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Corporations Eligible for Relief under Section 77B

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SECTION 77B

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The first words of section 77B of the National Bankruptcy Act provide that "any corporation" may have relief "which could become a bankrupt under section 4 of this Act," and also "any railroad or other transportation corporation" except as otherwise provided.2

Reference to section 4 of the Bankruptcy Act immediately reveals that municipal, railroad, insurance, and banking corporations, and building and loan associations could not become bankrupts in either voluntary or involuntary proceedings. Apparently all other corporations could become voluntary bankrupts. However, only "moneyed, business, or commercial" corporations, or unincorporated companies could be adjudged involuntary bankrupts.3

The question arises whether this same distinction exists under section 77B, between corporations which are entitled to relief in voluntary and in involuntary proceedings. The words in section

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1For an article dealing at length with this problem, and especially with the legislative history of the provision, see Weinstein, Corporations Amenable to Section 77B, (1935) 83 U. Pa. L. Rev. 853. This paper is designed rather to supplement than to duplicate Mr. Weinstein's able discussion. Other general treatments of the subject may be found in a note in (1936) 49 Harv. L. Rev. 1111, pp. 1111 to 1114, and in 1 Gerdes, Corporate Reorganizations 162-186.

2Section 77B(a), found in (1934) 48 Stat. at L. 912, 11 U. S. C. A. sec. 207(a) (Supp., 1934), Mason's U. S. Code, tit. 11, sec. 207A (Supp. No. 3, 1932-34). It is there provided as follows: "Any corporation which could become a bankrupt under section 4 of this Act, and any railroad or other transportation corporation, except a railroad corporation authorized to file a petition or answer under the provisions of section 77 of this Act, and except as hereinafter provided, may file an original petition."

3Section 4, as amended, Mason's U. S. Code, tit. 11, sec. 22 (Supp. No. 3, 1932-34) found in (1932) 47 Stat. at L. 47, 11 U. S. C. A. sec. 22 (Supp., 1934), it is there provided:

"(a) Any person, except a municipal, railroad, insurance, banking corporation, or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

"(b) Any natural person, except a wage earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation (except a municipal, railroad, insurance, or banking corporation, or a building and loan association) owing debts to the amount of $1000 or over, may be adjudged an involuntary bankrupt. . . ."
77B are "any corporation which could become a bankrupt" under section 4. There is no qualification. The words themselves seem to indicate that any corporation which could be adjudicated a bankrupt in either voluntary or involuntary proceedings may have relief under section 77B. The provisions of the Act are, to be sure, especially adaptable to moneyed stock corporations, but there is nothing in section 77B which would indicate either that non-commercial corporations may not be the subjects of involuntary proceedings, or that different corporations may be reorganized in voluntary and involuntary proceedings.

The next question which presents itself is the meaning of the word "corporations." By the terms of section 77B(k) all provisions of the Bankruptcy Act, with certain listed exceptions, which are here immaterial, apply to proceedings instituted under section 77B. Section 1(6) defines "corporations" so as to include "all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships" and especially "limited or other partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint-stock companies, unincorporated companies and associations, and any business conducted by a trustee, or trustees, wherein beneficial interest or ownership is evidenced by certificate or other written instrument." The problem is what this definition includes.

Individuals and partnerships are clearly excluded. It has been
expressly held, under section 77B, that a partnership is not entitled to relief.\(^9\)

Incorporated organizations could file voluntary petitions in bankruptcy prior to June 7, 1934, even though they were incorporated under statutes which allowed the enfranchisement of non-profit country clubs,\(^10\) or benevolent orders,\(^11\) and not merely commercial groups. It seems probable that, in the light of these decisions, "any corporation" will be construed literally at least in so far as incorporated "corporations" are concerned; that regardless of the nature or purpose of the organization it will be allowed relief under section 77B provided it is not within the express exceptions in section 77B(a) or section 4.

The chief difficulties will arise with respect to those organizations which are "neither fish nor fowl," but occupy the middle ground between partnerships and incorporated "corporations." The bankruptcy definition of corporations clearly includes a limited or partnership association, the capital of which is alone responsible for its debts. It also includes what are commonly described as joint-stock companies.

