August 2015

Section 17A(2) Objections To Discharge Filed By Small Loan Companies In Consumer Bankruptcies: A Practical Analysis

David L. Herbert

Please take a moment to share how this work helps you through this survey. Your feedback will be important as we plan further development of our repository.
Follow this and additional works at: http://ideaexchange.uakron.edu/akronlawreview

Part of the Bankruptcy Law Commons

Recommended Citation
Available at: http://ideaexchange.uakron.edu/akronlawreview/vol7/iss3/8
SECTION 17A(2) OBJECTIONS TO DISCHARGE
FILED BY SMALL LOAN COMPANIES
IN CONSUMER BANKRUPTCIES:
A PRACTICAL ANALYSIS*

The ultimate purpose of the Bankruptcy Act has been correctly characterized as being twofold: to distribute the bankrupt's assets fairly among his creditors and to "[R]elieve the honest debtor from the weight of oppressive indebtedness..." thereby to accomplish the debtor's economic rehabilitation. Problems arise, however, when the debtor has not been honest in his efforts to obtain money or property on credit.

The Bankruptcy Act has oftentimes been construed to apply only to the honest debtor and, therefore, to the exclusion of the dishonest debtor who has, in some manner, negated his right to the economic revitalization that the Bankruptcy Act can provide. This comment will explore only one dishonest practice that can result in a section 17 objection to discharge.

* A review of the reported cases in the American Bankruptcy Law Journal (formerly the Journal of the National Association of Referees in Bankruptcy) for 1971-1972, dealing with § 17a(2) objections to discharge under the Bankruptcy Act, filed by small loan and finance companies, coupled with over two years of substantive experience in the finance industry has led to the formulation of this comment. It appears from this review of the reported cases (and from personal experience) that bankruptcy courts are very much one-sided in their views regarding §17a(2) objections to discharge filed by finance companies in consumer bankruptcies (of the 17 reported "false financial statement" cases dealing with small loan creditors §17a(2) objections to discharge, only two were decided in favor of the objecting creditor). The implications of this conclusion deserve some analysis because of the obvious effects such a conclusion would have upon: (1) any decision to file a §17a(2) objection to discharge; (2) the true burden of proof regarding §17a(2) objections to discharge; (3) the right (if any) to jury determination of §17a(2) objection cases; (4) the proper procedure finance companies should follow in order to successfully litigate §17a(2) objection cases. Furthermore, the Commission on the Bankruptcy Laws of the United States has recently recommended that §17a(2) objections to discharge be eliminated. The obvious implications of this proposal will be discussed in the conclusion.

3 See, e.g., Dilworth v. Boothe, 69 F.2d 621 (5th Cir. 1934).
4 Williams v. United States Fidelity & Guarantee Co., 236 U.S. 549, 554-5 (1915); see Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
6 See, e.g., Local Loan Co. v. Hunt, 292 U.S. 234 (1934); Williams v. United States Fidelity & Guarantee Co., 236 U.S. 549 (1915).
7 See Fidelity & Cas. Co. v. Golombosky, 133 Conn. 317, 324, 50 A.2d 817, 820 (1946).
discharge—objections based upon the debtor's obtaining money or property on credit after uttering a materially false financial statement in writing with the intent to deceive and cause the creditor to rely thereon in granting credit. 8

Under our present bankruptcy laws, a debtor who files a petition for bankruptcy is entitled to a discharge upon the court's adjudication that he is bankrupt, 9 unless such bankrupt has committed one or more certain specified acts which negate his right to a release from all of his provable debts. 10 Setting aside section 14 objections to discharge which will not be considered in this comment, 11 a creditor may, under section 17, file an application with the bankruptcy court for a determination regarding the dischargeability of such creditor's individual claim. 12 If a creditor correctly contends that the bankrupt has obtained money or property on the basis of a materially false financial statement, the creditor's claim will not be discharged and the debtor will remain legally obligated to that creditor. 13 In reality, bankruptcy courts are not amenable to granting some creditor's objections to discharge under section 17 of the Bankruptcy Act. 14 The consequences of this conclusion will be the substance of the discussion that follows.

I. Small Loan Companies' Procedure in Granting Credit to a Consumer

When a consumer desires to obtain a loan from a small loan or finance company, he normally telephones the company and completes an initial credit application. Ordinarily, the creditor will take information

8 See Bankruptcy Act §17a(2), 11 U.S.C. §35a(2) (1970) which provides:
   (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as... (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another;...


11 Section 14c(3) objections to discharge now apply only to business bankrupts and therefore are beyond the scope of this comment. However, case law arising under §14c(3) that is analogous or applicable to §17a(2) will sometimes be cited; see Bankruptcy Act §14c(3), 11 U.S.C. §32c(3) (1970).


