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PARTNERSHIPS IN BANKRUPTCY

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Since the passage of the Bankruptcy Act of 1898¹ the bankruptcy law of partnerships has undergone most radical changes. In fact, the entire theory of the law prior to the Act of 1898 was modified by Congress therein. This in turn has necessitated the building of a new structure of case law on the base provided by the legislative enactment.

As is the case with all new statutes, novel situations have arisen which have tested the ingenuity of counsel and of the courts. Many of such questions have been settled only by resort to the Supreme Court; others, equally difficult, are not yet in that satisfactory condition.

It is the purpose of this article to discuss some of the high lights in the judicial construction of that part of the 1898 Act relating to partnerships. It would require a volume to consider, or even merely mention, all the cases; only a few of the most interesting can be discussed.

Bankruptcy Act of 1898

The Act provides that " 'persons' shall include . . . partnerships."² This definition is the basis for the holding of the Supreme Court that a partnership is a legal entity, a judicial person, within the purview of the Bankruptcy Act. The Act further provides that "A partnership, during the continuation of the partnership business, or after its dissolution and before the final settlement thereof, may be adjudged a bankrupt."³ As

¹ U. S. C. Title 11.

² 11 U. S. C. sec. 1 (19).

³ 11 U. S. C. sec. 23 (a).

pointed out by Mr. Justice Sanford in *Liberty National Bank v. Bear*,⁴ this section differs radically from the corresponding section (36) of the Act of 1867 (and also from sec. 14 of the Act of 1841) which did not permit the adjudication of a partnership as a legal entity, but merely authorized an adjudication of "persons who are partners in trade."⁵

The two prior Acts required that all partners be adjudged bankrupts before the assignee could administer the joint estate. In other words, the partnership did not exist apart from the members composing it.

The radical change made by the 1898 Act indicates the evident intention of Congress to designate a partnership as a legal entity, a legal "person," for the purposes of bankruptcy. This intention the Supreme Court has clearly declared.⁶ It can at this date no longer be considered a disputed point, and any decisions of the lower Federal Courts to the contrary, if not expressly, are at least impliedly overruled by these decisions.

Insolvency of Partnerships

Assuming, then, that a partnership as such may be adjudged a bankrupt, it must next be considered when it may be so adjudged.⁷ Sec. 3 (b) of the 1898 Act provides that "A petition may be filed against a person who is insolvent and who has committed an act of bankruptcy within four months after the commission of such act."⁸ The acts of bankruptcy are set forth in sec. 3 (a).⁹ Of the six acts so set forth, three do not require insolvency as an essential element.

It has been held by the Supreme Court that where the act of bankruptcy relied on does not require insolvency as an essential element, the provision of sec. 3 (b) above set forth does not require that insolvency at the time of the filing of the petition be alleged or proved.¹⁰ As Mr. Justice White remarks, "It fol-

⁴ (1928) 276 U. S. 215.

⁵ *In re Carleton* (D. C. Mass. 1902) 115 F. 246.

⁶ *Francis v. McNeal* (1913) 228 U. S. 695; *Meek v. Centre County Banking Co.* (1925) 268 U. S. 426; *Liberty National Bank v. Bear*, *supra* note 4.

⁷ See note (1929) 14 ST. LOUIS L. REV. 179.

⁸ 11 U. S. C. sec. 21 (b).

⁹ 11 U. S. C. sec. 21 (a) as amended May 27, 1926, c. 406 sec. 3, 44 Stat. 662.

¹⁰ *West Co. v. Lea* (1899) 174 U. S. 590.

lows that the mere statement in the statute, by way of recital, that a petition may be filed 'against a person who is insolvent and who has committed an act of bankruptcy,' was not designed to superadd a further requirement to those contained in paragraph (a) of section 3, as to what should constitute acts of bankruptcy."

But as to those acts of bankruptcy which require "the insolvency of the debtor to be an essential concomitant," it becomes necessary to consider the question: When is a partnership insolvent?

As defined by the Act itself,¹¹ a person is deemed insolvent whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts. At common law and under the provisions of the Uniform Partnership Act, each and every partner—excluding, of course, the case of a limited partner—is liable for all of the debts of the partnership.¹² How, then, can a partnership be insolvent unless all of the partners are insolvent? If any partner is solvent, that is, has sufficient assets, over and above his individual debts, to satisfy all partnership obligations, then the partnership is not insolvent. As Mr. Justice Holmes said in *Francis v. McNeal*,¹³ "But the fact remains as true as ever that partnership debts are debts of the members of the firm, and that the individual liability of the members is not collateral like that of a surety, but primary and direct, whatever priorities there may be in the marshaling of assets. The nature of the liability is determined by the common law, not by the possible intervention of the Bankruptcy Act. *Therefore, ordinarily it would be impossible that a firm should be insolvent while the members of it remain able to pay its debts with money available for that end.* A judgment could be got and the partnership debts satisfied on execution out of the individual assets."¹⁴

¹¹ 11 U. S. C. sec. 1 (15).