Massachusetts business trusts are definitely within the scope of the Act. Prior to the more inclusive amendments of 1926 which expressly extended the bankruptcy definition of "corporations" to include business trusts,\(^12\) such associations were held to be proper subjects of adjudication on voluntary petitions.\(^13\) A

mitting certain things to be done in a bankruptcy court by a corporation that could not be done by individuals. When Congress enacted section 74 (11 U.S.C.A. sec. 202, Mason's U. S. Code, tit. 11, sec. 202) to apply to individuals and sections 77A and 77B (11 U.S.C.A. secs. 206, 207, Mason's U. S. Code, tit. 11, sec. 206, 207) to apply to corporations in similar circumstances, it was certainly not contemplated that individuals might clothe themselves in corporate garments for the purpose of taking advantage of the statutes appertaining thereto, if, in financial extremes, the law respecting corporations seemed to afford greater advantages. Had that been the legislative intent, one statute might well have been made to serve the double purpose.\(^\)\(^\)\(^9\)\n
\(^10\) In re Poland Union. (D.C. N.Y., Jan. 10, 1935) C. C. H. Bankruptcy Service, par. 3313. On appeal this decision was reversed on the ground that the body in question was not a partnership but an unincorporated company. (C.C.A. 2nd Cir. 1935) 77 F. (2d) 855.
\(^11\) See Matter of Elmsford Country Club, (D.C. N.Y. 1931) 50 F. (2d) 238, 239. This club was organized under the Membership Corporations Law of New York.
\(^12\) Matter of Carthage Lodge, No. 365, I. O. O. F., (D.C. N.Y. 1916) 230 Fed. 694. This lodge was incorporated under the Benevolent Orders Law of New York.
\(^13\) See footnote 7 and text material there noted.
fortiori after 1926 a business trust should have been entitled to adjudication in bankruptcy, and, since 1934, to relief under section 77B. Moreover, business trusts have frequently been held to be unincorporated companies subject to adjudication under section 4b. The amended definition of "corporations" would consequently include business trusts in each of two separate phrases.

"Unincorporated companies and associations" is the most indefinite category of "corporations" under the Bankruptcy Act. Only one case has arisen under section 77B which involved the problem of what is included within this class.

That case involved a "co-operative country general merchandise store," known by the ambiguous name of Poland Union. It was not incorporated, but did business in accord with articles of association. It had a board of directors, officers, and standing committees. It accepted subscriptions to its capital in the form of either trading or interest-bearing shares. The holders of interest-bearing shares were protected from liability, but their share in the profits was limited to lawful interest on their investment. There were provisions for the transfer and withdrawal of shares, the retirement of interest-bearing shares, and the continuation of the "association" in case of the death of any member. The circuit court of appeals directed its inquiry toward determining whether the Poland Union was a joint-stock company, an unincorporated company, or an association. It first concluded that the store was a joint-stock association within the meaning of section 2 of the New York General Associations Law. It proceeded, largely in reliance on In re Tidewater Coal Exchange, to hold that the Poland Union was entitled to relief under section 77B. It is worth noting that in the Tidewater Coal Exchange Case a non-profit organization for facilitating the movement of coal on wharves was held to be a joint-stock company although it had no constitution, no articles of association, no by-laws, and no capital or initiation fee or assessments. The attitude of the court in the Poland Union Case indicates that such an organization as the Tidewater Coal Exchange would be entitled to relief under section 77B.
In *In re Poland Union* the lower court had held that on the same facts the debtor was a partnership,\(^\text{17}\) and, as has already been noted, that a partnership was not eligible for relief. The two decisions in that case seem to show that the primary problem for the courts will be in each case to determine whether, on the facts before them, they are dealing with a partnership or an entity within the meaning of "corporations." Only the latter is eligible for relief under section 77B.

Does the phrase “unincorporated companies and associations” include non-profit enterprises as well as those organized for gain, and social as well as business associations? The Tidewater Coal Exchange was entirely non-pecuniary with respect to all save the railroads who paid its expenses. Its members, coal-shippers and consignees, had to contribute no capital; it had no profits; nor even any income; yet it was held to be within the term “unincorporated company” as used in section 4b.\(^\text{18}\) The court in the *Poland Union Case* held that non-profit associations may also have relief under section 77B. That decision was undoubtedly correct in the light of the decisions under section 4, but the constant references in section 77B to creditors and stockholders as if they were the only interested parties provide strong reason for arguing that the Corporate Reorganizations Act was intended to apply only to organizations doing business for profit.

The courts were hesitant, prior to 1934, to include other companies than those with a “business” purpose within the phrase “unincorporated company” in section 4b.\(^\text{19}\) As has already been noted, a golf club operated solely for the recreation of its members was said to be entitled to relief as an incorporated “corporation.”\(^\text{20}\) It is submitted that unincorporated “corporations” should likewise be interpreted to include social and charitable and educational as well as business enterprises. The perpetuation of the former is at least as vital to the community as the rehabilitation of the latter. It should also be noted that the definition of corporations is broader than the phrase “unincorporated company” in section 4b which the cautious courts above referred to were construing. It includes “unincorporated companies and associations.”\(^\text{21}\) The word “asso-


\(^{19}\) *In re Order of Sparta*, (C.C.A. 3rd Cir. 1917) 242 Fed. 235.


