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THE BANKRUPTCY COURT AND THE COUNTY SHERIFF

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The existence of the bankruptcy remedy in the federal courts poses some problems for sheriffs and their legal advisers growing out of attachment, execution and garnishment which the sheriff has levied or which some creditor insists be levied in spite of bankruptcy. It will be assumed that the sheriff has no other connection with property of the debtor-bankrupt than under such levies. Briefly, but probably not exhaustively, the sheriff's primary questions are:

WHAT IS THE EFFECT OF FILING OF A BANKRUPTCY PROCEEDING?

In bankruptcy a debtor takes advantage of a federal law which enables him to seek relief from further actions of his creditors. In other words he seeks a discharge. Depending upon his conduct, he may or may not be granted one.[1] But regardless of the decision as to his discharge, the debtor must surrender most or in some cases all of his property for the benefit of his creditors.[2] This is true whether the bankruptcy was voluntarily filed by the debtor or filed against him by his creditors. The device used by Congress to administer the property is to select a representative of all the creditors, namely a trustee in bankruptcy, who takes legal title to property of the bankrupt as of the date of bankruptcy. The trustee is not actually selected until a few weeks after bankruptcy, but upon

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1 The grounds of objection to discharge are found in BANKRUPTCY ACT § 14, 11 U.S.C. § 32.

2 On property which passes from the bankrupt to his trustee, see BANKRUPTCY ACT § 70(a), 11 U.S.C. § 110(a). Section 70(a) excludes exempt property and section 6, 11 U.S.C. § 24 adopts state laws on exemptions.

his selection his title relates back to the date of filing. Should the situation require it a temporary trustee, called a receiver, may be appointed. The receiver takes no title, but he has the right and responsibility to take action to collect and preserve property.[3]

A few brief rules as to property to which the trustee takes title are important.

1. It is the bankrupt's title as of the date of bankruptcy which passes to the trustee.[4]

2. The exceptions to this are:
   a. Property inherited within six months of bankruptcy filing.
   b. Non-transferrable property interests which become transferrable within six months of bankruptcy filing, *e.g.*, a contingent remainder which vests within that time.
   c. Property in tenancy by the entireties which becomes vested within six months.
   d. Any property not covered by the provisions of section 70(a).

3. The trustee does not take title to property of the bankrupt which is exempt under state or federal law, but it passes to him for administration, which means he has a possessory right to examine and appraise it.[5]

4. Community property of the parties passes to the trustee of the husband even though the wife does not file in bankruptcy.[6]

Thus the bankrupt upon filing no longer has title. Any levies sought by the creditor upon property which passed to the trustee may be refused by the sheriff without incurring liability.[7] Even though the sheriff may have property under levy at the time of filing, it may be noted that the last sentence of section 70(a) of the act says that the title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court. Recalling that a levy prior to any sale does not give the creditor title to the property, but only a lien, it is obvious that the trustee takes his title to property held under levy subject to this lien unless there is some defect in the lien because of either state law or some invalidating provision of the Bankruptcy Act.

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[3] BANKRUPTCY ACT § 2(a)3, 11 U.S.C. § 11(a)3.
[4] BANKRUPTCY ACT § 70(a), 11 U.S.C. § 110(a).
[5] Vought v. Kanne, 10 F.2d 747 (8th Cir. 1926).
[6] Hannah v. Swift, 61 F.2d 307 (9th Cir. 1932); Gibbons v. Goldsmith, 22 Fed. 826 (9th Cir. 1915); Holahan v. Misuraca, 112 F. Supp. 504 (E.D. La. 1953).
[7] Hunydee v. Strand, 214 Cal. App. 2d 647, 29 Cal. Rptr. 647 (1963).

The limitation of the trustee's title to property of the bankrupt means that after-acquired property of the bankrupt (with the rare exceptions previously stated) is not affected by bankruptcy proceedings. Once a bankruptcy is filed, further levies upon property of the bankrupt which passed to the trustee are improper, but levies upon after-acquired property of the bankrupt are quite proper unless a court of competent jurisdiction restrains them. Indicative of the latter point is section 17 of the act which provides that even though a discharge is granted, certain debts may still be collected. It is clear that it is improper to take the position, as some do, that bankruptcy automatically stops everything in relation to the debtor who becomes a bankrupt.