¹² Burdick, PARTNERSHIP (3rd ed.) 155; U. P. A. sec. 15.

¹³ Note 6, above l. c. 699-700.

¹⁴ Italics ours.

Therefore, it naturally follows that under the Bankruptcy Act a partnership cannot be adjudged bankrupt while any of its members continues solvent, and this seems to be the holding of a great majority of the adjudicated cases.¹⁵

The decision of the Circuit Court of Appeals for the 8th Circuit, *In re Bertenshaw*,¹⁶ in so far as it announces a contrary rule, was expressly overruled by the Supreme Court in *Francis v. McNeal*, *supra*, and any decisions of the lower Federal Courts based on the decision in the *Bertenshaw* case are, therefore, also impliedly overruled.

It has been held likewise, as a logical result of the conclusion reached above, that an allegation of the insolvency of the partnership necessarily implies an allegation of the insolvency of the partners.¹⁷

Adjudication of Partnership as Necessary Adjudication of Partners

It does not necessarily follow from the conclusion that insolvency of the partnership necessarily involves the insolvency of the partners, that an adjudication of the partnership as a bankrupt likewise involves, as a necessary concomitant, the adjudication of each partner as such.¹⁸ The confusion of insolvency and bankruptcy has, without doubt, caused some of the District Courts at times to go astray in their decisions. This confusion has been abetted by a misunderstanding of the true effect of sec. 5 (h) of the Bankruptcy Act.¹⁹

It is now conclusively settled by the Supreme Court's decision in *Liberty National Bank of Roanoke v. Bear, Trustee*,²⁰ that the adjudication of a partnership as a bankrupt does not amount

¹⁵ *Francis v. McNeal*, *supra* note 6; *Vaccaro v. Memphis Security Bank* (C. C. A. 6, 1900) 103 F. 436; *Tumlin v. Bryan* (C. C. A. 5, 1908) 165 F. 166; *In re Young* (D. C. Mass. 1915) 223 F. 659; *Titus v. Maxwell* (C. C. A. 6, 1922) 281 F. 433; *In re Fuller* (C. C. A. 2, 1925) 9 F. (2d) 553; *In re Russell* (D. C. Del. 1926) 13 F. (2d) 928; *Baker v. Bates-Street Shirt Co.* (C. C. A. 1, 1925) 6 F. (2d) 854.

¹⁶ (C. C. A. 8, 1907) 157 F. 363.

¹⁷ *Meek v. Beezer* (C. C. A. 3, 1928) 28 F. (2d) 343 l. c. 347. *Certiorari denied* (1929) 278 U. S. 651.

¹⁸ See note (1928) 14 *ST. LOUIS L. REV.* 57.

¹⁹ 11 U. S. C. sec. 23 (h).

²⁰ (1928) 276 U. S. 215.

to an adjudication of bankruptcy against the partners as individuals. Mr. Justice Sanford, in his opinion in this case, to which there was no dissent, remarks that this has long been the established rule in the Circuit Courts of Appeals and District Courts, noting only a contrary decision of the District Court for Massachusetts.²¹

Under the present Act, which clearly recognizes the partnership entity for bankruptcy purposes, such a decision was imperative. There have been cases where the partners, or one or more of them, could not have been adjudged bankrupt, either because they had not committed acts of bankruptcy, because they were exempt from involuntary bankruptcy, being wage earners or engaged chiefly in farming or the tillage of the soil, or because they were insane or minors. In fact, this is one of the notable defects in the prior Acts which was remedied by the 1898 Act.

Francis v. McNeal did not involve the question here discussed, and can in no sense, as Mr. Justice Sanford points out, be said to conflict with the decision in *Liberty National Bank v. Bear*. It is true that several of the lower courts have been troubled by the remark of Mr. Justice Holmes in the former case that "we do not perceive that the clause imports that the partnership could be in bankruptcy and the partners not." But Mr. Justice Holmes by the word "clause" referred to sec. 5 (h) of the Act, which covers the situation where one or more, but not all of the members of the partnership are adjudged bankrupt. "In that case, naturally," says Holmes, "the partnership property may be administered by the partners not adjudged bankrupt, and does not come into bankruptcy at all, except by consent. But we do not perceive that the clause imports that the partnership could be in bankruptcy, and the partners not. The hypothesis is that some of the partners are in, but that the firm has remained out, and provision is made for its continuing out."