\(^{21}\) Section 1(6) found in (1926) 44 Stat. at L. 662, 11 U. S. C. A. sec.
ciations" does not connote a business enterprise as does the word "companies." Whether incorporated or not it would seem, in conclusion, that "corporations" should be entitled to relief regardless of their profit or non-profit character, or their social, charitable, educational or business purpose.\(^2\)

Section 4 which, as has been seen,\(^3\) is, except in the case of railroads, determinative of what corporations may have relief under section 77B, specifically denies the remedy of bankruptcy to "municipal, ... insurance," and "banking corporations" and "building and loan associations" in either voluntary or involuntary proceedings.\(^4\)

**Municipal corporations.** The late section 80 of the Bankruptcy Act\(^5\) was passed on May 24, 1934 to permit "municipal-debt readjustments." It afforded relief not only to those political units properly termed municipal corporations but also to all other political subdivisions of the state.\(^6\) Since sections 77B and 80 were


\(^2\) Section 77B(a) provides that "Any corporation the majority of the capital stock of which having power to vote for the election of directors is owned, either directly or indirectly through an intervening medium, by any debtor, or substantially all of whose properties are operated by such debtor under lease or operating agreement, may file, ... a petition". (1934) 48 Stat. at L. 912, 11 U. S. C. A. Sec. 207(a), Supp., 1934. Mason's U. S. Code, tit. 11, sec. 207(a) (Supp. No. 3, 1932-34). There have been no cases which have discussed what corporations are included within this provision. It has been suggested however that the above words should be limited in their scope to stock corporations which are subsidiaries of debtor corporations. Weinstein, Corporations Amenable to Section 77B, (1935) 83 U. Pa. L. Rev. 853, 871.

\(^3\) See footnotes 2 and 3.

\(^4\) Section 77B(a) provides that "any corporation" which is a subsidiary of a corporation undergoing reorganization may file a petition, and also that three or more creditors may file against "any corporation." 48 Stat. at L. 912, 913 (1934), 11 U. S. C. A. sec. 207(a) (Supp., 1934). Mason's U. S. Code, tit. II, sec. 207(a) (Supp. No. 3, 1932-34). The use of the term "any corporation" without qualification has raised the problem whether insurance, banking, etc., corporations are amenable to the Act under such circumstances. The same problem has arisen under section 77B(1) which concerns the reorganization of "a corporation" already in the hands of a receiver or trustee. (1934) 48 Stat. at L. 920, 11 U. S. C. A. sec. 207(1), Supp., 1934. Mason's U. S. Code, tit. II, sec. 207(1), Supp. No. 3, 1932-34. Although no cases have discussed this problem, it has been suggested that the exceptions should apply in all such situations. See Weinstein, Corporations Amenable to Section 77B, (1935) 83 U. Pa. L. Rev. 853, 865, 872, and 873.

\(^5\) On May 25 of this year the Supreme Court held section 80 unconstitutional in a 5 to 4 decision. Ashton et al. v. Cameron County Water Improvement Dist. No. 1, (U.S. 1936) 56 Sup. Ct. 683.

\(^6\) Section 80(a) found in (1934) 48 Stat. at L. 798, 11 U. S. C. A. sec. 303(a) (Supp., 1934). Mason's U. S. Code, tit. 11, sec. 303(a), (Supp. No. 3, 1932-34). It was there provided as follows: "Any municipality or other
part of the same scheme for debtor relief any governmental unit which was entitled to relief under section 80 would probably have been classified as a municipal corporation and denied relief under section 77B.\textsuperscript{27} The fact that section 80 was declared unconstitutional did not enlarge the applicability of section 77B, but in a close case the fact that no relief other than under section 77B is open to a given debtor might incline a court toward holding that the debtor is not a municipal corporation. With respect to the mutual exclusiveness of sections 77B and 80 it is significant that section 80 was law prior to the approval of section 77B by the President.\textsuperscript{28} It is also worthy of note that the Sumners Bill, the lineal ancestor of the Corporate Reorganizations Act, which was introduced into Congress on January 23, 1933 specifically included within its scope “drainage, irrigation, levee, sewer, and paving improvement districts established under the laws of the state of their creation.”\textsuperscript{29} This provision was omitted from section 77B as finally passed.