14 See prefatory remarks supra. See also Friebolin, Re-Examination of Section 14(c) as a Ground for Objection to Discharge, 39 MINN. L. REV. 673, 686-7 (1955) (Referee Friebolin therein reports the results of a national survey of bankruptcy referees. He reported that many referees believed that objections to discharge filed by small loan companies should be eliminated. It seems that referees generally believe that small loan creditors misuse objections to discharge and therefore should be discouraged from filing them).
regarding the consumer's place of employment, his past and present credit references, his marital status and other pertinent information designed to indicate the consumer's credit worthiness. After this initial information has exchanged hands, the creditor will complete a credit investigation to verify the consumer's information and to obtain some indication of the consumer's past employment and credit habits.\textsuperscript{15} If the creditor approves this initial application, he will then ask the consumer to come into his office to complete the application procedure. At this point, the creditor will require that the consumer complete a formal application-financial statement\textsuperscript{16} upon which the creditor will, in part, make his final decision to grant the loan. If the consumer's formal financial statement does not materially depart from the information that the creditor obtained during his credit investigation and from the consumer's first application, the loan will usually be granted at that point. However, if there is some substantial discrepancy, the creditor may defer final approval pending a reinvestigation of the consumer's credit background.

If the debtor repays the loan according to the loan agreement, no further credit investigation would take place. However, if the debtor begins to default upon his obligation to the creditor, the creditor may begin a reinvestigation of the debtor's application-financial statement in an effort to determine why the debtor is not repaying the loan. Usually this reinvestigation does not take place unless and until the debtor files a petition in bankruptcy.

Once the creditor receives formal notification of the debtor's application for discharge, he will begin an analysis of the debtor's formal financial statement to determine if the debtor misled him at the time the loan was granted. Normally the creditor will compare the debtor's schedule of liabilities as filed with his petition for discharge, with the debtor's financial statement as completed when the loan was granted. If a substantial discrepancy exists in the amount of the debtor's other indebtedness as listed in the financial statement, the creditor will then determine if he should file an objection to discharge on the basis of section 17a(2).

\textsuperscript{15}The thoroughness of any credit investigation will often depend upon a company's particular procedure, but it must be remembered that creditors do not have unlimited investigatory powers. Some debts, if not disclosed by the debtor, are simply not ascertainable (an inter-family loan, a purchase money security agreement with some retail store, an unsecured credit union loan, etc.). Often, credit bureaus have little, if any recent information. Similarly, some establishments will not give out any credit information at all. Consequently, a small loan creditor must in some cases depend almost totally upon the information it receives from the debtor.

\textsuperscript{16}Financial statement forms differ from one company to another, but for an example of a relatively simplistic form see Appendix I. For an example of a more comprehensive form see Appendix II. Creditors would be well advised to adopt a comprehensive form because of some courts' criticism of the simplistic-type forms. See, e.g., Sun Finance & Loan Co. v. Cononico, 20 Ohio Op. 2d 289, 177 N.E.2d 84 (Mun. Ct. Ohio 1959).
II. Decisions to File Section 17A(2) Objections to Discharge

Before making any determination regarding a section 17a(2) objection to discharge, a creditor must be absolutely sure that the debtor had, in fact, been dishonest in his efforts to obtain money or property from that creditor. In the past, small loan companies have been very severely criticized because of their unscrupulous practices in objecting to a bankrupt's discharge,17 and for this reason they cannot be too careful in making their decision to file an objection. In fact, some commentators18 and even some courts19 have contended that oftentimes small loan creditors will actually encourage debtors to make less than a complete and full statement of their outstanding liabilities and thereby render their financial statement ipso facto false. Others have contended that the small loan creditors do not, in fact, rely upon the formal financial statement but instead require it merely to insure themselves that they may have some basis upon which to object to a debtor's bankruptcy in the event that that does take place.20

In reality, these negative inferences have no basis or support in today's business community.21 Almost all lending institutions require debtors to complete some type of application-financial statement so that they will have some basis upon which to grant credit. The assumption that any creditor requires such a statement primarily to protect himself in the event that a debtor takes bankruptcy is without foundation.22

Once it has been determined that a debtor has, in fact, uttered a

17 See, e.g., In re Forgay, 140 F. Supp. 473, 478 (D. Utah 1956); In re Anderson, 104 F. Supp. 599, 604-5 (E.D. Wis. 1952). See also Friebolin, Re-Examination of Section 14(c) as a Ground for Objection to Discharge, 39 MINN. L. REV. 673 (1955); Comment, Bankruptcy Act: Abuse of Sections 14C(3) and 17A(2) by Small Loan Companies, 32 IND. L.J. 151 (1957).
18 See, e.g., Friebolin, Re-Examination of Section 14(c) as a Ground for Objection to Discharge, 39 MINN. L. REV. 673 (1955); Comment, Bankruptcy Act: Abuse of Sections 14C(3) and 17A(2) by Small Loan Companies, 32 IND. L.J. 151 (1957).
20 See, e.g., Household Finance Corp. v. Groscoast, 230 F.2d 608 (6th Cir. 1956); Helms v. Holmes, 129 F.2d 263 (4th Cir. 1942) (dissenting opinion); In re Anderson, 104 F. Supp. 599 (E.D. Wis. 1952).
21 See Proposed Amendments to the Bankruptcy Act Treated in Position Paper Filed by National Consumer Finance Association with National Bankruptcy Commission, 26 PERS. FIN. L.Q. REP. 51 (1972) wherein it is stated: "It is respectfully submitted that whatever criticism or claimed abuse existed prior to...[1970] can no longer be considered as a factual or emotional ground upon which to recommend the elimination of the right to question whether a debt should be discharged in a bankruptcy proceeding."
22 The percentage of small loan companies' losses due to consumer bankruptcies is relatively small. In fact total losses charged to bad debt (which includes losses other than bankruptcies) are often less than 2% of total receivables. See, e.g., Report to the Shareholders of Beneficial Corporation 24 (1972) (eleven-year summary) (The percentage of receivables charged off after offsetting recoveries, to average monthly balances amounted to only 1.11%-1.56% for the last eleven years. Surely this small percentage cannot justify the assumption that small loan creditors encourage debtors to complete false financial statements).
materially false financial statement, the creditor must be sure that his case meets the procedural prerequisites necessary to prove and substantiate his section 17a(2) objection. The creditor must prove, inter alia, that the financial statement was materially false; that money or property was obtained on the basis of the false financial statement; that the creditor relied upon the financial statement when extending credit, and that the debtor intended to deceive the creditor by uttering the false financial statement. 25 The burden of proof regarding these procedural essentials rests squarely upon the objecting party. 24