Adjudication After Dissolution

Inasmuch as the section of the Act above quoted permits the adjudication of a partnership even after dissolution, but before the final settlement thereof, the courts have quite uniformly held

²¹ In re Forbes (D. C. Mass. 1904) 128 F. 137.

that a partnership may be adjudicated in bankruptcy even after the death of one of the partners.²²

And where the state statute, as in Illinois, makes the surviving partner trustee of the partnership assets for the purpose of collecting them and paying the creditors, he may file a voluntary petition in bankruptcy on behalf of the firm.²³

In such cases, of course, the estate of the deceased partner is necessarily administered in the Probate Court, the administrator being required to pay any surplus remaining after the satisfaction of individual debts to the Trustee in Bankruptcy, and on the other hand, the latter being required to pay any equity of the deceased partner in partnership assets remaining after firm creditors have been satisfied, to the executor or administrator as the case may be.²⁴

Appointment of Trustee

The creditors of the partnership shall appoint the trustee; in other respects, so far as possible, the estate shall be administered as herein provided for other estates.²⁵

Although there are no specific provisions in the Act regulating the appointment of separate trustees for partnership and individual estates, it would seem to be proper in the normal case to appoint the same trustee for firm and individual estates. This would avoid confusion and expense. The matter, however, is discretionary with the court, and in extraordinary cases separate trustees may be appointed.²⁶

Where an individual trustee has been appointed prior to the adjudication of the firm, the appointment of a firm trustee does not vacate the prior appointment.²⁷

²² In re Wells (D. C. Ohio 1924) 298 F. 109; In re Lomont (D. C. Ind. 1925) 9 F. (2d) 407; Meek v. Beezer (C. C. A. 3, 1928) 28 F. (2d) 343. Certiorari denied (1929) 278 U. S. 651.

²³ In re Salladay (D. C. Ill. 1927) 22 F. (2d) 300.

²⁴ See cases in note 22, above.

²⁵ 11 U. S. C. sec. 23 (b).

²⁶ In re Currie (D. C. Mich. 1910) 197 F. 1012; In re Wood (C. C. A. 6, 1918) 248 F. 246. Certiorari denied (1918) 247 U. S. 512; In re Russell (D. C. Del. 1928) 28 F. (2d) 48.

²⁷ In re Deadwyler (D. C. Ga. 1923) 292 F. 510.

Jurisdiction of Bankruptcy Court

The Court of Bankruptcy which has jurisdiction of one of the partners may have jurisdiction of all the partners and of the administration of the partnership and individual property.²⁸

Under the Bankruptcy Act of 1867, two or more partners in trade might be adjudged bankrupt upon their petition or the petition of "any one of them."²⁹ There being no corresponding provision in the present Act, it is settled that a court cannot entertain an involuntary petition for adjudication of a firm where the petition is filed by only one partner.³⁰ The holding in this case was clear, since an involuntary petition under the present Act may be filed only by creditors. The Court expressly refused to consider the question as to the right of one partner to file a voluntary petition for the firm in its behalf without an affirmative showing that it was filed at the instance or with the consent of the other partners.³¹

Although there is some conflict in the decisions of the lower Federal Courts because of the provisions of General Order VIII., which was drawn by the Supreme Court in compliance with the terms of the 1867 Act, and which was expressly revoked by the Supreme Court in the *Meek* case, *supra*, as not fitted to the terms of the 1898 Act, and although the question is still an open one, it seems clear that a voluntary petition in bankruptcy by a partnership must be signed either by all the partners, or if signed by less than the whole number, must show on its face the consent of those not signing, or some special reason why they have not joined in the petition. As was said by the District Court for the Fort Worth Division of the Northern District of Texas in a well-reasoned case,

Inasmuch as the filing of a voluntary petition in bankruptcy is, as against the partners individually, equivalent to a general assignment of the partnership property for the benefit of creditors, and amounts to a confession of judgment as to the debts placed upon the schedules, puts an end

²⁸ 11 U. S. C. sec. 23 (c).

²⁹ 14 Stat. 517 c. 176 sec. 36.

³⁰ *Meek v. Centre County Banking Co.* (1925) 268 U. S. 426.

³¹ *Id.* l. c. 432.

to the partnership, and would involve the individual estates of the partners under their solidary liability as such, I cannot conceive that any number less than all of the partners could legally take such a drastic step without the consent of the others, and certainly not over their objection. . .

I am of the view that, not only is the showing made by Bateman in the motion to dismiss amply sufficient to justify the dismissal of the petition as to the partnership, but believe that, in order to justify a court of bankruptcy in making a voluntary adjudication of a partnership, it would be necessary, either that all of the partners join therein or that clear showing be made of their consent to such proceeding, or at least that the petition disclose the impossibility of their being joined, or of obtaining their consent, such as their having absconded, etc.³²

Administration of Individual Property by Firm Trustee Where Partners Not Adjudicated

Upon the adjudication in bankruptcy of the firm, the trustee may administer not only the firm assets, but also all the assets of the individual partners if necessary to pay firm debts. The trustee may petition the Court for an order directing any or all of the partners to turn over their separate assets for administration.³³ And this is true, regardless of the adjudication of any of the partners individually.³⁴

In such a case, the creditors of the partnership may prove their claims against the estates of the individual partners, as well as against the partnership estate, and vice versa, but such claims take only the surplus, if any, remaining after the individual or partnership creditors, as the case may be, have been paid in full.³⁵

It has been held in line with the Supreme Court's ruling in *Francis v. McNeal* that the partners, although not adjudicated,

³² In re York et al. (D. C. Tex. 1926) 18 F. (2d) 428. But see apparently contra: In re Lenoir-Cross & Co. (D. C. Tenn. 1915) 226 F. 227; In re Hansley & Adams (D. C. Cal. 1916) 228 F. 564.