WHAT KNOWLEDGE OR NOTICE IS REQUIRED TO AFFECT THE ACTIONS OF A SHERIFF?

A sheriff incurs no liability and does no legal wrong by executing writs after the filing of a petition in bankruptcy, but before he knows of it.[8]

It appears that the sheriff has no duty to search the records of bankruptcy filings every time he levies. On the other hand, if the sheriff is served with papers which the Bankruptcy Act makes sufficient proof of bankruptcy, he could not be heard to say he did not know of it. Section 21(e) of the act makes a certified copy of the order approving the bond of the trustee "conclusive evidence" of his appointment and qualification. In between is a shadow area in which the sheriff's knowledge of the bankruptcy may come about by accidental reading, anonymous telephone calls, or being advised by the attorney for the bankrupt or trustee. It has been held that the filing of the petition in bankruptcy is itself sufficient to prevent a sale thereafter, if the filing is brought to the attention of the sheriff before the sale is completed. The method of notice in the case was the delivery of an invalid restraining order.[9] But a sheriff was held not liable for conversion in selling after bankruptcy where advised by telephone that a bankruptcy was to be filed. The court observed that if the sheriff had refrained from selling and the bankruptcy were never filed, the sheriff would be guilty of contempt of court in failing to execute the writ.[10] In the same case the court

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[8] Conner v. Long, 104 U.S. 228 (1881).

[9] *In re* Miles Paint Mfg. Co., 32 Am. Bankr. R. 793 (E.D. Pa. 1914).

[10] Coppard v. Gardner, 199 S.W. 650 (Tex. 1917). In California, *Laubisch v. Roberdo*, 43 Cal. 2d 702, 277 P.2d 9 (1954) is cited as authority that process is required to obtain action by the sheriff. Aside from the fact that the case did not deal with bankruptcy, it seems that although it may stand for the point that process directed

said that notice of the filing of the bankruptcy "must come through official channels and can be of no efficacy when issued by a citizen clothed with no authority." If this imports that the sheriff must be served with valid process or that a restraining order is required to bar further levies, it is of questionable validity and inconsistent with the previously cited federal case on the service of the invalid restraining order. If, on the other hand, it means that some credible documentary proof that a bankruptcy has been filed for or against the debtor is required, it seems sound.

When Must a Sheriff Turn Over Money or Assets Which He Has Under Levy to the Trustee in Bankruptcy?

The discussion at this point relates to assets which, as between bankrupt and trustee, pass to the trustee. The problem of when the sheriff releases after-acquired assets to the bankrupt or levying creditor will be considered below.

The bankruptcy power of the federal system is constitutional, and Congress has the paramount power to confer on the federal bankruptcy court complete jurisdiction to handle all bankruptcy problems.[11] But it has not done so, and the resultant confusion and uncertainty over jurisdictional problems makes it questionable whether the reticence of Congress is wise. In the divided jurisdiction some matters relating to bankruptcy are to be handled by state courts only, some by that part of the United States district court presided over by the district judge, some by that part of the district court presided over by the referee in bankruptcy, while in some cases there may be concurrent jurisdiction. As a working premise one may say there is plenary jurisdiction in proceedings before the state court or the district judge and summary jurisdiction in matters handled by the referee. The primary difference is that summary jurisdiction brings matters on for hearing much more quickly by means of an application and order to show cause, while plenary jurisdiction requires the slower complaint, answer, discovery procedure, setting procedure, and pre-trial conference.

As a general proposition comity between courts is observed, and the first court to take jurisdiction will have the ultimate task of deciding a matter. In some instances the bankruptcy court will take over a matter pending in the state court. The key to exclusive summary jurisdiction in the bankruptcy court is possession of prop-

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to the sheriff is necessary to get him to act, it does not stand for the proposition that process is necessary to have him refrain from executing a levy.