A. The Financial Statement Must Have Been Materially False

The question of whether or not a financial statement is materially false admittedly depends upon the facts in each case. Consequently, no set rules can be enunciated which would be applicable to all cases generally. However, a substantial and material omission or understatement of a debtor's liabilities is often considered to be sufficient grounds to maintain a section 17a(2) objection to discharge. 25

An exact dollars and cents deviation from a debtor's true liabilities at the time of the loan approval would be difficult to present, but some courts have held that as little as a few hundred dollars deviation is sufficient. 26 One noted commentator has stated that "A financial statement usually will be considered . . . materially false when the total of the undisclosed obligations is more than twice as great as the sum borrowed . . . ." 27 Whether or not a specific omission of certain liabilities is material should depend upon the sum borrowed, i.e., if a loan of $2,000.00 is extended on the basis of a false financial statement, an omission of $50.00 in liabilities should not be as material as in a situation where the loan amount is only $200.00, because in the former case the omission amounts to 1/40 of the sum borrowed while in the latter case it accounts for 1/4 of the total sum borrowed. Even though most courts have been understandably hesitant to develop a hard and fast "deviation rule," many have used some sort of deviation-type standard to determine whether or not a particular omission is material. 28

23 See, e.g., In re Schweizer, 271 F.2d 95 (7th Cir. 1959); Industrial Bank of Commerce v. Bissell, 219 F.2d 624 (2d Cir. 1955); In re Stone, 172 F. Supp. 142 (E.D.N.Y. 1959). See also 1A W. Collier, Bankruptcy ¶ 17.16 (14th ed. 1972); 8 H. Remington, Bankruptcy § 3320 (6th ed. 1955).
Whether or not an omission is material should similarly depend upon the completeness of the lender's financial statement form. If the creditor uses a relatively simple financial statement form, he may not be able to present an adequate objection if the debtor omitted a liability to a particular creditor, such as a lessor, which the average consumer-debtor may not consider a creditor at all. These problems can be overcome by providing the debtor with detailed financial statements which explicitly point out specific groups of creditors that are to be included in the financial statement. If a financial statement requires a detailed disclosure of all creditors of every type, this fact will go to buttress a creditor's objection when a particular debtor claims that he did not remember to list one or more particular liabilities.

Aside from questions regarding the omission of certain liabilities, another factor which might result in a section 17a(2) objection may be based upon a debtor's overstatement of his income. If a debtor substantially and materially overstates his income on the financial statement, the creditor may be misled as to such debtor's ability to repay the loan. Once again, the debtor's deviation from the true state of facts should depend upon the amount of the overstatement, i.e., if a debtor overstates his income by 25%, this misrepresentation would not be as material as an overstatement of 50-100%. As unsettling as these conclusions may be, the fact still remains that each case must of necessity, depend upon its own particular circumstances.

B. Money or Property Must Have Been Obtained on the Basis of the Financial Statement

In order to successfully litigate a section 17a(2) objection to discharge, a creditor must prove that as a result of the debtor's utterance of the materially false financial statement, he extended and lost money or property. The rendition of services does not come within the "money or property" requirement of section 17a(2).

Objections to discharge are allowed in part, to prevent "[T]he bankrupt from retaining the benefits of property acquired by fraudulent means." Therefore, the creditor must show that he has been deprived of some type of property that he otherwise would not have relinquished, on
the basis of the debtor's false representations.\textsuperscript{37} This theory seems to be based upon general principles of unjust enrichment, \textit{i.e.}, the debtor should not be allowed to benefit from his own wrong.

The requirement that money or property must have been obtained has some particular significance when one considers that creditors often renew existing loans to advance the debtor additional money. When this is done, the lender normally requires that the debtor complete a new financial statement to certify his then existing economic status. Thus if a lender grants an additional sum of money to a debtor on the basis of a second financial statement which proves to be materially false, this constitutes obtaining money or property within the contemplation of section 17a(2) of the Bankruptcy Act.\textsuperscript{38}