³³ Francis v. McNeal, *supra* note 6.

³⁴ Francis v. McNeal, *supra* note 6; Menke v. Sundermann (C. C. A. 3, 1911) 186 F. 486; Abbott v. Anderson (1914) 265 Ill. 285, 106 N. E. 782; Carter v. Whisler (C. C. A. 8, 1921) 275 F. 743.

³⁵ In re Rice (D. C. Pa. 1908) 164 F. 509; In re Effinger (D. C. Md. 1911) 184 F. 728; In re Telfer (C. C. A. 6, 1910) 184 F. 224.

must file schedules of their separate property and debts, so that any excess can be reached.

This does not mean that the individual partners are to be dealt with in all respects as if themselves bankrupts, but means only that they, being the components of the bankrupt partnership, are fully under the control of the court as parties, and that they, being fully liable for the partnership debts, are under duty to present to the court and to make available the excess of individual property over individual debts, which excess is an asset of the partnership. . . The administration, to the individual creditors, in other words, would not be an administration in bankruptcy, but a marshalling under general equity principles for the purpose of ascertaining and securing that which is to be administered in bankruptcy.³⁶

Trustee's Accounts

The Trustee shall keep separate accounts of the partnership property and of the property belonging to the individual partners.³⁷

This provision is self-explanatory, and was inserted in the Act only to avoid confusion. Since the decision in *Francis v. McNeal*, it is, of course, of added importance, since, regardless of the adjudication of the individual partners, their separate estates may be taken by the trustee of the partnership and administered.

A failure of the trustee to comply with the provisions of this section cannot affect the rights of individual and firm creditors. Where a trustee deposited the proceeds of the sale of a New York Stock Exchange seat belonging to one of the partners in a bank account kept in the name of the firm, individual creditors could reach such proceeds by proper petition and have them allocated to the individual estate of the partner.³⁸

Expenses

The expenses shall be paid from the partnership property and the individual property in such proportions as the court shall determine.³⁹

³⁶ In re Sugar Valley Gin Co. (D. C. Ga. 1923) 292 F. 508. See also *Armstrong v. Fisher* (C. C. A. 8, 1915) 224 F. 97.

³⁷ 11 U. S. C. sec. 23 (d).

³⁸ In re Amy et al. (C. C. A. 2, 1927) 21 F. (2d) 301.

³⁹ 11 U. S. C. sec. 23 (e).

Several cases have considered the troublesome question as to whether referee, trustee and clerk are entitled to only one fee or more upon the filing of a petition for adjudication of both partnership and partners. The Act provides that certain fees are payable to trustee and referee in each "case" and to clerks for their services to each "estate."

It would seem reasonable to allow several fees although only one petition is filed, where such petition prays several adjudications, or even in a case where individual discharges were granted, although not prayed for in the petition.⁴⁰ The Circuit Court of Appeals for the Fifth Circuit, however, has distinguished between a "case" and an "estate," holding that the filing of a petition for adjudication of both partnership and partners was the institution of a "case" involving several "estates."⁴¹ This ruling seems untenable.

Distribution

The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership.⁴²

This section is but a restatement of the equity principles in reference to the marshalling of partnership assets. The corresponding provision of the Uniform Partnership Act (sec. 40 (h)) is similar. Under the Uniform Partnership Act the liabilities of a partnership rank in order of payment as follows:

1. Those owing to creditors other than partners;
2. Those owing to partners other than for capital and profits;
3. Those owing to partners in respect of capital;

⁴⁰ In re Borden (D. C. N. C. 1900) 101 F. 553; In re Farley (D. C. Va. 1902) 115 F. 359. But see In re Rider (D. C. Mont. 1915) 220 F. 193.

⁴¹ Willis v. Hart (C. C. A. 5, 1926) 11 F. (2d) 530.

⁴² 11 U. S. C. sec. 23 (f).

4. Those owing to partners in respect of profits;⁴³

and the liabilities of each partner rank in order of payment as follows:

1. Those owing to separate creditors;
2. Those owing to partnership creditors;
3. Those owing to partners by way of contribution.⁴⁴

It is often difficult to determine which debts are firm debts, and which individual. In some cases the obligation may be joint and several and the creditor may prove his claim both against the individual and firm estates, obtaining, of course, only one satisfaction. The cases dealing with the nature of firm and individual obligations are legion, and it is beyond the scope of this article to consider all phases of the question.