[11] Taubel-Scott-Kitzmiller v. Fox, 264 U.S. 426 (1924).

erty by the bankrupt or by one who does not hold adversely to him on the date of bankruptcy. The United States Supreme Court has held that the possession of a sheriff is the possession of the state court and that if there is no statutory grant of summary jurisdiction, the bankruptcy court (*i.e.*, the referee) may not take the property from the sheriff and state court by means of a turnover order requiring delivery to the trustee.[12]

Subsequent to this decision Congress gave a very important grant of summary jurisdiction to the bankruptcy court. The concept of what is now section 67(a) of the act has long been in the law. The policy of equitable distribution of the bankrupt's assets among his creditors requires invalidation of certain pre-bankruptcy transactions. Among them is the nullification of attachment and execution liens obtained within four months of bankruptcy while the bankrupt was insolvent. While this is an old concept, it was only after the previously cited case that section 67(a)4 was added giving summary jurisdiction to the referee to handle lien invalidation under this section. So although the state court may have possession of property through levies by its sheriff, this is one instance of federal jurisdiction superseding state jurisdiction. Under California law the sheriff need not decide at his peril if a court order regular on its face was validly issued,[13] and this is almost certainly the law in relation to orders of the bankruptcy court.

As section 67(a) purports to invalidate only levies obtained within four months of filing, the question arises as to levies made prior to that time. There are old decisions of lower federal courts which hold that it is proper to restrain sales by sheriffs upon executions levied more than four months before bankruptcy.[14] The rationale of the cases is that though the liens are not invalidated under section 67, nevertheless the property passes to the trustee and he may not destroy or disregard that lien, but is subject to it. These cases have been thoroughly discredited by later decisions of the Supreme Court.[15] As a practical matter experienced attorneys for trustees will not make a demand for assets levied upon more than four months before bankruptcy.[15a]

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[12] *Ibid.*

[13] CAL. CODE CIV. PROC. § 262.1.

[14] *In re* Vastbinder, 132 Fed. 718 (M.D. Pa. 1904); *In re* Baughman, 138 Fed. 742 (M.D. Pa. 1905).

[15] Stratton v. New, 238 U.S. 318 (1931); Taubel-Scott-Kitzmiller v. Fox, 264 U.S. 426 (1924).

[15a] Since this paper was originally presented a decision of the Court of Appeals for the Ninth Circuit in Rialto Publishing Co. v. Bass, 325 F.2d 527 (1963) was published. An attachment was levied when the creditor did not have reasonable cause to believe the debtor insolvent and judgments were obtained and executions levied

If the writ produces property subject to sale and the sale has taken place but the proceeds not delivered to the levying creditor, the money goes to the trustee if the levy was within four months.[16] Granting, then, that the bankruptcy court has summary jurisdiction of actions to invalidate levies within four months, when should the sheriff actually turn the money over to the trustee? If in a suit between private parties in the state court there is a dispute about the validity of a levy, the sheriff would not turn the property in question over to one of the parties pending decision of the court unless the necessary bonds were put up to release the property from attachment. The sheriff would await the decision of the court.

The situation in the bankruptcy court where there is a receiver or trustee is not comparable. This person is not a private party but an officer of the court and is under bond to the court for the faithful performance of his duties. In private litigation there may be the fear that a private party would sell or dispose of the asset in question before the matter is settled and then turn out to be financially unable to account for its value. In bankruptcy the rereceiver or trustee may make no dispotion of the asset without the order of the court having jurisdiction. Thus the danger in turning an asset over to a trustee, pending decision of the bankruptcy court as to the validity of the levy, is minimal or non-existent.

If the receiver or trustee brings proceedings in the bankruptcy court to invalidate the lien of the levy and the levying creditor is named and served, I consider it proper for the sheriff to release the property to the trustee or receiver upon being served with a copy of the papers. The existence of summary jurisdiction is, of course, no guarantee that the lien of the levy will be invalidated. Should the trustee be unsuccessful, the property will be returned to the sheriff by the order of the referee. Because there is a possibility of an unnecessary handing back and forth of assets, many experienced trustee's attorneys will be perfectly content with the assurance of the sheriff that he will hold the property pending receipt of the order of the court. If there are perishables or a business involving substantial rental expense, the receiver or trustee will wish to move promptly and may desire to take physical possession of the property. In any case the trustee should be given physical access to take inventory and appraise the property.