Assuming for a moment, that a particular debtor had at first, obtained money on the basis of a true and complete financial statement, and then sometime later, obtained an additional loan amount on the basis of a material false financial statement, the question arises as to whether or not the total loan (the original amount minus repayments, coupled with the renewal amount), should be subject to a section 17a(2) objection. Prior to the 1960 amendment to section 17a(2),\textsuperscript{39} the phrase "obtaining an extension or renewal of credit" was not present in section 17a(2), and some courts held that the entire obligation was not non-dischargeable upon a creditor's successful section 17a(2) objection.\textsuperscript{40} However, after the 1960 amendment was enacted, courts generally determined that a debtor's utterance of a materially false financial statement to obtain an extension or renewal of credit would result in a non-dischargeable debt as to the entire amount of liability outstanding.\textsuperscript{41}

C. The Objecting Creditor Must Have Relied Upon the Financial Statement When Extending Credit

This third element must be established if a creditor is to successfully litigate a section 17a(2) objection to discharge. If the creditor has not in fact relied upon the financial statement in extending credit, he cannot be heard to complain.\textsuperscript{42} Oftentimes, this requirement is an unsurmountable

\textsuperscript{37} See 8 H. Remington, Bankruptcy § 3322 (6th ed. 1955).
\textsuperscript{39} Act of July 12, 1960, Pub. L. No. 86-621.
\textsuperscript{42} See 8 H. Remington, Bankruptcy § 3322 (6th ed. 1955).
hurdle which many creditors cannot seem to overcome.\textsuperscript{43}

As pointed out earlier,\textsuperscript{44} many courts believe that creditors do not in fact rely upon the financial statement and therefore should not be heard to complain.\textsuperscript{45} The basis for this belief generally rests upon the assumption that small loan creditors do not place much emphasis on the formal financial statement because they have in fact, investigated the applicant before extending credit.\textsuperscript{46} However, a small loan creditor's investigatory powers are often severely limited and in actuality, these investigations may reveal little, if any substantive information.\textsuperscript{47} Consequently, small loan creditors (like most other creditors) require the completion of a formal financial statement to insure that they have done all that is possible to ascertain a debtor's true financial condition.\textsuperscript{48}

Generally, there must be a distinct causal connection between the utterance of the financial statement and the granting of credit.\textsuperscript{49} Stated another way, an action of the debtor (completion of the financial statement) must result in a reaction from the creditor (granting of the desired credit). The creditor must have granted the credit on the basis of the financial statement,\textsuperscript{50} although he need not have granted the credit on the sole basis of this information.\textsuperscript{51} Partial reliance upon the financial statement has oftentimes been construed to be sufficient to meet the reliance requirements.\textsuperscript{52}

Considering the skepticism that exists among many courts as to small loan companies' reliance upon the financial statements,\textsuperscript{53} the burden of proving reliance may be a formidable one indeed. Creditors may, in part,
overcome this burden by attesting on the statement itself that they have, in fact, relied upon the financial statement in granting credit. While this attestation clause would not be absolutely controlling, it would perhaps help creditors in their efforts to show reliance.

D. The Creditor Must Show That the Debtor Intended to Deceive Him

This fourth element of proof may be considered the most formidable because of the obvious difficulties in attempting to prove another's state of mind. Admittedly, a debtor's state of mind cannot be directly examined, but his intent can usually be ascertained from his outward actions and his own personal knowledge or experience.

Generally a creditor must show that the false financial statement was uttered with conscious knowledge of its falsity or with reckless indifference as to its truthfulness.

If a financial statement is sufficiently detailed so as to require a disclosure of all indebtedness, a particular debtor will be hard pressed to allege that he simply "forgot" to list one or more specific obligations. The omission of such obligations would thus hopefully be considered a prima facie indication of a conscious intention to deceive. Similarly, a reckless indifference or disregard as to the truthfulness of a particular financial statement may be considered to be made with knowledge of its untruthfulness.

A particular debtor's education and/or business experience will often be considered in any examination into his intent to deceive. Obviously, a college graduate or one with some particular experience in the business community, should be held to a higher standard or duty, than a high-school graduate who has little understanding or knowledge of practical business necessity. Unquestionably, a signed statement of any debtor, without some incapacity, as to his financial condition should be prima facie proof of his truthfulness or untruthfulness. If the statement is in fact, false, the burden of proof should shift from the creditor to the

54 See Appendix II.
61 See In re Sam, Bankr. No. 71-2075 (N.D. Ohio 1971) (Bankrupt was an experienced used car salesman, familiar with business necessity and was not an "uneducated" nor "unsophisticated" consumer).
debtor, whereby the debtor should be required to show to the court's satisfaction that he did not intend to deceive.\textsuperscript{62} In this same regard, frail excuses should not be considered persuasive or result in a determination in favor of the bankrupt. Since intent can only be shown by overt acts, the bankrupt should not be allowed to simply assert that he could not remember some obligations, particularly when the financial statement requires sufficiently precise information.\textsuperscript{63}