The principles of this section are well illustrated in a case decided by the Circuit Court of Appeals for the Third Circuit,⁴⁵ where one of the partners of a bankrupt partnership was itself a partnership. It was held that creditors of the partner partnership must be paid in full before any of the assets of such partner could be available to creditors of the bankrupt firm.⁴⁶

It has been lately held in a case where both the firm and its members were adjudicated bankrupts, that obligations held by a creditor containing the signature of the firm as well as the individual signatures of the partners as sureties, created a double liability, and that such a creditor had a right to prove his claim against both separate and firm estates. It was objected that sec. 5 (f) of the Bankruptcy Act, by appropriating the individual estate of a partner to his individual debts, impliedly excluded debts that were also partnership obligations from sharing with the former on equal terms. But Mr. Justice Holmes logically points out that as there was nothing in the state laws prohibiting the individual partners from creating claims against their individual estates by their separate contracts, certainly there was no prohibition in the Bankruptcy Act.

The firm creditors know that they will be postponed to

⁴³ U. P. A. sec. 40 (b).

⁴⁴ U. P. A. sec. 40 (i).

⁴⁵ *In re Knowlton & Co.* (C. C. A. 3, 1913) 202 F. 480.

⁴⁶ *Accord, Bank of Reidsville v. Barton* (C. C. A. 4, 1919) 259 F. 218.

individual creditors, and that they have no voice or knowledge as to who the individual creditors shall be, or what the amount of their claims. The only real equity is not to disturb the equilibrium established by the parties. Those who take less security have no claim to be put on a footing with those who require more. It is not necessary to go into nice speculations as to what a partner can add to the liability already incurred when he offers a separate contract in addition to that which is made by his firm. We may assume that by the firm contract he is bound to the uttermost farthing—but he is bound only as a member of the firm, and therefore subject to the bankruptcy rule. His creditor may require more, and we can see nothing to hinder his putting himself in the position of a separate debtor also.⁴⁷

For a long time there was a serious conflict of decisions in the Federal Courts respecting the question as to the right of firm creditors to share ratably with individual creditors of one partner, where there were no firm assets and no solvent partners, the only fund for distribution being produced by the individual estate of one member. The English courts had allowed such a proceeding, engrafting it as an exception on the general rule as to the marshaling of assets. The question finally reached the Supreme Court, which, in a lucid opinion by Mr. Chief Justice White, held that in such a case the statute was clear and mandatory, and the individual creditors were entitled to priority in the distribution of the fund, to the exclusion of firm creditors.⁴⁸

Discharge

One of the most puzzling problems with which the courts have had to deal since the passage of the 1898 Act has been that relating to the granting of discharges to the firm and to individual partners so far as firm debts are concerned. The Act merely provides that "Any person may, after the expiration of one month, and within the next twelve months, subsequent to being adjudged a bankrupt, file an application for a discharge . . ." ⁴⁹

Of course, if the firm as an entity has been adjudicated, it may

⁴⁷ Mitchell v. Hampel (1928) 276 U. S. 299.

⁴⁸ Farmers' & Mechanics' National Bank of Philadelphia v. Ridge Ave. Bank (1916) 240 U. S. 498.

⁴⁹ 11 U. S. C. sec. 32 (a).

be discharged upon proper application therefor, from all liability for provable firm debts except those specifically mentioned in the Act.⁵⁰ Likewise, the individual partners may be discharged in the usual way from both individual and firm debts, provided they have been separately adjudicated and have listed the firm debts as liabilities.

The interesting and troublesome question remains as to whether a discharge of the firm carries with it a discharge of the individual partners from individual liability for firm debts, although they have not been separately adjudicated bankrupts.

If the premise is true, that the adjudication of the firm necessarily implies the insolvency of the partners (where the Act of Bankruptcy involves insolvency) and if each partner, after his individual creditors are satisfied, is liable in toto to firm creditors for firm debts, then a discharge of the firm as an entity should necessarily carry with it a discharge of the individual partners so far as their individual liability for firm debts is concerned. This logical conclusion has not as yet been reached by the Federal Courts, which are in irreconcilable conflict. Until the exact question is decided by the Supreme Court, it is impossible to say what the law is, except for particular circuits, but it is submitted that the Supreme Court will ultimately hold that a discharge of the firm necessarily discharges its members from their individual liability for firm debts where their individual estates have been taken into custody by the trustee and marshalled in accordance with the provisions of the Act and the decision in *Francis v. McNeal*.

A contrary conclusion has been reached by several of the lower courts, most of the decisions having been rendered prior to *Francis v. McNeal*. For instance, the Circuit Court of Appeals for the Eighth Circuit has held that a discharge of the firm does not discharge the partners from their individual liability for firm debts.⁵¹ This holding is based upon the theory that since a partnership may be adjudicated bankrupt where some of the partners are solvent, and since the trustee may only administer the partnership assets (both of which postulates

⁵⁰ 11 U. S. C. sec. 35.