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when the creditor did have reasonable cause to believe the debtor insolvent. In holding there was a preference under section 60 of the Act the court declined to recognize the attachment as of sufficient weight to comprise a lien for the purposes of section 60. If a similar view is taken of attachments under section 67(a) then attachments more than four months before bankruptcy may no longer be immune.

[16] Clarke v. Larremore, 188 U.S. 486 (1903).

It should be clear that not all levies prior to bankruptcy are invalidated upon the filing of a bankruptcy petition. Thus physical release does not appear to be required if no proceedings are commenced to invalidate the lien of the levy, if there is no allegation that the levy was within four months of bankruptcy, or if the levying creditor is not named and served.

A practical consideration arises from the fact that the majority of levies are upon wages and are in such comparatively small amounts that extensive legal proceedings are not justified. In most of these the creditor will not answer or appear to contest any proceedings to invalidate his levy. A simple and inexpensive procedure to turn over this money to the trustee would be desireable. In some counties sheriffs will turn the money over to trustees with nothing more than the proof of their appointment. However, a sheriff who refuses to release the money without proof of the commencement of proceedings is within his legal rights.

Should the sheriff be in doubt about the propriety of making or refraining from further levies or of turning over the money to the trustee, there is a simple and swift procedure available, if a receiver or trustee has been appointed. He can file an application with the referee and serve both the levying creditor and the trustee or receiver. Such an application should contain the advice that the sheriff has been given a writ to levy upon property of the named person, a bankruptcy has been filed as to that person, there is a dispute between the levying creditor and the estate of the bankrupt as to the title to and liens upon the property, and applicant prays that a determination be made as to the title or right of possession of the property or both. If the matter arises in the interval between filing and appointment of a trustee or receiver, a request may be added that a receiver be appointed to represent the creditors and that applicant be permitted to bring such receiver in as a party to the proceedings. In the normal course the matter is heard within a few days, and so no claim of great harm from the delay is likely to be valid. As a note of extra caution a motion might be made in the state court proceedings for leave to file the application.

Theoretically, there may be nothing wrong with asking the state court to determine that no further levies should be made until the matter is settled by the bankruptcy court, but experience shows that state courts tend to regard such a question as properly before the bankruptcy court. All this procedure is, of course, something that would be likely to be used only in a very large case. Seldom will a bankrupt have property of such value as to make these precautions very important.

When Is a Sheriff Justified in Refraining, or Required To Refrain, from Further Levies?

This question has been partially answered. Unless he has some proper notification of an actual filing of bankruptcy or the lien which results from the levy predates bankruptcy by more than four months, he should not disregard his customary duties. But all this relates to levies on property passing to the trustee. After-acquired property which does not pass to the trustee belongs to the bankrupt subject to the rights of certain creditors to resort to it with levies. Creditors whose claims arise after bankruptcy are not impeded by the proceedings, and there is no basis for refusal to execute writs obtained in aid of their collection. As to creditors of debts existing before the bankruptcy filing, there are several problems. Section 17 of the act designates certain types of debts which survive a bankruptcy discharge. These creditors may levy, although there may be litigation to determine whether a particular debt is within these classes. Furthermore, if the bankrupt's discharge has been denied, all of his old creditors may levy. If the bankrupt waives his discharge as to otherwise discharged debts by making a new promise or otherwise, these creditors are free to pursue him. To impose upon the sheriff the burden of examining each claim for its exact status in relation to discharge is improper. The granting of a bankruptcy discharge unfortunately makes no decision or adjudication as to the effect of bankruptcy on particular debts. It merely arms the bankrupt with a defense similar to such defenses as the Statute of Frauds or the statute of limitations. It is up to the bankrupt to provide his own protection by making the proper use of this defense. To aid him bankruptcy law provides two types of restraining orders.