**Railroad Corporations.** It is important to note that section 4 of the Act does not control this exception. Section 77B affords relief for “any railroad or other transportation corporation” except a railroad more than 20% of the revenues of which are derived from operations under the control of a municipality,\textsuperscript{30} and railroads entitled to relief under section 77, namely, those engaged in interstate commerce other than certain “street, suburban, or interurban electric railway” systems.\textsuperscript{31} It seems, as a consequence of the political subdivision of any state, including (but not hereby limiting the generality of the foregoing) any county, city, borough, village, parish, town, or township, unincorporated tax or special assessment district, and any school, drainage, irrigation, reclamation, levee, sewer, or paving, sanitary, port, improvement or other districts . . . may file a petition.” See note 6 supra.

\textsuperscript{27}In this connection the reader should consider the language of the court in *In re North Kenmore Bldg. Corporation*, (C.C.A. 7th Cir. 1936) 81 F. (2d) 656, set forth in footnote 8, supra.

\textsuperscript{28}Section 80 was added to the Bankruptcy Act on May 24, 1934. (1934) 48 Stat. at L. 798. Section 77B was approved on June 7, 1934. Hamilton Gas Co. v. Watters, (C.C.A. 4th Cir. 1935) 75 F. (2d) 176.


\textsuperscript{30}Section 77B(a) and (n) found in (1934), 48 Stat. at L. 912 and 922, 11 U. S. C. A. Sec. 207(a) and (n) (Supp., 1934). Mason’s U. S. Code, tit. 11, sec. 207(a) and (n) (Supp. No. 3, 1932-34).

\textsuperscript{31}Section 77B(a) excepts from the operation of the section “a railroad corporation authorized to file a petition or answer under the provisions of section 77 of this Act.” Section 77(a) found in (1933), 47 Stat. at L. 1474, 11 U. S. C. A. sec. 205(a) (Supp., 1934) Mason’s U. S. Code, tit. 11, sec. 205(a) (Supp. No. 3, 1932-34) allows “any railroad corporation” to file a petition. Section 77(r), found in (1933), 47 Stat. at L., 1482, 11 U. S.
recent amendments, that any railroad may have its debts readjusted in bankruptcy under section 77 or 77B, depending on its nature, with the important exception indicated above of railroads under the control of municipalities.\textsuperscript{32}

\textit{Insurance Corporations.} The variety of businesses which at the present time issue insurance against any of a host of contingencies has made the construction of “insurance company” more than ordinarily difficult.

Most, if not all, companies which engage in or intend to engage in an insurance business are chartered under special state statutes which provide for their regulation and limit their powers. The problem therefore arises whether the powers so conferred on them, or their activities, or the class in which they are placed by the state of incorporation, should determine their classification. On Dec. 1, 1934 the district court for the Northern District of New York decided that the New York Title and Mortgage Co., was an insurance company, and regretfully denied it relief under section 77B.\textsuperscript{33} The court first listed the sections of the Insurance Law of New York under which it was originally incorporated and later merged, and the articles of the Banking Law under which the company with which it had merged was organized. After listing the powers conferred by those laws the court said, “The incomes received from the various activities of the debtor are, doubtless, the controlling factor in determining whether the debtor comes under section 77B.”\textsuperscript{34} Judge Cooper then set forth a detailed account of the income received during 1930, and decided that at least three-fourths of it was received from insurance activities, namely “the insuring of title, the guaranteeing of mortgages and mortgage certificates, and things incidental thereto.”\textsuperscript{35} The court concluded as to this phase of the case:

C. A. sec. 205(r) (Supp., 1934), Mason’s U. S. Code, tit. 11, sec. 205(r), Supp. No. 3, 1932-34 defines a railroad corporation as “any common carrier by railroad engaged in the transportation of persons or property in interstate commerce, except a street, suburban, or interurban electric railway which is not operated as a part of a general railroad system of transportation or which does not derive more than 50 per centum of its operating revenues from the transportation of freight in standard steam railroad freight equipment.”

\textsuperscript{32}For a further discussion of this exception see Weinstein, Corporations Amenable to Section 77 B, (1935) 83 U. Pa. L. Rev. 853, 866.


\textsuperscript{34}In re New York Title and Mortgage Co., (D.C. N.Y. 1934) 9 F. Supp. 319, 324.

