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FEDERAL PROCEDURE-APPLICABILITY OF STATE DECISIONAL LAW INTERPRETING STATE STATUTES OF LIMITATIONS UNDER SECTION 11 (e) OF THE BANKRUPTCY ACT

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FEDERAL PROCEDURE—APPLICABILITY OF STATE DECISIONAL LAW INTERPRETING STATE STATUTES OF LIMITATIONS UNDER SECTION 11 (e) OF THE BANKRUPTCY ACT—Plaintiff is the trustee in bankruptcy of a Virginia corporation whose petition for reorganization under chapter X of the Bankruptcy Act was approved by a Virginia federal district court in 1942. Plaintiff filed this action in a New York federal district court under section 11 (e) of the Bankruptcy Act against defendant, the principal stockholder, and others for breach of fiduciary duty. The alleged breaches of duty occurred in 1927 and 1929. The defendant pleaded the New York statute of limitations[1] and contended that it should be applied as interpreted by New York decisions, which hold that the statute begins to run on the date of the wrongful act.[2] Thus, according to New York decisional law this action was barred before the reorganization petition was filed. The trial court construed the statute in accordance with equitable principles which suspend the running of the statute so long as the injured party is ignorant of the fraud,[3] or the dominating parties control the corporation.[4] From a judgment for the plaintiff,[5] the defendant appealed. *Held*: reversed. The New York statute of limitations as interpreted by the New York decisions bars this action. Clark, J., dissented. *Austrian v. Williams,* (2d Cir. 1952) 198 F. (2d) 697.

It should be noted (1) that the federal court has jurisdiction in this case by virtue of the Bankruptcy Act rather than because of diversity or the existence of a federal question,[6] and (2) that the cause of action, if any, was created by state law.[7] The court held that the conflict of laws rules of New York control.[8] Since New York adheres to the usual rule that a statute of limitations is pro-

[1] The court did not decide which of two New York statutes would apply since either would have barred this action prior to 1942 under New York decisions.

[2] Pollack v. Warner Bros. Pictures, Inc., 266 App. Div. 118, 41 N.Y.S. (2d) 225 (1943); Hastings v. Byllesby & Co., 293 N.Y. 404, 57 N.E. (2d) 733 (1944).

[3] Bailey v. Glover, 88 U.S. 342 (1875).

[4] Michelson v. Penny, (2d Cir. 1943) 135 F. (2d) 409.

[5] Austrian v. Williams, (D.C. N.Y. 1952) 103 F. Supp. 64.

[6] Williams v. Austrian, 331 U.S. 642 at 658, 67 S.Ct. 1443 (1947). This was an earlier appeal from the same proceedings in which the defendant questioned the jurisdiction of the district court. The Supreme Court held that §2 of the Bankruptcy Act, 52 Stat. L. 842 (1938), 11 U.S.C. (1946) §11, "established the jurisdiction of federal courts to hear plenary suits brought by a reorganization trustee, even though diversity or other usual ground for federal jurisdiction is lacking."

[7] National Mutual Insurance Co. v. Tidewater Transfer Co., 337 U.S. 582 at 589, 69 S.Ct. 1173 (1949): "Austrian, as trustee, sued in Equity for an accounting based on the charge that affairs of a state-created corporation had been conducted by the officers in violation of state law. . . . [this] called for a determination of no law question except those arising under state law."

[8] This is the general rule in diversity cases. Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 61 S.Ct. 1020 (1941). Query whether there is any authority for the rule in non-diversity cases? The court cites CONFLICT OF LAWS RESTATEMENT §187 and §603 (1934), which was written prior to Erie R.R. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817 (1938). The court also cites GOODRICH, CONFLICT OF LAWS, 3d ed., 240 (1949), which applies to state courts. Cf. GOODRICH, §15, which applies to federal courts. Thus it appears that the court has applied a rule heretofore applicable only to diversity cases in a non-diversity case.

cedural in the conflict of laws sense, the statute of the forum, New York, was held to govern although the cause of action was created by Virginia law.[9] The conflict as to the application of New York decisional law arises in this case because of the peculiar type of federal jurisdiction. Had this case, which is a traditional equity action, involved a federal right the court would have been free to use the equitable doctrines or laches.[10] Had this been a diversity case it would be clear under *Erie R. R. v. Tompkins*[11] that the federal court must use both the New York statute and interpretative decisions in either an equitable or legal action. The exact scope of the *Erie* doctrine is uncertain.[12] If it can be said that the *Erie* rule covers all non-federal causes of action, as distinguished from diversity actions only, then New York decisional law is applicable in this case. The purpose of the *Erie* doctrine is to insure uniformity of result in all courts, whether state or federal, in any given state in actions involving a state-created right. Since the principal case also involves a state-created right, it could be argued that the *Erie* doctrine should apply here just as in diversity cases.[13] However, the decided cases and the writers of both opinions in the principal case agree that the *Erie* doctrine is limited to diversity cases.[14]

Judge Chase chose to place the majority opinion upon a construction of section 11 (e), independent of the *Erie* doctrine. This section provides that a "trustee may, within two years subsequent to the date of adjudication . . . institute proceedings in behalf of the estate upon any claim against which the *period of limitations fixed by Federal or State law* had not expired at the time of the filing of the petition in bankruptcy . . . ."[15] Judge Chase held that the term "state law" includes decisional law. It is submitted that this position is sound.

