



In Re Matter of the Trustee of Clothing Store Dissolution
Bankruptcy Court of the Southern District of New York (1935)

14 F. Supp. 739 (1935)

No. 56232

District Court, S.D. New York.

November 14, 1935.

PATTERSON, District Judge.

This case involves an involuntary bankruptcy petition levied against a series of 26 Clothing stores, in cities across the United States.

The petitioner represents three suppliers of clothing articles to Farley Credit Clothing Stores, the proprietor of which is Edward A. Farley of Riverdale, New York.

Petitioners allege they have not been timely paid pursuant to their contracts. Their petition seeks dissolution of the clothing business, liquidation of its assets, and immediate payment of the amounts due and owing. One of the petitioners, claims seventy-five dollars (\$75.00) for an allegedly delinquent bill concerning hats sold on consignment. The two other petitioners each claim a far more substantial sum of one hundred and twenty thousand dollars (\$120,000.00), for clothing articles sold on an installment basis.

Farley Credit Clothing Stores has been a family owned business, started by several of Edward Farley's brothers before the turn of the century. At its height, the four brothers had in excess of one hundred stores in states from New York to California. In 1929, before the Great Crash, Edward Farley's brothers sold out their stores to competing interests. Edward Farley, the youngest of the Brothers, kept his stores, which are the subject of this petition. His clothing stores continue to sell clothing articles to the general public for both cash and credit.

Due to the current economic downturn, many accounts receivable held by Mr. Farley and his operation are delinquent or in arrears from full payment. Despite the fact that Mr. Farley and his stores have assets, including real property and inventory, greatly in excess of the amounts claimed by the petitioners, greatly in excess of the amounts claimed by petitioners, the present "Cash on Hand" of the business is presently insufficient to satisfy the total amounts of the claims of the creditors/petitioners on an immediate basis.

Mr. Farley seeks to transform the filing of this action into an Article 11 proceeding of Reorganization, invoking an automatic stay, and delaying the payment of petitioners under the protections of the Bankruptcy Code. The petitioners object, and seek an immediate dissolution of the business under Article 7 Liquidation.

Petitioners rightly contend, as a matter of law, that their filing of this involuntary bankruptcy petition under Article 7 Liquidation, cannot be transformed into a different proceeding, by the subject of their petition. It is undisputed that the subject of the petition, though technically not insolvent as described above, cannot make the required payments to fully satisfy the petitioner/creditor claims for amounts due and owing on an immediate basis. It is further undisputed, that given time and a restructuring of the payments due and owing to petitioner/creditors, that the Mr. Farley and his business would most likely be able to make them whole, with interest, from the operations of his business given sufficient time. How long such would take, however, is a matter of controversy between the parties.

The Court finds, that although this case really represents a miscarriage of justice, in that the assets of the business and operations of Mr. Farley and his stores, represent many times more than the disputed amounts due and owing to the petitioners/creditors, no equitable remedies are available under current law for this court to apply, so as to require the transformation of an involuntary petition under Article 7 Liquidation into an Article 11 Reorganization. Had the subject of the petition filed for voluntary Bankruptcy pursuant to Article 7, such a transformation of the action to an Article 11, would be so allowed. As a result, the petitioners cannot be forced to have their action so transformed, and the Article 7 Liquidation, however unjust, must proceed within the parameters of the Bankruptcy Code.

The Court further finds that as personal guarantees, which are a standard course of business practice, were obtained from Mr. Farley, that his personal assets shall also be considered to a part of the Bankruptcy Estate under the Liquidation, subject to the amounts due and owing to petitioners. Accordingly, certain exemptions which otherwise might be deemed to apply, shall apply in this matter. This is due to the requirement that the Trustee must take into account the personal guarantees in determining the proceeds and settlement of the Bankruptcy Estate.

Lastly, Mr. Farley, through his counsel, has asserted as a defense, that petitioners colluded, in violation of the terms of the Bankruptcy Code, to bring this petition. This Court cannot make such a determination, despite the fact that there has been presented certain testimonial evidence regarding such. Allegations of fraud, due to its inherent scienter requirement, have a high threshold for proof.

Federal courts, including Bankruptcy Courts, have long held that a party must prove facts giving rise to a "strong inference" of scienter, showing cogent and compelling evidence. Such level of proof has not been established, and therefore such an allegation cannot be confirmed by this court.

The Trustee is accordingly hereby ordered to proceed with Liquidation of Farley Credit Stores in accordance with Article 7.