"While neither its certificate of incorporation nor its supervision by the superintendent [of Insurance] is conclusive as to the nature of the business, the fact that little other than insurance business is shown seems to make the matter quite clear that it was an insurance company."36

Four months later an appeal from an order dismissing the petition of the Union Guarantee and Mortgage Company was taken to the circuit court of appeals for the Second Circuit. The distinguished court which decided the case consisted of Judges Learned Hand, Swan, and Augustus Hand. In a concise but profound opinion it was held that since the debtor was incorporated under the Insurance Law of New York it could not seek relief under section 77B.37

The court first examined the purpose of Congress in excepting municipal, railroad, insurance, and banking corporations, and building and loan associations from the general terms of section 4. "From such similarity as exists between the excepted groups" the court inferred that those classes were excepted which, because of the public interest involved, required public supervision and control; that Congress excepted these businesses because it "meant to leave to local winding up statutes the liquidation of such companies;" that Congress intended the states by their regulatory acts to determine the specific kinds of business which should be included within these five exceptions. The court thus concluded that "it is the powers conferred upon the company, not its activities which are decisive." With regard to the Union Guarantee and Mortgage Company it was said: "The state has chosen to regard it so [as an insurance company], and that is all we may ask."

Three months later the same court, with Judge Manton sitting in place of Judge Learned Hand, reached the contrary result with respect to the Prudence Co., Inc., but followed the same technique.88

The Prudence Co., was incorporated under the investment company article of the Banking Law of New York but had power to guaranty mortgages which it sold. It was held not to be an insurance company in spite of this power. The court said:

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"the state has not classified the debtor as an insurance company, since it was not organized under the Insurance Law, and consequently we cannot, consistently with In re Guarantee and Mortgage Co. . . . hold the debtor exempt from bankruptcy as an insurer."

The court followed the state's classification of the company although it had power to issue insurance at least incidentally to its other powers. This case leads to the conclusion that it is not the activities nor the powers which are conclusive, but the classification adopted by the state of incorporation which determines whether a company is outside the scope of section 77B.

This result necessarily means that what is an insurance company in one state might not be such in another. That does not make the technique adopted in the Union Guarantee and Prudence Cases bad however, since in almost all if not all states insurance companies, as defined by the local laws, are subject to rehabilitation under state law, and other corporations are within section 77B. Those corporations to which the state procedure is adapted may be doctored by the state's specialists. Those which have no local relief may go to the federal general practitioner. Such a result is consistent with the purpose of the insurance corporation exemption as set forth above.

The Union Guarantee and Prudence test of classification is especially satisfactory because of its simplicity as compared with classification according to sources of income or activities. Whether proceedings are instituted by the debtor or its creditors, it will probably be desired to attempt another means of rehabilitation if the debtor is an insurance company excluded from the benefits of section 77B. This clear test is of decided benefit to all parties concerned for it makes it possible more definitely to know in advance, without protracted hearings, whether the debtor will be admitted to the corporate Valhalla. Expediency is vital in the field of corporate reorganizations. The fewer the uncertainties as to which route it may follow, the more opportunity there is for a corporation or its creditors to seek the shortest road to rehabilitation.

Are fraternal benefit societies insurance companies? Two such organizations which met the benefit claims by assessments on other members were held not to be insurance companies and adjudicable

89 In re Prudence Co., Inc., (C.C.A. 2nd Cir. 1935) 79 F. (2d) 77, 80.
40 Valhalla is defined as "The hall of Odin, into which he received the souls of heroes slain in battle." Webster's Collegiate Dictionary, 3d Ed., Merriam Series, 1924. The propriety of the appellation depends no doubt on the critic's point of view.
In the case of the Order of Sparta the court said:

"The Order is not an insurance company, and does not do an insurance business; the essential difference between its beneficiary or so-called insurance contracts and the policies of regular insurance companies being that its pecuniary benefits are met by assessments paid by the members, these assessments being the chief and practically the only asset of the Order."  

District Judge Dooling, in the opinion which subjected the Grand Lodge of the Ancient Order of United Workmen to the tragic ending of bankruptcy, said:

"As a matter of fact it did not insure. Its only obligation was to collect, from such of its members as were willing to contribute, funds with which, if and when collected, it would pay certain amounts to the beneficiaries of deceased members."

The Supreme Lodge of the Masons Annuity was a corporation which changed its purpose from "Masonic benevolence" to "mutual insurance pure and simple." It developed from a fraternal organization somewhat like the Grand Lodge or the Order of Sparta into a business which issued certificates like insurance policies to persons selected according to the usual standards of insurance regulations. It received fixed dues determined as premiums are determined, and promised the full payment of stated sums. The court did not hesitate to hold that the Lodge was an insurance company and not within the scope of the Bankruptcy Act. These cases indicate that whether benefits are to be treated like insurance depends on the particular facts of each case. It would avoid adding another "question of degree" to the uncertainties of the law, if the doctrine of the Union Guarantee and Prudence Cases were extended to apply to this situation. If that were done the states' classification of benefit societies as insurance companies or in a separate category would be determinative. As yet no cases have arisen under section 77B which involve this particular problem.

