Washington University Law Review

Volume 1953 | Issue 3

January 1953

Bankruptcy—Federal Equitable Doctrine Not Applicable to State Statutes of Limitation

COMMENTS

Bankruptcy—Federal Equitable Doctrine Not Applicable to State Statutes of Limitation

In 1942 Central States Electric Corporation, incorporated under the laws of Virginia, was reorganized under Chapter X of the Bankruptcy Act. The reorganization trustees brought suit in a federal district court of New York for an accounting and damages against its officers and directors for alleged fraud and mismanagement. Jurisdiction was attained by reason of the Bankruptcy Act.[1] The principal defense was a plea of the New York statute of limitation, which had run prior to the filing of the reorganization petition. The federal district court held that a federal court is free in a non-diversity action to adopt federal equitable principles when construing a state statute of limitation. On appeal, held: reversed, one judge dissenting. The federal court sitting in New York is required not only to apply the New York statute of limitation but to apply it as interpreted by the New York courts.[2]

The problem in the principal case originated in the fact that the law of New York does not provide for the tolling of the applicable statute of limitation because of concealment or domination.[3] This rule is inconsistent with the federal equitable principle which prevents the running of the applicable statute in such contingencies.[4] The federal equitable rule appears to be firmly rooted in federal law where state or federal statutes of limitation are to be applied[5] to causes of action arising under federal substan-

1. 52 STAT. 842 (1938), 11 U.S.C. § 11 (1946).
2. Austrian v. Williams, 198 F.2d 697 (2d. Cir.), *cert. denied,* 344 U.S. 909 (1952).
3. N.Y. CIV. PRAC. ACT § 11 provides that the only matters which suspend the running of the limitation period are those "specifically prescribed" in the Act itself. The specified exceptions do not include domination or control of a corporation. In Pollack v. Warner Bros. Pictures, Inc., 266 App. Div. 118, 120, 41 N.Y.S.2d 225, 226 (1st Dept. 1943) the court stated, "The statute begins to run from the date of the commission of each separate wrongful act alleged in each cause of action regardless of the date of the discovery or of the continuance in control by [the officers and directors of the corporation]."
4. Bailey v. Glover, 21 Wall. 342 (U.S. 1874).
5. From the time of the decision in Campbell v. Haverhill, 155 U.S. 610 (1895), it has been clear that when Congress creates a right of action without specifying a period of limitation, federal courts will, in actions at law, generally apply the state statute of limitation locally applicable to the

tive law or where[6] Congress has stipulated that a federal statute of limitation is to be applied.[7] It followed therefore, that the decisive issue in the principal case was whether a federal court might apply the above federal equitable principle in construing a state statute of limitation when that statute was applied to a plenary, equitable, non-diversity suit, based upon a state-created claim brought under the permissive provisions of the Bankruptcy Act.[8]

In answering this question in the negative, the Court of Appeals stated that their decision was directed by Section 29 (e) of the Act.[9] The court, in interpreting this section, was of the opinion that the cause of action was *state created*[10] and that, even though diversity jurisdiction was lacking, the intent of Congress was to make *state law* applicable in this instance and to leave uniformity in the administration of the Bankruptcy Act to be secured by making the application of *state law* uniform. This opinion appears to be in accord with prior decisions construing the precursor sections of Section 29 (e),[11] for there seems to be implicit in those decisions the rule that the trustees could pursue a cause of action provided the applicable state or federal statute of limitation had not run prior to the bankruptcy proceeding.[12]

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same or to the most nearly similar state created right. Although such statutes are not binding in suits in equity, a federal equity court will usually be guided by them, and may follow them by analogy. Holmberg v. Armbrecht, 327 U.S. 392 (1946).

6. Holmberg v. Armbrecht, 327 U.S. 392 (1946).

7. Dabney v. Levy, 191 F.2d 201 (2d Cir.), *cert. denied,* 342 U.S. 887 (1951).

8. See note 1 *supra.*

9. 52 STAT. 849 (1938), 11 U.S.C. § 29 (e) (1946) provides in part:

> A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. . . .

10. In National Ins. Co. v. Tidewater Co., 337 U.S. 582, 599 (1949) the Court stated:

> . . . The only way in which any law of the United States contributed to the case [Williams v. Austrian, 331 U.S. 642 (1947)] was in opening the district courts to the trustee . . . . The fact that the congressional power over bankruptcy granted by Art. I could open the court to the trustee does not mean that such suits arise under the laws of the United States; but it does mean that Art. I can supply a source of judicial power for their adjudication. The distinction is important. . . .

11. 14 STAT. 518 (1867); 30 STAT. 549 (1898), 11 U.S.C. § 29 (d) (1934), as amended, 52 STAT. 849 (1938), 11 U.S.C. § 29(e) (1946).

12. *See* Isaacs v. Neece, 75 F.2d 566, 569 (5th Cir. 1935); Garland v. Arrowood, 172 N.C. 591, 593, 90 S.E. 766, 767 (1916); Fuller v. Rock, 125 Ohio 36, 44, 180 N.E. 367, 369 (1932).