[9] The dissenting justice in the principal case at 703 feels that the New York statute should not apply since the cause of action was created by Virginia. This is an attack on the conflict of laws rule followed by the court. Although this rule is well settled in diversity cases, it has often been criticized. See Blume and George, "Limitations and the Federal Courts," 49 MICH. L. REV. 937 at 988-992 (1950), for discussion and citations.

[10] Holmberg v. Armbrecht, 327 U.S. 392, 66 S.Ct. 582 (1945). Where a federal cause of action involves a legal remedy or a remedy concurrent with a legal remedy, the federal court follows the state statute and interpretative decisions unless there is an applicable federal statute.

[11] 304 U.S. 64, 58 S.Ct. 817 (1938).

[12] Guaranty Trust Co. v. York, 326 U.S. 99, 65 S.Ct. 1464 (1945); Ruhlin v. New York Life Ins. Co., 304 U.S. 202, 58 S.Ct. 860 (1938). For a comprehensive analysis of the applicability of state statutes of limitations in federal courts both before and after the Erie case, see Blume and George, "Limitations and the Federal Courts," 49 MICH. L. REV. 937 (1950).

[13] See Justice Jackson's concurring opinion in D'Oench, Duhme & Co. v. Federal Deposit Ins. Corp., 315 U.S. 447 at 465, 62 S.Ct. 676 (1942). Blume and George, supra note 12, divide the cases into those involving "state-created" rights and federal rights.

[14] Cf. the seemingly inconsistent position taken as to the applicability of New York conflict of laws rules, supra note 8.

[15] 52 Stat. L. 842 (1938), 11 U.S.C. (1946) §29(e). Emphasis supplied. It was immaterial whether this action was commenced within two years after 1942 since the action was barred prior to that date. Footnote 2, principal case at 699. 1 COLLIER, BANKRUPTCY, 14th ed., 165 (1940): ". . . the equitable powers of the court are to be exercised within the limits laid down by the Act and subject to and consistent with any provisions contained in it."

Congress refers to the "period of limitations fixed by . . . State law" rather than to the state statute of limitations. This in itself would seem to indicate that Congress intended both statutory and decisional law regarding the period of limitations to be applicable. This is consistent with the interpretation given to similar expressions in other federal statutes.[16] Since limitation statutes are usually phrased in general terms, they are often meaningless unless construed in accordance with the interpretative decisions. The contention that the equitable doctrines should be utilized is based in part upon the premise that Congress intended nation-wide uniformity in the administration of bankrupt estates. It must be conceded that this is the dominant purpose of the Bankruptcy Act, but query whether such uniformity was intended under section 11 (e)? The fact that the case involves a state cause of action and Congress' use of the term "state law" in section 11 (e) would appear to negative any intent for nation-wide uniformity. In addition, even if the equitable doctrines are utilized, results will still be far from uniform because of the diverse statutory periods to be found in various state statutes. Section 11 (e) does not purport to enable the trustee to recover upon causes of action which are barred by state law at the time the petition is approved. The trustee is simply empowered to prosecute subsisting causes of action belonging to the estate. Had the bankrupt sued in either a state or federal New York court after 1939 recovery clearly would have been barred. Thus, the district court and the dissenting judge in the principal case would give to the trustee greater rights in this respect than the bankrupt possessed. It is submitted that such a position is inconsistent with the wording and intent of section 11 (e).[17]

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[16] The term "the laws of the several States," as found in §34 of the Federal Judiciary Act of 1789, is the foundation of the Erie doctrine, under which it is clear that decisional law is used. Even before the Erie case the federal courts, when applying the state statute of limitations, used state interpretative law in conjunction therewith. Bauserman v. Blunt, 147 U.S. 647, 13 S.Ct. 466 (1893).

[17] Cf. note, 38 VA. L. REV. 680 (1952) approving the district court opinion of principal case, supra note 5. For authority disapproving the district court opinion, see 1 COLLIER, BANKRUPTCY, 14th ed., 104 (cum. supp. 1951). See also Dabney v. Levy, (D.C. N.Y. 1950) 92 F. Supp. 551, which is consistent with the district court opinion.