1. *Temporary Restraining Orders*

Although the bankruptcy discharge is a defense similar to such defenses as Statute of Frauds or statute of limitations, there is an important difference. These latter defenses must be based upon facts which exist at the date of the filing of the complaint, or else they may not be used. The bankruptcy discharge defense may not exist because it has not been granted when the complaint was filed. The discharge is not even granted at the time the bankruptcy is filed; it comes later in the proceedings, although it relates back to the date of bankruptcy. It is not proper to plead to a state court complaint that a discharge will be obtained in the future in a bankruptcy that has been or will be filed, because there is no guarantee that the bankrupt will be given a discharge.

To solve this problem and let the bankrupt avail himself of a discharge if he receives one, the act authorizes a restraining order against continued prosecution of suits pending at the time of bankruptcy filing, if the debt is one which would be discharged.[17] Although there is no specific statutory authorization, most referees will grant the restraint as to suits commenced after bankruptcy but before the discharge is rendered. It is up to the bankrupt to persuade the referee that the debt in question is dischargeable. If the referee makes the order, I think the sheriff need not pay heed to a creditor's argument that the debt is not a dischargeable one. There are regular appellate channels to raise that argument.

There has grown up a practice on the part of some referees in California and elsewhere which somewhat troubles me. It is good practical administration but of questionable legal validity. I refer to the practice of granting these restraining orders ex parte in chambers with no prior notice to the creditor or opportunity to be heard. In a number of cases the order provides that if the creditor desires to be heard in reference to setting aside such an order, he may appear by filing an application to set aside the order, serve it and then appear. In the interim, however, it is an order of court, and a creditor may be harmed because the sheriff refuses to make levies on account of the order. I am not sure that this complies with the due process requirements of fair notice and an opportunity to be heard.[18] I do not believe that a sheriff is in contempt of the bankruptcy court in levying on after-acquired property of the debtor if he has been served with such an ex parte restraining order. Let me, however, draw a distinction. If one commences what I consider proper procedure in these matters by filing an application for the order together with an order to show cause seeking to get the restraining order after hearing upon notice, a provision restraining proceedings until such time as the matter can be heard is proper. I think it would be contempt to disregard that. The difference is whether the papers served show that a hearing is contemplated. If they do not, I would question their validity.

Aside from the question of contempt, there is the question of liability of the sheriff to the bankrupt if the levy is wrongful, or to

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[17] BANKRUPTCY ACT § 11(a), 11 U.S.C. § 29(a).

[18] Possibly relevant and indicative of the attitude of Congress and the Supreme Court are General Order 23 and section 314 of the act which is a part of Chapter XI. The General Order provides that in all orders made by a referee, it shall be recited as the fact may be, that notice was given and the manner thereof or that the order was made by consent or that no adverse interest was represented at the hearing or that the order was made after hearing adverse interests. Section 314 authorizes restraining orders "upon notice" against the commencement or continuation of any proceeding to enforce any lien upon property of the debtor.

the creditor if the refusal to levy is wrongful. I previously cited the case of no liability to a creditor for refusal to levy after service of an invalid restraining order in the case of levy on property passing to the trustee. Possibly the result would be the same in the matter of after-acquired property. It may be more difficult to defend the making of a levy under writ where the restraining order is invalid than it is to defend the refusal to levy.

Since these restraining orders are by the terms of section 11(a) of the act only temporary, any order which purports to last beyond the final ruling on the discharge is beyond the power granted by Congress. It would at least be invalid as to the excess time, but it would probably not be considered totally invalid.

2. *Permanent Restraining Orders*

The second type of restraint available in the bankruptcy court is a permanent restraining order. There is no duplication or overlapping because section 11(a) orders are available only before the discharge is granted and can last only until discharge, while the second type is available only after discharge. The latter is nonstatutory but was clearly enunciated by the United States Supreme Court.[19] The Court found that a bankruptcy court, like any other court, has jurisdiction to enforce its own orders, that the discharge was such an order, and that there was jurisdiction to grant a permanent restraining order. There were some problems as to qualification for these, but I think the sheriff need not be concerned if the order recites service upon the creditor.