III. Who Determines (Who Should Determine) Section 17A(2) Objections to Discharge

As mentioned previously, small loan companies have been very harshly criticized for certain unscrupulous practices that have occurred in some companies' objection to discharge.\textsuperscript{64} As a partial result of this criticism, the Bankruptcy Act was amended in 1960\textsuperscript{65} to limit an objecting creditor's ability to totally negate a consumer bankrupt's right to a general discharge.\textsuperscript{66} As a result of the 1960 amendment, consumer bankrupts can no longer be refused a general discharge on the basis of one party's objection. While this amendment has been generally lauded as being beneficial to the individual bankrupt, it may also be considered beneficial to the defrauded creditor.\textsuperscript{67} Therefore, the 1960 amendment provided a more equitable result for both the bankrupt and the defrauded creditor. Furthermore, by another amendment to the Bankruptcy Act which became effective December 18, 1970,\textsuperscript{68} bankruptcy courts were vested with the exclusive jurisdiction to determine the dischargeability of individual debts.\textsuperscript{69} Formerly, a disgruntled creditor could sue in state court for a determination that his particular claim was not dischargeable in bankruptcy,\textsuperscript{70} because of the debtor's misrepresentations in obtaining the

\textsuperscript{62} Although this is not the majority position, it seems as if this position would perhaps be more evenly balanced between the debtor and the objecting creditor. For a detailed discussion regarding the burden of proof in these matters, see Comment, \textit{Fraudulent Financial Statements and Section 17 of the Bankruptcy Act—The Creditor's Dilemma}, 1967 \textit{Utah L. Rev.} 281, 284, n. 14.

\textsuperscript{63} If the creditor uses a detailed financial statement form and impresses the debtor with its importance, these factors will go to buttress the creditor's claim.

\textsuperscript{64} See Comment, \textit{Bankruptcy Act: Abuse of Sections 14C(3) and 17A(2) by Small Loan Companies}, 32 \textit{Ind. L.J.} 151 (1957). See also Countryman, \textit{The New Dischargeability Law}, 45 \textit{Am. Bankr. L.J.} 1, 10-11 (1971).

\textsuperscript{65} Act of July 12, 1960, Pub. L. No. 86-621.

\textsuperscript{66} See Bankruptcy Act § 14c(3), 11 U.S.C. § 32c(3) (1970) [only business bankrupts can now be denied a general discharge under § 14c(3)].

\textsuperscript{67} Prior to the 1960 amendment, a creditor's successful objection under § 14c(3) would result in denying the bankrupt a general discharge. Therefore all his creditors would be free to seek collection of their claims. After 1960, one creditor's successful objection under § 17a(2) would result only in a non-dischargeable claim as to that creditor. Therefore, this one creditor would be free to seek collection of his claim and would have a much better chance of collecting than if he had to compete with numerous other creditors as in the pre-1960 procedure.


\textsuperscript{70} See Twinem, \textit{Bankruptcy Act Amended: Determination of Dischargeability of Debts}
debt in question. While this amendment has also been lauded as being beneficial to the consumer-bankrupt, it also invests the bankruptcy referees with the sole and exclusive power to determine the dischargeability of individual obligations.71 Prior to the 1970 amendment, a creditor could demand a jury trial in a state court proceeding, on questions regarding the debtor’s utterance of a materially false financial statement with the intent to deceive and cause the creditor to rely thereon in granting credit.72

The 1970 amendment to section 17 also provides that “Nothing in this subdivision c shall be deemed to affect the right of any party, upon timely demand, to a trial by jury, where such right exists.”73 However, at least one court has held that there is no right to a jury trial in section 17a(2) cases.74 Thus, the amendments have conferred very broad powers upon the referees which may or may not have been properly delegated to them. In view of the pro-bankrupt philosophy that has existed since the 1970 amendment, in cases where small loan creditors filed section 17a(2) objections, it is submitted that this power may have been improperly placed.75 Furthermore, it is herein submitted that the right to a jury trial in section 17a(2) objection cases, is not nearly as clear cut as some commentators76 and courts77 would have us believe.

One noted bankruptcy commentator, Asa S. Herzog,78 has contended in a recent article,79 that Congress intended to insure complainants the right to a jury trial in section 17a(2) objection cases.80 Referee Herzog contends that Congress was extremely hesitant in its quest to transfer section 17a(2) objection cases to bankruptcy courts because these cases “[T]raditionally were tried in state courts before a judge and jury (footnote in Bankruptcy Proceedings to be Made by Referee, 25 Pers. Fin. L.Q. Rep. 18 (1970). See also Comment, Bankruptcy Act; Abuse of Sections 14C(3) and 17A(2) by Small Loan Companies, 32 Ind. L.J. 151, 155-9 (1957).


75 When the Bankruptcy Rules and Official Bankruptcy Forms were approved by the Supreme Court, Mr. Justice Douglas dissented to the Court’s action, in part, because he felt that the Rules gave referees too much power (on a different matter than dischargeability). Perhaps they were given too much power over dischargeability too.


77 In re Swope, 466 F.2d 936 (7th Cir. 1972).

78 Referee in Bankruptcy, Southern District of New York; Member of the Judicial Conference Committee on Bankruptcy Rules; Member of the National Bankruptcy Conference.


80 Id. at 237.
The article criticizes a recent case, *In re Swope,* which held that there was no right to a jury trial in section 17a(2) cases. Referee Herzog contends that the bankruptcy court's rationale ("[T]hat the seventh amendment to the Constitution [which] preserves the right to jury trial in suits at common law . . . does not extend to bankruptcy proceedings which fall within the equity jurisdiction of the court."), nullified Congress' specific intention to preserve the right to a jury trial in section 17a(2) cases.

