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Bankruptcy - Creditor's Right Against Entirety Property - Applicablity of State Law When United States is Plaintiff

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BANKRUPTCY—CREDITOR'S RIGHT AGAINST ENTIRETY PROPERTY—APPLICABILITY OF STATE LAW WHEN UNITED STATES IS PLAINTIFF—The United States as assignee sought a joint judgment on four unsecured promissory notes signed by the defendants, who are husband and wife. The proceeds of the notes were used to improve real property held by the entireties by the defendants. The husband had filed in bankruptcy before the assignment of the notes to plaintiff and was discharged from his joint and several liability on the promissory notes prior to the commencement of any action on them. His estate by the entireties, however, was not used to satisfy any listed debts because under state law he had no divisible title which could pass to the trustee in bankruptcy.[1] The federal district court entered judgment for the plaintiff.[2] On appeal to the Court of Appeals for the Sixth Circuit, *held,* judgment set aside and case remanded with instructions to dismiss. Since federal courts are not bound to apply state law when the United States is plaintiff, the husband's liability on the notes was discharged in bankruptcy and his release likewise precluded recovery from his wife. *Fetter v. United States,* (6th Cir. 1959) 269 F. (2d) 467.

The court in the principal case stated that merely because the United States was plaintiff[3] it was not bound by *Erie Railroad Co. v. Tompkins*[4]

1 In re Berry, (E.D. Mich. 1917) 247 F. 700. See McMullen v. Zabawski, (E.D. Mich. 1922) 283 F. 552. For a general discussion of the rules governing the relationship of creditors to their debtors' entireties property in Michigan, see Bienenfeld, "Creditors v. Tenancies by the Entirety," 1 WAYNE L. REV. 105 (1955).

2 United States v. Fetter and Fetter, (E.D. Mich. 1958) 163 F. Supp. 10. For a discussion of the district court decision, see note, 57 MICH. L. REV. 607 (1959).

3 Jurisdiction was based on 28 U.S.C. (1958) §1345.

4 304 U.S. 64 (1938).

to apply state law.[5] The court expressly stated that had the suit been brought by the original creditor it would have been bound to apply Michigan law which allowed recovery on the notes notwithstanding the husband's discharge in bankruptcy.[6] Although it is frequently stated that the *Erie* doctrine has no application where jurisdiction is not based on diversity of citizenship, this in not completely accurate; rather, the applicability of the *Erie* doctrine depends upon whether a local issue, as contrasted with a federal issue, is before the court.[7] In determining whether an issue is federal or local it is more meaningful to talk in terms of the source of the right involved, rather than the source of the jurisdiction of the court.[8] Since the *Erie* decision, the Supreme Court has regularly decided that federal courts are not bound by state law when the United States sues because the subject matter is invariably governed by the Constitution, thus raising a federal issue.[9] This is so even when the United States sues as a private party, although the issue raised is not expressly related to a federal statute or the Constitution.[10] The need to be free to develop uniform rules of law in certain areas of government operation has apparently led to this result.[11] The language used by the Supreme Court is broad enough to include instances, as in the principal case, where the United States is merely an assignee;[12] nevertheless, the actual holdings of the Supreme Court do not necessarily warrant the inference that the *Erie* doctrine will not apply in cases where the United States is merely an assignee.[13] In the principal case

[5] Principal case at 470. For a general discussion of the applicability of the Erie doctrine, see Gorrell and Weed, "Erie Railroad: Ten Years After," 9 OHIO ST. L.J. 276 (1948).

[6] Principal case at 470.

[7] See 1 MOORE, FEDERAL PRACTICE, 2d ed., §0.305(3) (1959). See also Newman, "The Federal Common Law," 26 DICTA 303 (1949); Snepp, "The Law Applied in the Federal Courts," 13 LAW AND CONTEM. PROB. 165 at 168-169 (1948).