⁵¹ In re Bertenshaw (C. C. A. 8, 1907) 157 F. 363 l. c. 369.

have since been held false by the Supreme Court) the discharge cannot affect the liability of the individuals for firm debts. Since the basis of this case was overturned by *Francis v. McNeal*, the same court which decided *In re Bertenshaw* has changed its former ruling in a later decision.⁵² This was a petition to revise an order of the United States District Court for the Southern District of Iowa. Partnership creditors in 1913 had filed an involuntary petition in Kansas against B & N, partners. The petition did not pray an adjudication of B & N individually. B and N filed answers both as individuals and as a partnership, admitting the ground charged, and an adjudication of the firm was made. The schedules revealed only firm creditors and debts, and dividends of about 30% were paid. In 1914 N filed his application praying for his discharge both "as an individual bankrupt and as a member of said bankrupt firm." This application was never heard, and no other application by the firm or either partner was ever made in the Kansas court.

In 1915 N filed a voluntary petition in the Southern District of Iowa and was adjudged bankrupt. The schedules showed no assets and listed only the firm creditors and debts which had been listed in the proceeding in Kansas. In January, 1916, petitioners (who were creditors holding claims that were proved and allowed in Kansas) moved the Iowa court to vacate its adjudication of N, dismiss the voluntary petition, and enjoin N from petitioning for a discharge. This motion was denied in April, the Iowa court holding that N had not been individually adjudicated bankrupt in Kansas, was not entitled to a discharge there, and that therefore his failure to procure one did not bar his proceeding in Iowa. In May the Kansas court on N's motion entered an order that his petition for discharge might be withdrawn without prejudice to his right to commence a new bankruptcy proceeding or to continue one already begun. Petitioners then filed their petition in the Circuit Court of Appeals to revise the order of the Iowa court made in April.

The Circuit Court of Appeals held that the matter of a discharge in bankruptcy is "essentially a constituent of the proceeding in which the adjudication and the administration of the bank-

⁵² *Armstrong v. Norris* (C. C. A. 8, 1917) 247 F. 253.

rupt estate are had. It cannot be detached and taken to a court of another jurisdiction. If Norris was a party to the proceeding in Kansas, and the court there had jurisdiction to grant or deny him a discharge from the debts of his firm, that was the tribunal of exclusive cognizance."

After considering the fact that the adjudication in Kansas was only of the firm, the court makes this pertinent statement:

Ordinarily it is true that a discharge in bankruptcy implies a prior adjudication of the person discharged, but the rule should not be applied too literally. When a partnership alone has been adjudged bankrupt, the individual partners and their estates are drawn into the proceeding and are subject to the jurisdiction of the court; and when all the conditions and requirements of the Bankruptcy Act have been observed by them, jointly and severally, there is no sound reason why the court should not, upon their application in the same proceeding, discharge them from further liability for the partnership debts. That is a natural and logical outcome of such a proceeding, and is consistent with the long established practice in equity. An adjudication against the partnership, the necessary relation of the partners thereto, and the jurisdiction of the court over them, empowers the court to award them, if they so desire, the relief which from their standpoint is in the nature of a final decree.

It is submitted that although a direct ruling was not made, as the point was not involved, the Circuit Court of Appeals has practically said in this case that a discharge of the firm discharges the individual members from their liability for firm debts. The writer is unable to agree with the Court that the applications of the various members are necessary. It would seem to be sufficient if an application is made by the firm, the party adjudicated. In the very nature of things, a discharge of the firm (which, after all, is not a legal entity, but only a collection of individuals) from its debts, for which each partner is wholly liable, must necessarily discharge each of the partners from that liability. As was said by Mr. Justice Holmes in *Francis v. McNeal*:⁵³

Finally, it would be a third incongruity to grant a dis-

⁵³ Note 6, *supra* l. c. 701.

charge in such a case from the debt considered 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 member 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.

On the other hand, it would seem equally clear that unless a partner is adjudicated a bankrupt individually, he should not be able to obtain his discharge from his individual debts—as distinguished from his individual liability for firm debts—even upon his application therefor.

It has been lately held by the Supreme Court that a discharge of a partnership does not constitute a discharge of its members, so far as their individual debts are concerned.⁵⁴ But in this case the Court expressly stated:

We are not called upon to determine whether the discharge of the notes as debts of the partnership which resulted from the confirmation of the composition, carried with it the discharge of the defendants, as partners, from the liabilities on the notes as partnership debts which arose from their membership in the firm.⁵⁵

Horner v. Hamner,^{55a} decided by the Circuit Court of Appeals for the Fourth Circuit in 1918, is contrary to the theory here advanced. The decision is based on the reasoning of the Eighth Circuit in the case of *In re Bertenshaw*, *supra*, and although the Court realizes that the latter case had been expressly disapproved by *Francis v. McNeal*, it remarks that the part of the decision regarding discharge was not affected by the Supreme Court's disapproval. As has been shown above, the entire theory on which the Court's decision in the *Bertenshaw* case was based has been overturned, and it is submitted that the case decided by the Fourth Circuit is not authority for the point now under discussion.