In summation, Referee Herzog concluded:

[T]he seventh amendment does not guarantee that right [to a jury trial], and while jury trials do not ordinarily exist respecting estates in custody of the bankruptcy courts, Congress has now said that the right does exist in the area of dischargeability where the same issues of fact would be resolved by a jury had the matter been left with the state court.

Another noted bankruptcy commentator, Professor Vern Countryman, has adopted a different viewpoint from that expressed by Referee Herzog. It is Professor Countryman's position that a creditor's objection to discharge on the basis of section 17a(2) "[d]oes not present the occasion for summoning a jury. The bankruptcy court may rule without a jury on the dischargeability issue." In his reply to Referee Herzog, Professor Countryman submits that Referee Herzog "[I]s wrong and that [the] new section 17c(5) of the Bankruptcy Act neither preserves nor confers a right to jury trials on issues of dischargeability, as distinguished from issues of liability or damages." Professor Countryman contends that section 17c(5) was not meant to confer a right to a jury trial but only to preserve such a right where it previously existed. This viewpoint is not completely incongruous to Referee Herzog's in that Referee Herzog contends only that the right to a jury trial did exist prior to the 1970 amendment in state courts and that Congress meant to preserve that right in bankruptcy court proceedings. Professor Countryman, like Referee Herzog, analyzes the legislative history of the 1970 amendment and concludes that section 17c(5) "[W]ill usually operate to preserve existing..."
rights to [a] jury trial on issues of liability and damages after the issue of dischargeability is determined."

In and of itself, the debate on this point makes it rather obvious that the jury trial question is not as clear cut as some courts have contended. An independent analysis of the legislative history of section 17c(5) has proven equally unhelpful because either viewpoint may be supported by this history. In essence, poor draftsmanship may have created the confusion because the statement that the right to a jury trial is preserved where such right exists does not answer the related question of whether Congress intended to preserve the right as it existed in state courts when creditors attempted to litigate the false financial statement issue or whether Congress intended to preserve the right only as it previously existed in the bankruptcy courts. However, if Professor Countryman's viewpoint is adopted there is no right to a jury trial at all, and Congress' intent may have been effectively circumvented.

This comment concurs in the viewpoint as expressed by Referee Herzog. It seems inconceivable to assume that Congress meant to preserve the right to a jury trial on issues previously arising in bankruptcy courts (dischargeability) when they were vesting those very courts with exclusive jurisdiction over cases based upon false financial statements which were previously tried in state courts before juries. Is it not more logical to assume that Congress meant to preserve the right to a jury trial on issues that were previously tried before both judge and jury, in state court proceedings? This would appear to be the sounder contention.

Courts confronted with jury trial requests in section 17a(2) cases should take the time to fully explore the question before blindly espousing

---

92 See In re Swope, 466 F.2d 936 (7th Cir. 1972).
93 See 116 Cong. Rec. 9549 (1970). Therein Congressman Wiggins stated:
One ground for opposition to some of the dischargeability bills introduced in earlier years is resolved in S. 4247. It was said that compelling either the bankrupt or the creditor to submit to the procedure contemplated in the Bankruptcy Court might constitute unjust deprivation of the right to trial by jury. Section 7 of the bill adds a new Section 17c(5) to the Bankruptcy Act which specifically protects the right to trial by jury upon timely demand where such right presently exists.
94 See 1A W. COLLIER, BANKRUPTCY ¶¶ 17.28A(6) (14th ed. 1971).
96 See 1A W. COLLIER, BANKRUPTCY ¶¶ 17.28A(6), at 1742.3 (14th ed. 1972): Prior to the 1970 amendments to § 17, creditors would bring suit in state court on the debt after the bankrupt had received a discharge in bankruptcy and, as Collier points out:
When the affirmative defense of discharge was pleaded, the elements of false financial statement and reliance [usually a § 17a(2) type lawsuit], would be raised by the plaintiff in response to the affirmative defense, i.e., that the defense was not valid because the debt was non-dischargeable under the Bankruptcy
the theory of but one noted writer. Congress should seek to definitively clarify the issue so as to end the fruitless speculation that presently exists.

Furthermore, in light of the skepticism that exists among many bankruptcy courts, how can litigants expect to secure an objective analysis of the facts from the court alone? Obviously, they cannot. As Referee Herzog so aptly pointed out: "[I]f the word gets out that a particular referee is bankrupt oriented, that creditors do not stand a ghost of a chance to succeed—who can fault the creditors for turning to a jury demand to get a fair trial?"

IV. Conclusion

The whole of the foregoing discussion may, in fact, prove to be moot if Congress should formulate legislation based upon the Report of the Commission on the Bankruptcy Laws (hereinafter Report). The Commission, created in 1970 by a joint Congressional resolution, issued its recommendations on July 30, 1973, after two years of study. The Report, inter alia, recommends that section 17a(2) objections to discharge in consumer bankruptcies be absolutely eliminated.

In his letter of July 30, 1973, to the President, Congress and the Chief Justice, Mr. Harold Marsh, Jr., Chairman of the Commission, stated:

The system of bankruptcy administration is designed to deal with the unfortunate situation where a debtor is not able to negotiate an

Act. If a jury trial had been demanded, the jury would consider all the facts, including the falsity of the financial statement and the reliance. Granted that there may well have been a right to a jury trial in the action on the debt, did that right encompass the issue of dischargeability necessitating additional facts? It seems not. Now, in the bankruptcy court the issue [sic] is strictly one of dischargeability, a Bankruptcy Act issue.... In the case of an application under § 17c, the issue of dischargeability is the prime issue, although the court may also have to determine if there is a debt. It may be, therefore, that there is, in fact, no right to trial by jury preserved by § 17c(5) [under this theory].