The Act of 1867,[13] moreover, expressly provided that all rights of action barred upon the appointment of an assignee remained barred.[14]

In his dissent, Judge Clark appeared to be of the opinion that the court was applying the rationale of *Erie R.R. v. Tompkins*,[15] and was thus unwittingly sanctioning an extension of that doctrine to include state created actions authorized by Congress to be pursued in federal courts where diversity of citizenship was lacking.[16] He was of the belief that there was nothing in the *Erie* doctrine which compelled the court's decision and that the application of the *Erie* rule to the trustees' case operated disadvantageously from the point of view of nationwide uniformity. The majority, however, applied *Erie R.R. v. Tompkins* only by way of analogy and in the final analysis grounded its decision upon a strict statutory construction. Furthermore, it intimated that it would have reached the same result if it had been called to rule upon these facts before the *Erie* Case.[17]

The analogy drawn by the court to the *Erie* case was not wholly inappropriate, however, and as it pointed out in its opinion, the absence of diversity jurisdiction did not alone preclude a result similar to that which would have been reached if there had been such jurisdiction. It is well settled that concurrent federal jurisdiction in diverse citizenship cases is for the purpose of providing the parties with a federal forum in which to litigate because of the presumed prejudice against the stranger litigant in the courts of a state.[18] Where such jurisdiction exists, state and not federal substantive law, under the *Erie* doctrine, must be applied[19] and the conflict of laws rule of the state in which the court resides governs.[20] State statutes of limitation, whether regarded as having procedural or substantive effect are binding on federal courts, sitting in equity or at law, where the rights pursued in the federal courts are granted by the state.[21] The result

13. 14 STAT. 518 (1867).
14. Freelander v. Holloman, 9 Fed. Cas. 748, No. 5,081 (S.D. Miss. 1873).
15. 304 U.S. 64 (1938).
16. *See* Austrian v. Williams, 198 F.2d 697, 702 (2d Cir. 1952) (dissenting opinion).
17. Austrian v. Williams, 198 F.2d 697 n.6 (2d Cir. 1952).
18. DOBIE, FEDERAL PROCEDURE § 63 (1928).
19. Erie R.R. v. Tompkins, 304 U.S. 64 (1938).
20. Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487 (1941).
21. Guaranty Trust Co. v. York, 326 U.S. 99 (1945); Bergeron v. Mansour, 152 F.2d 27, 28 (1st Cir. 1945).

of this approach has been that the federal courts have been subordinated to the state courts to the extent that the parties' rights could neither be extended nor diminished by the application of what has been called federal common law.[22]

In a prior decision in the same case, solely on the question of jurisdiction, the United States Supreme Court held that even though diversity of citizenship or other usual ground for federal jurisdiction was lacking, Section 2 of the Bankruptcy Act[24] granted federal district courts jurisdiction to hear plenary suits brought by a Chapter X trustee. Chief Justice Vinson in delivering the opinion of the Court seemed to indicate that jurisdiction was granted for the purpose of providing a choice of a forum in which to litigate plenary suits, which is similar to the reason for federal jurisdiction in diversity cases. Under this rationale it would seem to follow therefore, that the federal court would be sitting as another court of the state and bound to apply state law just as if there were diversity jurisdiction, which in effect is the analogy to the *Erie* rationale as drawn by the majority in the principal case.

In the earlier case, Justice Frankfurter dissented and argued that if federal jurisdiction were to be extended to the Chapter X trustee, that jurisdiction would be *exclusive* rather than *concurrent*.[25] There is nothing in the Act to indicate that the federal court's plenary jurisdiction is *exclusive*, and without such a provision it is doubtful that it could be so considered.[26] Regardless of the validity of Justice Frankfurter's contention, however, it would appear necessary to adopt that contention in order to accomplish the uniformity urged by Judge Clark in his dissent in the principal case. Even this, however, would lead to a highly anomalous situation where the trustee, having only the rights which the estate had prior to reorganization proceedings,[27] could

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22. *E.g.*, Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938).
23. Williams v. Austrian, 331 U.S. 642 (1947).
24. See note 1 *supra*.
25. Williams v. Austrian, 331 U.S. 642, 672 (1947) (dissenting opinion).
. . .[T]he Court now concludes that as to Chapter X trustees Congress implied an exception so as to allow the trustee to sue in any federal district court in the country. If this be so, I see no escape from the conclusion that not only have the federal courts jurisdiction but the State courts no longer have it. . . .
26. 6 COLLIER, BANKRUPTCY § 3.21 (14th ed. 1947).
27. 52 STAT. 879 (1938), 11 U.S.C. § 110 (1946).

maintain an action the day he was so appointed where the bankrupt could not maintain such an action the day before the reorganization petition was approved. If the jurisdiction of the federal court is *concurrent* with that of the state court, an even greater anomaly would result if Judge Clark's dissenting opinion were adopted: the trustee would be able to sustain his action in a federal court because of the Bankruptcy Act, but if federal jurisdiction were based upon diversity grounds or the cause pursued in a state court by the bankrupt prior to reorganization proceedings, or by the trustee following the proceedings, the action would be dismissed.

When this is brought to light, the opinion of the court in the principal case that the proceeding was based wholly upon a state created claim which was not incorporated into the Bankruptcy Act and was not to be construed as being a part of "proceedings in bankruptcy" for which uniformity was sought, is the only proper and practical conclusion.

SALES—IMPLIED WARRANTY—NON-LIABILITY OF WHOLESALER FOR UNWHOLESOME PACKAGED FOOD

Plaintiff's wife purchased some "apricot puff" cookies in their original package from a retail grocer, who had previously bought them from defendant, a wholesaler. In eating one of the cookies he was injured when he swallowed a wire allegedly contained therein. The trial court gave judgment for the plaintiff. On appeal the intermediate appellate court affirmed the trial court's decision and certified the question of whether the wholesaler is directly liable to the consumer to the Texas Supreme Court. On the first hearing, the question was answered in the affirmative, but on a re-hearing, the question was answered in the negative, four judges dissenting. The liability of the wholesaler is logically contingent on that of the retailer. Since the retailer is not liable to the consumer because he has no better knowledge of the contents of the container than the consumer, the wholesaler is not liable.[1]

The court in the principal case reached the same result as the majority of courts which have considered this problem, but for a

1. Bowman Biscuit Co. of Texas v. Hines, 251 S.W.2d 153 (Tex. 1952).