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NOTES.

RIGHT OF THE DIRECTORS OF A CORPORATION TO FILE FOR IT A VOLUNTARY PETITION IN BANKRUPTCY

In discussing the right of the directors of a company to file for it a voluntary petition in bankruptcy the first question that presents itself is as to what authorization from the stockholders, or what circumstances dispensing with the need of such authorization, must be present.

In respect to corporations, there being no special provisions in the bankruptcy act, reference must be made to the state statute controlling the authority of officers and directors of *corporations* to dispose of the property of the corporation for the benefit of its creditors. Under the New York statute, a board of directors alone has power to determine whether a general assignment for the benefit of creditors shall be made, and where a petition of a corporation to be adjudged a voluntary bankrupt does not show that corporate action has been taken authorizing the president of the corporation to execute and file the petition, the court has no jurisdiction to adjudge the corporation a voluntary bankrupt. (*In re Jefferson Casket Co.*, 182 Fed. 689.)

In the case of *In re Foster*, 210 Fed. (Pa.) 652, the court held that the directors of the Pennsylvania corporation had without special authority of the stockholders, a right to file a petition to have the corporation adjudged a bankrupt, and that this right was governed by the state law. The court said: "It must be conceded that if the directors of the corporation have power to make a general assignment for the benefit of creditors without authority from the stockholders, they have equal power to file a petition in bankruptcy."

In *In re Guanacevi Tunnel Co.* (1912) 201 Fed. 316, it is said that a voluntary petition for adjudication as a bankrupt is the same thing in effect as a general assignment for benefit of creditors or an application for a receiver. And in *In re Kenwood Ice Company*, 189 Fed. (Minn.) 525, the court held that the power of the directors to put the corporation into bankruptcy was governed by the state laws of Minnesota. So also the case of *Bell v. Blessing, infra*, holds that an authorization to a corporation to file its voluntary petition in bankruptcy, given by its board of directors, a member of which practically owned all the stock, is sufficient, notwithstanding Civ. Code Cal. Sec. 361a, prohibiting any assignment of the business, franchise, and property of a corporation, unless with the consent of the stockholders thereof holding at least two-thirds of the stock.

If the corporation is unable to meet its current obligations, in the absence of any restriction by statute, or by charter, or by-laws, the power of the board to make a general assignment is presumed.

Thus in the case of *Hutchinson vs. Green*, 91 Mo. 367, there was an assignment for the benefit of creditors by the directors, and the court held that it was the duty of the directors to care for its creditors when it became embarrassed and unable to meet its obligations in the usual course of business, that it is competent for the directors to

make an assignment for the benefit of creditors, and this they may do, not only without the consent, but even against the expresed will of the stockholders; that where there is no restriction within the statute, articles of association, or by-laws, as to the disposition of the property of a corporation by the directors, the latter and they alone are the proper parties to make the assignment.

In the case of *Banta vs. Hubbell,* 167 Mo. App. 38, the court said: "When a corporation becomes insolvent in the sense in which we shall define that term, it is the duty of the directors to make an assignment for the benefit of creditors." "When a corporation possesses assets substantially in excess of its liabilities to creditors, is not embarrassed by demands of creditors, and is a going concern, apparently endowed with sufficient resources and vitality to continue its business indefinitely and successfully, it is not insolvent, so far as creditors are concerned, though its capital stock be impaired." "So long as there is a reasonable prospect of success and the corporation is able to respond to the lawful demands of creditors, it should not be pronounced insolvent." "When it becomes merely 'a nominal, inert body' it may generally be considered an insolvent corporation. In other words, when a corporation's assets are insufficient for the payment of its debts, and it has ceased business, or has taken, or is in the act of taking, a step which will practically incapacitate it for conducting the corporate enterprise with reasonable prospect of success, or its embarrassments are such that early suspension and failure must necessarily ensue, then such corporation must be pronounced insolvent."