⁵⁴ *Myers v. International Trust Co.* (1927) 273 U. S. 380.

⁵⁵ Citing *In re Coe* (C. C. A. 2, 1910) 183 F. 745; *Abbott v. Anderson* (1914) 265 Ill. 285, 106 N. E. 782; *Curlee Clothing Co. v. Hamm* (1923) 160 Ark. 483, 254 S. W. 818; *Horner v. Hamner* (C. C. A. 4, 1918) 249 F. 134; *In re Neyland & M'Keithen* (D. C. Miss. 1910) 184 F. 144.

^{55a} See note 55.

In re Neyland & M'Keithen,^{55b} decided by a District Court of Mississippi in 1910, follows *In re Bertenshaw*, but as it was decided prior to *Francis v. McNeal*, it cannot be considered seriously.

In re Coe^{55c} was decided by the Circuit Court of Appeals for the Second Circuit in 1910. The firm of Cadenas and Coe, composed of Coe and Knox, was adjudicated bankrupt, together with the partners. The firm had accepted certain drafts and trust receipts wherein the partners acknowledged themselves to be bailees of certain property for which the drafts were drawn, and agreed to sell the property, collect the proceeds and deposit them in bank. Instead, they deposited the proceeds in the partnership account, and then failed. Knox offered a twenty per cent composition to the firm and his individual creditors. This was accepted, and the bank then filed its claim, after deducting the twenty per cent, against the individual estate of Coe. It was held that not only was the firm liable on the acceptances, but each partner was liable severally as for a wrongful conversion, and therefore the acceptance of the composition did not discharge Coe from this several liability. As a dictum the Court said:

The Referee regarded the acceptance of the composition as a bar to any claim of the bank against the individual estate of Edward P. Coe, and so it would have been if the liability asserted against his estate were for his contractual liability on the acceptances as to which the partners were jointly liable.

In the case of *Curlee Clothing Co. v. Hamm*,⁵⁶ decided by the Supreme Court of Arkansas, the note sued on was signed not only by the partnership but by the individual defendant as well. The partnership had been adjudicated and a composition offered to the firm creditors only. This was accepted by the firm creditors and notes were given to them. The assets scheduled in the bankruptcy proceeding embraced only partnership property. The court states that there was language in the order confirming the composition which purported to discharge the individual members of the firm from their individual indebtedness but that

^{55b} See note 55.

^{55c} See note 55.

⁵⁶ (1923) 160 Ark. 483, 254 S. W. 818.

such language should be regarded as surplusage. With the record in this condition the court should have held that the individual defendant was not discharged by the composition, either because his obligation was individual and not a firm obligation or because his individual assets had not been scheduled in the bankruptcy proceedings. The court, however, although holding that the defendant was not discharged, bases its ruling on the broad ground that a discharge in bankruptcy of a partnership in which the individual members are not adjudicated bankrupts has no effect upon the individual liability of such members. It is submitted that the decision is correct, but is placed on the wrong grounds.

On the other hand, *Abbott v. Anderson*⁵⁷ holds correctly that a discharge of the firm discharged the partners individually from firm debts, the decision being placed squarely on the authority of *Francis v. McNeal*.

With the authorities in the unsatisfactory condition shown, it is almost impossible to state what the law is. If it is within the discretion of the trustee of the partnership estate to administer on the separate assets of the partners, then it would seem to be necessary in each case to first see whether the trustee had exercised his discretion and administered on the separate assets. This does not seem to be a question which should be left to the trustee's discretion. If the partnership assets are not sufficient to satisfy the partnership creditors, then the latter certainly have a right to proceed directly against any surplus remaining of the individual assets of the partners after their individual creditors have been satisfied. In other words, if the partnership as an entity is insolvent, then it should be mandatory with the trustee to proceed to administer the individual assets.

If the individual assets have been administered and the partnership creditors paid in full, or paid to the extent of the individual and partnership assets, then a discharge of the bankrupt firm upon its application should automatically discharge the individual partners from their liability as members of the firm to partnership creditors.