Must the sheriff be personally named as a respondent in these restraining order proceedings? I have previously taken the position that for proper protection of the bankrupt the sheriff should be named.[20] I do not retreat from that position, but from the point of view of the sheriff one must consider an old decision of the California Supreme Court.[21] The sheriff was held liable to a debtor for damages resulting from a sale after being served with a restraining order in which he was not named. The court raised but did not answer the question of whether the sheriff was a necessary party. It observed that in any event he would merely be a formal party and his absence was not fatal to the action against him for damages. The restraining order in the case was not issued out of a bankruptcy court, but this would seem to make no difference. I do not consider that the sheriff incurs any liability for contempt of

19 Local Loan Co. v. Hunt, 292 U.S. 234 (1934).
20 COWANS, BANKRUPTCY LAW AND PRACTICE 506 (1963).
21 Buffandeau v. Edmondson, 17 Cal. 436 (1861).

the bankruptcy court for levying, if he is not named in the order. But, once again, the civil liability picture may not be consistent with the contempt matters.

Akin to the problem of turning over money held on pre-bankruptcy levies to the trustee or the creditor is the problem of the release by the sheriff of any monies obtained on levies before restraining order proceedings were determined. The restraining order procedure under section 11(a) of the act does not purport to determine who is entitled to the money, but only to preserve the *status quo* until final ruling on the discharge. Therefore, the granting of this type of restraining order does not mean that the creditor may not eventually become entitled to the money. It would be improper to release it to the bankrupt at this point. A subsequent decision of the state court will decide who is entitled to it. Correspondingly, the refusal of the bankruptcy court to grant this restraining order does not mean that the creditor in attachment is irrevocably entitled to it. He may, for example, not be able to establish his cause of action. The refusal to grant the order means only that bankruptcy discharge will not be a successful defense to the action. If the writ is execution and not attachment, the refusal to restrain removes the possibility that a bankruptcy discharge may be used as a basis of an attempt to quash or recall the writ. Thus release after decision on the section 11(a) restraining order is not indicated.

In the permanent restraining order proceedings after discharge, the granting of an order permanently prohibits the creditor from taking any action and justifies release of anything held to the bankrupt. The provision for release may well be included in the order, but release is proper even if it is not included. If a permanent restraining order is denied, the matter is then to be treated as if there were no bankruptcy court to consider. Any further relief to the bankrupt must come from the state court. If the denial in the bankruptcy court was on the merits or it was refused because a state court had previously ruled the debt to be nondischargeable, then no further relief will be forthcoming from the state court, and the sheriff would have to proceed with his levy procedure. If denial in the bankruptcy court was because the bankruptcy court did not consider the matter to meet the requirements under the Supreme Court views in *Local Loan*, then the bankrupt's only recourse is to the state court. The sheriff then would proceed as ordered by the state court.

There is authority to the effect that fairness to all parties requires that, pending decision on whether restraining order or a discharge will be granted, any temporary restraint should be limited.

That is, the sheriff may go on collecting the property of the debtor, but may not disburse it to the creditor until the decision is final.[22] This is not the most common practice. In any event, from the sheriff's point of view the matter is simple. He must read the order. If he is restrained from taking further action, he should neither collect nor disburse. If he is merely restrained from disbursing without further order of the court, he has not been restrained from collecting under the levy.

Finally, a note about sheriff's fees. In many counties the sheriff will not extend credit and requires deposits by levying creditors against his fees. There is no bankruptcy problem here. In other counties if the sheriff has a claim not covered by a deposit, it has been held that he has no right to retain possession of property under attachment for his fees because the bankruptcy court will protect his fee claims.[23] Fees for services rendered after filing of the petition in bankruptcy which had the effect of preserving the estate will be considered an expense of administration claim and thus be entitled to share as a claim of the highest class of priority.[24] If state law gives a lien for the fees, the lien will not be invalidated by bankruptcy.

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22 *In re* Parkening, 145 F.2d 690 (9th Cir. 1944); *In re* Vollweiler, 52 F. Supp. 347 (E.D.N.Y. 1943); *In re* Brecher, 19 F. Supp. 283 (S.D.N.Y. 1937).

23 *In re* Francis-Valentine, 94 Fed. 793 (9th Cir. 1899).

24 BANKRUPTCY ACT § 64(a)1, 11 U.S.C. § 104(a)1.