The question has, however, already come up in several cases, whether a company which once admittedly operated as an insurance company ceased to be such when it went into the hands of a

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42 In re Order of Sparta, (C.C.A. 3rd Cir. 1917) 242 Fed. 235, 237.
receiver or state superintendent of insurance. The basis for the contention that such a company is no longer an insurance corporation is that the new manager of its affairs usually stops the issue of policies and other normal activities of an insurance company, and merely manages investments and business operations preparatory to winding up the business. It has been uniformly decided that such a corporation is still an insurance company within the terms of the Act.\textsuperscript{45}

In the \textit{Peoria Life Insurance Co.} \textit{Case} the court pointed out that the control and management of investments was a major function of an insurance business. It declared that if the company was no longer operating as an insurance company, the court was at a loss to know by what authority it acted at all. The court, in the \textit{New York Title and Mortgage Case}, indicated that Congress could not have intended that insurance companies should be within the scope of section 77B only when they were so greatly disturbed in a prior proceeding as to have their character changed, for it was the purpose of the section to permit reorganizations with as little dislocation as possible. It might be added that if the reason for the exclusion of insurance companies was that state agencies were better qualified to conduct rehabilitation proceedings, the one time when such companies should not be eligible for relief in bankruptcy is when they are already in the hands of the superintendent of insurance. The conclusion of the courts was succinctly stated in the \textit{National Surety Co.} \textit{Case}:

"The character of a corporation does not change while being administered by a court. Even though, during the period of rehabilitation or liquidation, it ceases some or all of its former activities, yet its classification remains the same."\textsuperscript{46}

As in so many statutes, the provisos in section 77B cause much of the uncertainty in its construction. This is very likely because they are added in most cases after the act as a logical unit has been drafted. Section 77B (a) provides that any corporation may file an original petition or a petition "in any proceeding pending in bankruptcy, whether filed before or after this section becomes effective, provided the present operations of such corporation do not exclude it hereunder."\textsuperscript{47} In both the \textit{Peoria} and \textit{New


\textsuperscript{46}In re \textit{National Surety Co.}, (D.C. N.Y. 1934) 7 F. Supp. 959, 961.

\textsuperscript{47}Section 77B(a) found in (1934) 48 Stat. at L. 912, 11 U. S. C. A.
York Title and Mortgage Cases it was contended that this "present operations" clause should be the means of including the insurance companies within the scope of section 77B. Both courts rejected the contention because the phrase was said to be designed to exclude corporations otherwise included rather than to include corporations otherwise excluded. The court in the latter case further limited the clause to cases where the debtor's petition was filed in a proceeding pending in bankruptcy. In that case there was a creditors' petition and no proceeding pending in bankruptcy.

There have been frequent expressions of dissatisfaction with the exclusion of insurance companies from the operation of the Act. In the New York Title and Mortgage Case the court dismissed the petition "with regret," "for the superiority of section 77B for reorganization of the debtor corporation with its ramifications in many states is manifest." That corporation did business in twenty-five states. Since a business area covering many states is characteristic of insurance corporations, the extension of section 77B to include them would at least centralize their reorganization.

In all cases involving insurance companies, it is debatable whether the state procedure is sufficiently better adapted to the rehabilitation of debtor corporations to make up for the broader powers and wider jurisdiction of the federal courts under section 77B. If it be conceded that the balance is in favor of the state modes of relief where specially designed to treat insurance corporations, then the exclusion of them from the benefits of section 77B is justified.

On the other hand if this is not conceded then the Act should be amended to include insurance corporations within its scope. If it were so amended the courts should be encouraged or required to refuse their approval of petitions filed by debtor corporations unless they clearly proved the "need for relief" under section 77B as distinguished from relief under state laws. The

Sec. 207(a) (Supp., 1934). Mason's U. S. Code, tit. 11, sec. 207(a) (Supp. No. 3, 1932-34).

On March 28, 1935 Senator Walsh of Massachusetts introduced an amendment to section 77B to afford its remedies to title and mortgage companies. 79 Cong. Rec., March 28, 1935, at 4581.