If, on the other hand, the individual assets of the partners

⁵⁷ (1914) 265 Ill. 285, 106 N. E. 782.

have not been administered in the bankruptcy court, a discharge of the firm should not discharge the partners from their liability to firm creditors. As a practical proposition, the referee should require the partners to submit schedules of their individual liabilities and assets in any case where the partnership is adjudicated bankrupt. In this way firm creditors can prevail upon the trustee to administer the individual assets for their benefit. It has been shown above that where the act of bankruptcy relied upon involves insolvency, a partnership can only be adjudicated when the assets of the firm, plus the assets of the partners after allowing for their individual debts, are not sufficient in amount to pay firm creditors. It is certainly the right of firm creditors in such a case to require that the surplus of the assets of the individual partners after paying their individual debts be brought into the bankruptcy court and administered by the trustee of the firm. If this is done, then certainly it is the right of the individual partners to obtain their discharge in the same proceedings from their individual liability as members of the firm for firm debts. It should not be necessary in such a case for the partners individually to apply for their separate discharges; the discharge of the firm should automatically discharge them.

Proof of Claims and Marshaling

The court may permit the proof of the claim of the partnership estate against the individual estates, and vice versa, and may marshal the assets of the partnership estate and individual estates so as to prevent preferences and secure the equitable distribution of the property of the several estates.⁵⁸

It has been held that this section prescribes only remedial rights and does not affect any substantive rights given by sec. 23 (f) *supra*.⁵⁹

In the *Telfer* case the firm and all the partners were adjudicated bankrupts. The trustee of the firm filed a claim on a note signed by G, one of the partners, against his separate estate in

⁵⁸ 11 U. S. C. sec. 23 (g).

⁵⁹ In re Denning (D. C. Mass. 1902) 114 F. 219; In re Telfer (C. C. A. 6, 1910) 184 F. 224.

an attempt to share equally with G's separate creditors. The trustee claimed that the common law rule had been abrogated by sec. 23 (g), but the Circuit Court of Appeals held that

the rule of distribution prescribed by Section 5 (f) is not to be varied by anything permissible under Section 5 (g), where the partnership and the individual members are all adjudged bankrupts and the estates of all are before the court, . . .

The converse of the above case is likewise true, namely, that a trustee of one of the partners might prove his claim against the firm estate for advances made to the firm, but could receive no dividends until all other firm creditors had been paid in full.⁶⁰

Under the present Bankruptcy Act, where the partnership and all the partners are adjudicated, claims may be filed against both firm and individual estates as a matter of right, but

as to which estate shall pay, or be first devoted to payment, is a matter of properly marshaling the assets

under the provisions of sec. 5 (f).⁶¹

Adjudication of Less Than all of the Partners

In the event of one or more, but not all, of the members of a partnership being adjudged bankrupt, the partnership property shall not be administered in bankruptcy unless by consent of the partner or partners not adjudged bankrupt; but such partner or partners not adjudged bankrupt shall settle the partnership business as expeditiously as its nature will permit, and account for the interest of the partner or partners adjudged bankrupt.⁶²

The Uniform Partnership Act⁶³ provides that dissolution of the firm shall be caused "by the bankruptcy of any partner or the partnership." This section of the Bankruptcy Act is but a declaration of this common law rule, together with the added provision that, unless all the partners consent, the firm property cannot be administered in bankruptcy where less than all of the

⁶⁰ In re Rice (D. C. Pa. 1908) 164 F. 509; In re Effinger (D. C. Md. 1911) 184 F. 728.

⁶¹ In re Kardos (C. C. A. 2, 1927) 17 F. (2d) 706; Ft. Pitt Coal & Coke Co. v. Diser (C. C. A. 6, 1917) 239 F. 443.

⁶² 11 U. S. C. sec. 23 (h).

⁶³ Sec. 31 (5).

partners are bankrupt. This section has caused much confusion in the decisions, although a casual analysis reveals its real meaning. Since the firm is an entity so far as its adjudication in bankruptcy is concerned, its assets may not be administered if it is not itself adjudicated, and if there is one partner not adjudicated, unless he consents.⁶⁴

Under the provisions of this section the right of the solvent partner or partners to have the firm business and property administered elsewhere than in the bankruptcy court is absolute, unless waived.⁶⁵

Conclusion

It is a noteworthy fact that the lower Federal Courts, with the occasional assistance of the Supreme Court, have evolved a fairly uniform bankruptcy law of partnership. The fact is noteworthy because the law has been remarkably well settled in the comparatively short space of thirty-one years, and because there is so little conflict in the decisions. With so many Federal Courts, one would expect to find a multitude of conflicting decisions, but this is happily not the case.

The bankruptcy law of partnership is entirely a new concept since the introduction of the "Entity Doctrine" in the 1898 Act. The effort of this article has been to present some of the decisions construing the Act, in an attempt to show that the law is gradually weaving itself into an harmonious pattern.

* *Mills v. J. H. Fisher & Co.* (C. C. A. 6, 1908) 159 F. 897; *Francis v. McNeal*, *supra* note 6; *Sturm v. Ulrich* (C. C. A. 8, 1925) 10 F. (2d) 9.

* *Marnet Oil & Gas Co. v. Staley* (C. C. A. 5, 1914) 218 F. 45; *Collier, BANKRUPTCY* (8th ed.) 137.