petition in bankruptcy upon which the debtor had been adjudicated a bankrupt merely because the debtor had not filed an application for a discharge after the adjudication and within the statutory time. The fifth ground for denial of a discharge as set forth in the Bankruptcy Act refers only to previous *discharges* within six years before the filing of the application for a discharge in a second proceeding.[11] It can readily be seen that the idea of *res judicata* is important with respect to those debts for which a discharge has been refused in the first proceeding if the debtor lists the same debts when he or his creditors begin a second proceeding in bankruptcy against his estate.[12] But it is not a necessary corollary to that proposition that a debtor should be barred from subsequent relief in bankruptcy on the same scheduled obligations when he had neglected to apply for a discharge within the time set by statute after the adjudication on the first petition. There are some bankruptcy courts which have been willing to prescribe that such neglect, even if it is inadvertent on the part of the debtor, has the same effect on the debtor's subsequent position in a bankruptcy court as if the debtor had petitioned for a discharge and been denied it, and that any subsequent discharge for the same debts following adjudication on another petition in bankruptcy is barred whether the subsequent petition is filed within six years or at any other time after the filing of the first petition in bankruptcy.[13] These courts say that failure to apply within the period set out in the Act is equivalent to a judgment by default and establishes conclusively, so far as the creditors then scheduled are concerned, that the bankrupt is not entitled to a discharge.[14]

This line of reasoning reads into the Bankruptcy Act a provision which is not literally there, *viz.*, that failure to file an application for a discharge within the time permitted by the Act bars a subsequent discharge for the debts scheduled when the first petition in bankruptcy was filed.[15] One court which has had occasion to work out this additional restriction has explained that Congress must have intended to impose as a condition precedent to the debtor's getting a discharge, the filing of a petition therefor within the time prescribed, or the legislature would not have prescribed in the Act a time limit within which the debtor must make application.[16] Where

[10] Section 14(b), 30 STAT. 550 (1898), 32 STAT. 797 (1903), 36 STAT. 839 (1910), 44 STAT. 663 (1926), 11 U.S.C.A. 32(b) (1934).

[11] Section 14 (b) (5), 30 STAT. 550 (1898), 11 U.S.C.A. 32 (b) (5) (1934).

[12] "Undoubtedly, as in all judicial proceedings, an adjudication refusing a discharge in bankruptcy, finally determines, for all times and in all courts, as between those parties or privies to it, the facts upon which the refusal was based." *Bluthenthal* v. *Jones,* 208 U.S. 64, 66, 28 Sup. Ct. 192, 52 L.ed. 390 (1908). In accord, *In re Royal,* 113 Fed. 140 (E.D.N.C. 1902).

[13] *In re Loughran,* 218 Fed. 619 (C.C.A. 3rd, 1914); *In re Brislin,* 10 F. Supp. 181 (N.D.N.Y. 1934).

[14] See also *Siebert* v. *Dahlberg,* 218 Fed. 793 (C.C.A. 8th, 1914).

[15] See *In re Skaats,* 233 Fed. 817 (S.D. Ala. 1914).

[16] *In re Loughran,* 218 Fed. 619 (C.C.A. 3rd, 1914).

a debtor has been denied a discharge in any proceeding for some reason involving his own misconduct the matter of discharge from the debts then scheduled is forever settled. There has been a determination on the merits. The debtor ought not be discharged from these same debts in any proceeding begun thereafter.[17] But it is submitted that if the debtor has merely failed to file an application for a discharge in a previous proceeding there has been no determination with respect to any misconduct on his part and he ought not be barred.[18]

It has been argued that the true basis for refusing a discharge from the debts previously scheduled is that Congress by Section 14 (a) intended to relieve creditors from the necessity of remaining prepared for an unreasonable length of time to prove the existence of grounds for the denial of a discharge under Section 14 (b) and that this intent would be practically nullified if the bankrupt were permitted to evade the bar by instituting a second proceeding.[19] It has been held that the right of a debtor to a subsequent discharge covering the same debts is not precluded even though he did fail to apply for a discharge in the first proceeding within the time permitted.[20] In this case the court contended there has been no judicial determination with respect to the debtor's claim. Nevertheless, it is probably the majority rule that the mere failure to file application for a discharge within the time set has the same effect as though the discharge were actually denied.[21] The United States Supreme Court has never directly passed upon the matter. In *Freshman* v. *Adkins*,[22] the court said that a pending application still undisposed of serves to abate a second application so far as the same debts are concerned, and that the bankruptcy court may take judicial notice of the records of former bankruptcies of the applicant before the court to ascertain whether he may proceed.

Suppose a bankrupt has been granted a discharge from his debts in 1920. According to the Bankruptcy Act he is not permitted to obtain another discharge from any subsequent debts within a period of six years thereafter. In 1923, however, a second petition in bankruptcy is filed. He schedules the debts which have accrued since 1920 and makes a second appearance in the bankruptcy court. The debtor does not make an application for a discharge in this proceeding. Perhaps he has discovered that he cannot obtain a discharge now because of the six-year provision, or perhaps his attorney re-

[17] "A proceeding in bankruptcy is in the nature of a bill in equity in which the bankrupt is complainant and the creditors are defendants. Where a discharge is refused on the merits the judgment inures to the benefit of all the creditors. Both parties are bound by it and neither party should be permitted to try the same question again; it is *res judicata*." *In re Fiegenbaum*, 121 Fed. 69, 70 (C.C.A. 2nd, 1903).