Section 77B(a) requires that a debtor state facts in its petition or answer showing the "need for relief under this section"; and that the petition be approved only if the court is satisfied that the "petitions or answer
Act does not require that a creditor’s petition state facts showing the "need for relief." 51 Such a requisite might well be added to the section to cover this situation. But even if such a change were not made, the courts could hold that a creditors’ petition was not filed in “good faith” where they did not show a need for relieving the debtor insurance company in the federal rather than the state courts. 52 Two courts have already reached this result in cases which did not involve insurance companies. 53

Here, as throughout the Corporate Reorganizations Act, there would be grave danger of so overburdening the federal courts with a mass of detailed work, both judicial and administrative, that they would be unable to do justice in any case. That danger might here, as elsewhere, be avoided by the appointment of Masters to determine whether the allegation of the “need for relief” is sustained by the facts, or whether the petition is filed in “good faith” as judged by the necessity for relief in bankruptcy, in preference to the mode afforded insurance companies by state laws. 54


Section 77B(a) provides that a creditors’ petition shall be approved only if the court is “satisfied that it . . . has been filed in good faith.” (1934) 48 Stat. at L. 912. 11 U. S. C. A. sec. 207(a). Supp. 1934. Mason’s U. S. Code, tit. 11, sec. 207(a) (Supp. No. 3, 1932-34).


Section 77B(c) (11) provides that “Upon approving the petition or answer or at any time thereafter the judge, . . . may refer any matters to a special master, who may be one of the referees in bankruptcy, for consideration and report either generally or upon specified issues.” (1934) 48 Stat. at L. 915-917, 11 U. S. C. A. sec. 207(c) (11) (Supp., 1934), Mason’s U. S. Code, tit. 11, sec. 207(c) (11) (Supp. No. 3, 1932-34). It might be argued that this clause precludes the use of special masters by the judge to aid in determining whether the petition should be approved. However “judge” is used in section 77B(c) advisedly to prevent the delegation of the control of the debtor’s property to a referee. Hearings before the Committee on the Judiciary on H. R. 1670 etc. and H. R. 5009, 73rd Cong., 1st Sess. (1933) p. 192. In section 77B(a) it is the court which must be satisfied that the petition was filed in good faith or that the need for relief was proved. “Court” might be interpreted to include special masters appointed to aid the judge in reaching his decisions. In the light of the importance of a thorough investigation of the status of the debtor before a petition is approved or dismissed, it is to be hoped that the latter view will be adopted, and that the judges will be permitted to be assisted by special masters from the start of proceedings under section 77B. A master was appointed for the purpose of determining whether a petition should be approved in In re Missouri Kansas Pipe Line Company, (D.C. Ill. Sept. 12, 1934) C. C. H. Bankruptcy Service, par. 3061 (Referee’s Opinion).
Banking Corporations. What has been said with regard to the reason for excluding insurance corporations from the operation of the Act, the basis for classifying a company as an insurance corporation, and the propriety of excluding insurance companies from the benefits of section 77B, applies with equal force to banking corporations.

The only case to date which involved the classification of an alleged banking corporation is worthy of note, for it indicates some of the special problems relating to banks. The Prudence Co., was incorporated under the article of the Banking Law of New York which relates to investment companies. Its business consisted of the sale of mortgages and guaranties of payment. The circuit court of appeals for the second circuit judged the status of the Prudence Co., in the light of its classification by the state rather than on the basis of its activities. It determined that the debtor was not a banking corporation, by using the same technique by which it determined what are insurance corporations.56

The court pointed out that the Banking Law of New York was entitled “An Act in relation to banking corporations . . . and corporations under the supervision of the banking department.”56 It concluded from this title that all corporations organized under this law were not treated by the state as banking corporations, and that safe deposit and investment companies were not included in the phrase “banking corporations.” The court reached this conclusion at least with respect to investment companies, because they do not have power to receive deposits, “which is generally recognized as the essential characteristic of a banking business.”57 The Prudence Co., could not have been a bank under this test because first, a New York statute required an institution which received deposits to place securities with the superintendent of banks, which the Prudence Co., had not done; and second, a New York statute forbade any investment company which had preferred stock outstanding to receive deposits. The debtor had such an issue outstanding.

Under section 4b “any unincorporated company, and any moneyed” etc., corporation, except a banking etc., corporation, could be adjudicated an involuntary bankrupt. Private bankers,

57 In re Prudence Co., Inc., (C.C.A. 2nd Cir. 1935) 79 F. (2d) 77, 79.
58 In re Prudence Co., Inc., (C.C.A. 2nd Cir. 1935) 79 F. (2d) 77, 79.
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doing business as unincorporated companies, were therefore eligible for relief. Now the case is different. Unincorporated companies are within the scope of section 77B only as they are included within the definition of "corporations." The banking corporation exception applies to unincorporated companies as well as to incorporated "corporations." It therefore appears that private bankers are not eligible for relief under section 77B, at least where classified as bankers by the State.