Congress was aware of the state court practice, and it seems inconceivable to assume that they would seek to preserve the right to a jury trial if, in fact, they knew no such right would exist.

See Herzog, The Case for Jury Trials on the Issue of Dischargeability, 46 AM. BANKR. L.J. 223 (1972). See also 1A W. COLLIER, BANKRUPTCY ¶ 17.28A(6), at 1742.4 (14th ed. 1972), where it is stated in part:

It is clear, however, that Congress intended that a party should not be deprived of his right to a jury trial if he makes a timely demand therefore. To effectuate that intention, therefore, it may be argued that until this legislation all of the underlying facts on both issues [liability and dischargeability] would have gone to the jury, had one been demanded in the state court action, and that is what has been preserved. This certainly would give more meaning to § 17c(5) and the expressed intention of Congress.

See note 14 supra.


Id.
accommodation with his creditors without resort to court; therefore, by its very nature it involves a process which is unpleasant both to the debtor and to his creditors. No recommendations will change this fundamental fact. However, it is important that the objectives of this system, to effect an equitable distribution of the assets of the debtor and to relieve the honest but unfortunate debtor from the weight of oppressive indebtedness, be accomplished as economically and humanely as possible. Also, the efficiency of the process and the rules applied in it have an impact on the entire credit economy which goes far beyond the specific cases involved in the process itself. [emphasis added].

These prefatory remarks seem completely incongruous with the Commission's recommendations designed to eliminate section 17a(2) objections to discharge. In one breath, the Commission submits that it wants to effectuate the process whereby the honest debtor will be relieved from his indebtedness but in a second breath, implies that even dishonest debtors will be afforded the same equitable relief.

The Bankruptcy Act has been consistently characterized as providing an equitable remedy to those honest debtors who for one reason or another have become financially unable to repay their outstanding obligations. A diligent search of available authority has admittedly failed to uncover any opinion allowing a patently dishonest debtor the right to an equitable remedy.

As early as 1935, the Supreme Court characterized bankruptcy courts as "essentially courts of equity." Since that time, numerous federal courts have reached the same conclusion determining that since these courts are courts of equity, they must be guided by equitable principles or maxims in the exercise of their jurisdiction. This does not mean that general principles of equitable jurisprudence prevail over statutory law, but simply that equitable principles must be exercised.
within the confines of the Act.\textsuperscript{109}

Coming now to the Commission’s proposal designed to eliminate section 17a(2) objections to discharge, it can be readily determined that several important equitable maxims would undoubtedly be circumvented if this proposal was implemented:

(1) Equity regards that as done which ought to be done;
(2) [H]e who seeks equity must do equity;
(3) [H]e who comes into equity must come with clean hands;
(4) [E]quity will not suffer a wrong without a remedy.\textsuperscript{110}

These general principles have little to do with strict notions of jurisdiction as such, but are generally regarded as principles applicable in the decision making process.\textsuperscript{111} One author has rightly contended that the “clean hands doctrine” operates as a constraint upon equitable jurisdiction in that a party with “unclean hands” should not be afforded an equitable remedy.\textsuperscript{112}

The foregoing discussion now brings us to the ultimate question: Should a dishonest debtor be afforded the equitable remedy of a discharge in bankruptcy as to a creditor whom he has in fact defrauded? Clearly the answer must be no.\textsuperscript{113} A debtor with “unclean hands” should not be able to benefit by his own wrong to the disadvantage of the defrauded creditor. To put both honest and dishonest debtors on the same footing would be to completely circumvent time-tested and honored equitable principles. If all debtors are allowed the right to a discharge without objection, dishonesty will be rewarded and thereby encouraged. Congress should take a hard and long look at this particular recommendation. If it simply “rubber stamps” the Commission’s proposal, there no longer will be any forum in which to raise questions of dishonesty.\textsuperscript{114} In essence, creditors may simply have to drastically curtail their lending operations to the detriment of all consumers who are “on the borderline.” As section 17a(2) objections now stand, a creditor has an almost impossible burden of proof, and any proposal designed to eliminate even this objection must be scrutinized very carefully indeed.

\textbf{David L. Herbert}

\textsuperscript{109} See Pepper v. Litton, 308 U.S. 295, 304 (1939) where the Court stated:

[T]his Court has held that for many purposes “courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity” ... By virtue of §2 [of the Bankruptcy Act] a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence....

\textsuperscript{110} See 2 J. Pomeroy, \textit{Equity Jurisprudence} § 363 (5th ed. 1941).


\textsuperscript{112} Id.

\textsuperscript{113} See, e.g., \textit{In re Beam}, 163 F. Supp. 333, 335 (N.D. Ala. 1958) (the court refused to affirm a referee’s decision granting a discharge, where the bankrupt had come into court with unclean hands).