[18] *Cf In re Elkin*, 175 Fed. 64 (C.C.A. 2nd, 1909); *In re Lyons*, 287 Fed. 602 (E.D.N.Y. 1922); (1932) 45 HARV. L. REV. 1110.

[19] See (1920) 33 HARV. L. REV. 978.

[20] *In re Skaats*, 233 Fed. 817 (S.D. Ala. 1914).

[21] *In re Loughran*, 218 Fed. 619 (C.C.A. 3rd, 1914); *Siebert* v. *Dahlberg*, 218 Fed. 793 (C.C.A. 8th, 1914); *In re Brislin*, 10 F. Supp. 181 (N.D.N.Y. 1934); *In re Pullian*, 171 Fed. 595 (E. D. Tenn. 1909); *In re Von Borries*, 168 Fed. 718 (E.D. Wis. 1909).

[22] 269 U.S. 64, 46 Sup. Ct. 41, 70 L. ed. 193 (1925).

fuses to proceed. In any event the debtor now waits until 1927 when he files another voluntary petition in bankruptcy. In 1923 and in 1927 his non-exempt estate which he has turned over to the bankruptcy court's administration is comparatively small in substance. After the adjudication on the petition filed in 1927 the debtor makes application to be released from his debts and he files this petition within the statutory period. Is he to be denied a discharge from the debts accrued since 1920 because he failed to get a discharge from a portion of them in a proceeding which was prematurely brought? Has he committed any offense which the Bankruptcy Act states to be ground for denial of a discharge? Can it be said that his right to a discharge of those debts accrued before 1923 has been settled against him? Unless the courts which have laid down what is perhaps the "majority rule" would distinguish between the case where the debtor has merely neglected to file an application for a discharge and the case where he could not have obtained relief because the whole proceeding was prematurely begun, the answers would have to be, Yes.[23]

The leading case upon which some courts have built up their conclusions as to the effect of a failure to file an application for a discharge decided that a bankrupt should not obtain a discharge from the same debts scheduled with a second petition while the first proceeding was still pending.[24] In the hypothetical case suggested above the first proceeding in fact had been abandoned. In the "leading case" it appeared that the debtor had failed to comply with an order of the referee in a previous proceeding begun against him by his creditors on an involuntary petition in bankruptcy. The order of the referee had never been modified. The debtor had never complied with it. He could not get a discharge until he should comply with the referee's order.[25] The debtor never did file a petition for a discharge in that proceeding. He did, however, file a voluntary petition some months thereafter in another division of the same bankruptcy court asking to be adjudged a bankrupt. He listed the same debts with the second petition in bankruptcy that he had listed in the first proceeding. He was adjudged a bankrupt but his petition for a discharge was denied. The decision in that case was obviously sound. The court could have done nothing else. But any language in that opinion about the consequences of a failure of a bankrupt to file a petition for a discharge must be taken to be limited by the precise facts of the case. Some of the cases frequently referred to as "precedents" were decided under earlier bankruptcy or insolvency acts.[26] And any case, in which it appears that a debtor is denied a discharge because a bankruptcy court had already refused to grant him one for the same debts in an earlier proceeding, is simply not in point. In those cases where the courts have refused to bar the debtor by reason of his failing to file an application for a discharge on a previous petition it will be found that the courts have inquired

[23] But compare *Prudential Loan & Finance Co.* v. *Robarts,* 52 F. (2d) 918 (C.C.A. 5th, 1931).
[24] *Kuntz* v. *Young,* 131 Fed. 719 (C.C.A. 8th, 1904).
[25] Section 14(b) (6), 30 STAT. 550 (1898), 11 U.S.C.A. 32 (b) (6) (1934).
[26] See *In re Drisko,* Fed. Cas. No. 4,086 at 1092 (C.C. Mass. 1876); also *Gilbert* v. *Hebard,* (Mass. 1844) 8 Metc. 129.

into the conduct of the debtor and have found at most delay on the part of his attorney or some other excusable reason for the failure to file.[27]

If a bankrupt files a voluntary petition in a bankruptcy court within six years from the date of a prior discharge he would be denied relief from the burden of his current obligations. The Bankruptcy Act so provides in Section 14 (b). Nor is that because of any conduct on the part of the debtor which has hurt his position. The purpose of this section is to prevent the debtor's taking advantage of the provisions of the Act too often.[28] It is not intended to bar him forever. If a bankrupt is denied a discharge in one proceeding because of a previous discharge within six years it is because of a temporary disability. When the requisite six years have elapsed and the disability is removed there is no reason, at least as suggested in the Act itself, why the previous denial should be taken to bar a discharge covering debts which have accrued since the previous effective discharge.

The Bankruptcy Act contemplates that a party may take advantage of its provisions more than once. Where no creditor has acted to his disadvantage because of the debtor's delay it is difficult to accept any line of reasoning worked out to support the holding that mere neglect or failure to file an application for a discharge in one proceeding should forever prevent the debtor's escaping from the burden of his debts. In the light of the literal provisions of the Act it would be difficult to accept any explanation for even a six-year delay from the burden of his debts merely because of the filing of a petition in bankruptcy at some previous time without the debtor's asking for a discharge.

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[27] *Prudential Loan & Finance Co.* v. *Robarts,* 52 F. (2d) 918 (C.C.A. 5th, 1931); *In re Skaats,* 233 Fed. 817 (S.D. Ala. 1914); *In re Lyons,* 287 Fed. 602 (E.D. N.Y. 1922).

[28] *Prudential Loan & Finance Co.* v. *Robarts,* 52 F. (2d) 918 (C.C.A. 5th, 1931).