[8] Puerto Rico v. Russel & Co., 288 U.S. 476 (1933); Gully v. First Nat. Bank, 299 U.S. 109 (1936). See also London, "'Federal Question' Jurisdiction—A Snare and a Delusion," 57 MICH. L. REV. 835 (1959). See, generally, note 7 supra.

[9] Board of Commrs. v. United States, 308 U.S. 343 (1939); Royal Indemnity Co. v. United States, 313 U.S. 289 (1941); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943); United States v. County of Allegheny, 322 U.S. 174 (1944); United States v. Standard Oil Co., 332 U.S. 301 (1947).

[10] United States v. Standard Oil Co., note 9 supra. In cases where no legislative or constitutional guide is available "it is for the federal courts to fashion the governing rule of law according to their own standards." Clearfield Trust Co. v. United States, note 9 supra, at 367. But see the Rules of Decision Act, 28 U.S.C. (1958) §1652, which requires that state law be applied ". . . except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide. . . ." See also comment, 53 COL. L. REV. 991 (1953).

[11] See note 9 supra.

[12] In United States v. County of Allegheny, note 9 supra, at 182, the Court pointed out: "Every acquisition, holding or disposition of property by the Federal Government depends upon proper exercise of a constitutional grant of power."

[13] In United States v. Standard Oil Co., note 9 supra, at 309, the Court in dicta stated that federal courts may be bound by the Erie doctrine to apply state law ". . . where the government has simply substituted itself for others as successor to rights governed by state law. . . ." Steingut v. Guaranty Trust Co. of New York, (2d Cir. 1947) 161 F. (2d) 571 expressly recognized the distinction between the United States in its own rights and a suit by the United States as assignee, distinguishing Supreme Court cases on this basis.

the rights of the United States as assignee of the original creditor were dependent upon the rights created by the contract made between the original creditor and the defendants. The rights of the creditor were admittedly governed by state law because, although the husband was discharged of his joint and several liabilities in federal bankruptcy proceedings, interpretation of the effect of discharge in these circumstances has been left to the state courts.[14] Thus, to argue that the claims of the United States were ultimately derived from federal law,[15] merely because it had authority under the Constitution to enter into such transactions, seems quite tenuous. Even assuming that the application of state law is not compelled, the Supreme Court has recognized that it is often the appropriate law to follow where there is no federal statute from which an overriding federal policy could be derived or where there is no need for uniformity throughout the country.[16] The principal case in holding that it was not bound by state law did not discuss its possible appropriateness.[17] Yet state law would seem to be particularly appropriate in this case for two reasons. First, in reaching its decision in the principal case the court was forced to look to two factors controlled by state law, the married woman statutes and the unique estate of tenancy by the entireties.[18] Having relied on state law to this extent, it seems to follow that the court should go one step farther and apply state law entirely. Secondly, whenever the United States is merely an assignee, in absence of clear federal policy to the contrary, state law should be adopted because otherwise rights and liabilities of prior parties might be unforeseeably altered by the unilateral act of one party who assigns his interest.

James Cripe

[14] Recognition of this fact is implicit in the court's reasoning in the principal case at 470 that under Michigan law a discharge in bankruptcy does not preclude a joint judgment. See also note, 57 MICH. L. REV. 607 (1959).

[15] The holding in the principal case that under federal law a discharge in bankruptcy of the husband precludes a judgment against the wife seems difficult to reconcile with the rather express language of §34 of the Bankruptcy Act, which provides: "The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt." 30 Stat. 550 (1898), 11 U.S.C. (1958) §34.

[16] United States v. Standard Oil Co., note 9 supra, at 308-309; Royal Indemnity Co. v. United States, note 9 supra, at 297. See Clearfield Trust Co. v. United States, note 9 supra, at 367.

[17] Reconstruction Finance Corp. v. United Distillers Products Corp., (2d Cir. 1956) 229 F. (2d) 665, was relied on by the court in the principal case as authority for holding that state law was not binding. But in that case it was also held that state law, though not binding, was appropriate.

[18] Principal case at 468-469.