APPENDIX I

APPLICATION AND FINANCIAL STATEMENT*

For the purpose of showing my ability to repay said loan and to induce you to grant said loan, I hereby declare that a list of all my debts and liabilities is as follows:

<table>
<thead>
<tr>
<th>NAMES OF CREDITORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mark &quot;X&quot; by those Debts you will pay with proceeds of this Loan</td>
</tr>
<tr>
<td>AMOUNT OWED</td>
</tr>
<tr>
<td>MONTHLY INSTALMENT BEING PAID</td>
</tr>
</tbody>
</table>

| PRESENT BALANCE ON PRIOR LOAN WITH YOU |
| $ | $ |

If the above spaces are not sufficient, please list any additional debts on the back hereof. YOU MUST LIST ALL OF YOUR DEBTS.

My salary is $_________ per _________. My income from other sources is $_________ per _________.

I hereby state, affirm, represent and warrant to you that my total indebtedness and liabilities on this date do not exceed $_________.

WITNESS:

____________________________________________________
Name

____________________________________________________
Address

* This financial statement form is deficient in several important aspects. It does not provide sufficient space; it does not adequately point out specific groups of creditors that are to be included; it does not warn the consumer of the ramifications of less than a complete disclosure; it does not provide the loan office with any means to indicate on the form itself that he has relied on the financial statement in granting the loan.
APPENDIX II
CREDIT STATEMENT*

NOTICE: If you knowingly give a false Statement regarding your credit, and the lender relies on it in part in making the loan, your obligation would be not dischargeable in bankruptcy. For your benefit this Credit Statement should be true and complete.

To: ___________________________ Date: ______________
(Corporate Name)

Address _________________________

In connection with my application to you for a loan of $__________, I hereby submit the following information for the purpose of showing my ability to repay the same and to induce you to grant said loan. I hereby represent and warrant to you that a full complete and correct list of ALL my debts and liabilities and other claims against me of $25.00 or more is as follows:

<table>
<thead>
<tr>
<th>NAMES OF CREDITORS</th>
<th>Mark &quot;X&quot; by these Debts you will pay with proceeds of this Loan</th>
<th>AMOUNT OWED</th>
<th>MONTHLY INSTALMENT BEING PAID</th>
</tr>
</thead>
<tbody>
<tr>
<td>Be sure to include ALL DEBTS owed on:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Real Estate Mortgages</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Contracts on Automobiles, Furniture, etc.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Loans with Finance Companies, Credit Unions or Banks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Credit Card Obligations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Charge Accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Medical Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. All other Obligations</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

PRESENT BALANCE ON PRIOR LOAN WITH YOU: $ ______$ ______

1. REAL ESTATE MORTGAGES
   a. First Mortgage
   b. Second Mortgage

2. CONTRACTS ON
   a. Automobiles
   b. Furniture

3. LOANS WITH
   a. Finance Companies
   b. Banks
   c. Credit Unions

4. CREDIT CARD OBLIGATIONS

5. CHARGE ACCOUNTS

6. MEDICAL EXPENSES

7. RENTAL OBLIGATIONS

8. OTHER OBLIGATIONS

TOTALS $ ______$ ______

If above spaces are not sufficient, please list any additional debts on the back hereof.

YOU MUST LIST ALL OF YOUR DEBTS OVER $25.00
Please Read These Instructions

Before completing and signing this statement below, please review all your debts carefully. Be sure you have disclosed all your debts of all kinds and that the facts stated in this statement are correct. Do not omit any debts. We rely upon your good faith and the truth of your representations.

For your protection against an over extension of credit, you are requested above to list each and all of your debts, liabilities and claims against you which are in excess of $25.00. If you have no other debts, liabilities, etc., please initial the box alongside statement below and affix your signature beneath it.

I have no debts and liabilities in excess of $25.00 other than those listed hereon. I certify that I have not been instructed by the lender to which I have made an application for a loan to list only certain debts. Instead, my instructions have been to list all outstanding debts and liabilities.

Signature of Borrower

My "take-home" pay is $_______ per _________. My net income from other sources is $_______ per _________. I hereby state, affirm, represent and warrant to you that my total indebtedness and liabilities on this date do not exceed $_______.

WITNESS: Name________________________

Address______________________________

FOR LOAN OFFICE USE ONLY

Before approving the making of a loan to the above named borrower, I carefully examined this statement and relied upon it in passing upon the credit worthiness of such borrower.

Signer _______________________________ Title _______________________________

8OR 2-1 Ed. Apr. '73

* This financial statement form provides sufficient space for all groups of creditors; it warns the consumer of the consequences of uttering a false statement; it provides an attestation clause on the statement itself, whereby the loan officer can indicate that he has, in fact, relied upon the statement in granting credit.

Corporal Punishment in the Public Schools:
The Legal Questions

Introduction

Public education in the United States has come a long way since the one-room schoolhouse days. This phenomenal growth has been paced by the controversy surrounding the use of corporal punishment as a means of enforcing discipline in the schools. From the oldest reported case reaching the issue of corporal punishment back in 1833 down to the present, the proponents of corporal punishment have had to defend their actions in the courts from a wide variety of attacks based on criminal law, tort law, state statutes, school board regulations and, most recently, constitutional guarantees. Although the attacks on corporal punishment have been largely unsuccessful, the recognition by the courts of the substantive and procedural constitutional rights of students who