Building and Loan Associations are expressly placed without the scope of section 77B.

Dissolved Corporations. The cases indicate that a dissolved corporation is entitled to relief under section 77B whenever it could have had such relief as a going concern.

Two cases have raised this point before the district court for the eastern district of Illinois. In both it was held that dissolution did not terminate the court's jurisdiction under section 77B. An Illinois statute provided that dissolution of a corporation did not impair remedies against it for liabilities incurred previous to dissolution, if suit were brought and process served within two years after dissolution. The dissolution of a corporation under similar statutes was no bar to proceedings in bankruptcy prior to the addition of section 77B to the Bankruptcy Act.

In its opinion in the 211 East Delaware Case the court did not, however, rely on this statute, but relied on the more general proposition that the dissolution of a corporation should not deprive the federal courts of their paramount power over the administration, liquidation, and distribution of the property of a corporation. It

62The dissolution, for any cause whatever, of any corporation, shall not take away or impair any remedy given against such corporations, its officers, or stockholders, for any liabilities incurred previous to its dissolution, if suit therefor is brought and service of process had within two years after such dissolution." Illinois Rev. Stat. (Smith-Hurd, 1931) ch. 32, No. 79.
quoted Hammond v. Lyon Realty Co., 59 F. (2d) 592 (C.C.A. 4th, 1932) to the effect that:

"It has . . . been the view of the courts that the National Bankruptcy Act so far controls the dissolution of an insolvent corporation as to prevent its legal extinction by superseding, at least temporarily and to the extent necessary, all state laws which would prevent the creditors from having the assets of insolvent debtors administered in accordance with the terms of the federal act. It has been thought that to hold otherwise would be to allow the states, by a particular form of legislation, or by the action of their courts, to override a law of Congress on a subject over which the constitution has given to Congress supreme power."\(^3\)

The National Surety Co., was dissolved pursuant to the terms of the Insurance Law of New York. By virtue of that statute dissolution of the company vested the superintendent of insurance with title to all the property, contracts and rights of action of the insurer.\(^6\) The court declared that it had no jurisdiction under section 77B because first, the debtor was an insurance corporation, and second, title to all the debtor's property has passed to the superintendent of insurance.\(^6\)

The second basis for the result reached in the National Surety Case would be inconsistent with the language used in the 211 East Delaware Case were it not for the fact that the corporation in the former case was an insurance company, outside the scope of the Act. There was thus no possibility of a jurisdictional conflict between state and federal courts. If all divesting dissolution statutes are limited to companies, such as insurance corporations, which are excluded from the operation of the Act, dissolution might be given as an additional reason for not admitting a corporation to relief under section 77B, without endangering the operation of that law.

On the contrary, if divesting dissolution statutes are passed to apply to corporations within the scope of section 77B, they should not be given the effect indicated in the National Surety Case. The court there justified its second basis for the decision by stating that all earlier cases which had allowed bankruptcy proceedings against a dissolved corporation arose in states where the statutes allowed dissolution only for limited purposes, and thereby indicated its

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\(^3\)See In re 211 East Delaware Place Building Corp., (D.C. Ill. 1934) 7 F. Supp. 892, 894, affirmed in (C.C.A. 7th Cir. 1935) 76 F. (2d) 834.

\(^6\)"The superintendent and/or his successors shall be vested by operation of law with the title to all the property, contracts and rights of action of such insurer as of the date of the order so directing them to liquidate." New York Insurance Law, (McKinney's Supp., 1935) Sec. 404.

conviction that absolute dissolution should in all cases be a bar to subsequent bankruptcy proceedings.\footnote{6} This was not true in at least one earlier case where the Maryland statute terminated the corporation for all purposes and vested title to its property in a receiver. The court there held that dissolution under the statute was no bar to subsequent proceedings in bankruptcy. It declared that the federal bankruptcy power was paramount, and superseded all state insolvency laws inconsistent therewith; that even though an insolvent corporation had been technically dissolved for all purposes, still its affairs were subject to the jurisdiction of the federal courts.\footnote{7} Because an insurance company was involved, the \textit{National Surety Case} was probably rightly decided on its facts, but the second reason given for the decision should not be a bar to a corporation otherwise eligible to relief. If the uniformity of our bankruptcy system is to remain a fact no such simple device as technical dissolution should be allowed to supplant the federal jurisdiction with that of the states.

\footnote{6} In re National Surety Co., (D.C. N.Y. 1934) 7 F. Supp. 959, 961.  