It would seem to be the effect of the decisions that insolvency, such as is described in the last case examined, is a prerequisite to any rightful filing of a voluntary petition for the company by the directors. It will be noted, however, that it is impossible to define the meaning of insolvency, used in this connection, with any degree of clearness, and it would seem that even in cases where the assets of the company are considerably greater than its liabilities, but where there is no further prospect of doing business—or where there are in addition liquidated debts, of smaller amount than the quick assets, large unliquidated claims against the company, and its affairs are in unsettled condition—that the policy of the law would favor the right of the directors to use the bankruptcy courts as a means of winding up the affairs, or liquidating the assets of, the concern. We shall presently note some cases involving such situations.

When the question of the power of the directors is settled there re-

mains a further question as to whether the corporation must, by the terms of the bankruptcy act, be insolvent, before its voluntary petition may be filed. Under Chapter 3, Section 3 of the Bankruptcy Act, defining acts of bankruptcy, there are five sub-sections. Under sections two, three, and the second part of four, insolvency is a necessary element to the act of bankruptcy. Under one, and first part of four, and under five, insolvency is not necessary. The fifth sub-section requires the petitioner to *state* his inabiilty to pay his debts, and his willingness to be adjudged a bankrupt on that ground. By the first part of sub-section four, "a general assignment for the benefit of his creditors" is made an act of bankruptcy, and by subsection one, his act, where he has concealed, transferred, etc., any part of his property with intent to hinder or defraud his creditors.

In *West vs. Lea,* 174 U. S. 590, 43 L. Ed. 1098, the court held that the separate sections of the act were to be considered separately, and that under some of them as explained above, insolvency is not prerequisite to filing a petition either voluntarily or involuntarily. To the same effect is *Bray vs. Cobb,* 91 Fed. 102, and *In re Chappell,* 113 Fed. 545: A solvent individual may thus file a voluntary petition. Similarly it would appear that probably a corporation may become a voluntary bankrupt under the act without proving insolvency. In the case of *Bell v. Blessing,* 225 Fed. 750, it was held that a corporation, not a municipal railroad, insurance, or banking corporation, has, under Bankr. Act. July 1, 1898, c. 541, Sec. 4a, 30 Stat. 547 (Comp. St. 1913, Sec. 9588), the same privilege of becoming a voluntary bankrupt as an individual, and its petition therefor need only show that it owed debts which it is unable to pay in full, and that it is willing to surrender its property for the benefit of its creditors; and a resolution of the board of directors, authorizing the filing of a voluntary petition, need not authorize, in conformity with section 3, subd. 5 (Comp. St. 1913, Sec. 9587), an admission in writing on the part of the corporation of its inability to pay its debts and its willingness to be adjudged a bankrupt on that ground, and a resolution authorizing its cashier, treasurer, and bookkeeper to prosecute in the name of the corporation a petition in bankruptcy to final discharge, is sufficient to authorize the corporation to proceed as a voluntary bankrupt to obtain its discharge.

It may be here noted that a creditor has not in any case a right to oppose the filing of a voluntary petition, (*In re Ives,* 113 Fed. 913-14, *In re Jehu,* 94 Fed. 638), so that cases like *In re Duplex Radiator Co.,* 142 Fed. 906, where the insolvency of the corporation is ques-

tioned by a creditor, and the question thus raised declared immaterial, cannot be relied on as conclusive.

Effect of Proceedings Pending in a State Court.

We now come to a question on which there are clear decisions but which cannot be called settled because of the amount of litigation still appearing in respect to it. The question is as to the effect on the jurisdiction of the Federal Bankruptcy Court of proceedings in a state court, commenced prior to the proceedings in bankruptcy, and covering the very property which is proposed to be dealt with in bankruptcy. Where the Federal courts have exclusive jurisdiction in such cases they must necessarily get it from the Bankruptcy Act. So much of section 67-f of the Bankruptcy Act as is revelant to the question here involved is as follows:

> "That all levies, judgments, attachments or other liens, obtained through legal proceedings against a person who is insolvent, at any time within four months prior to the filing of a petition in bankruptcy against him, shall be deemed null and void in case he is adjudged a bankrupt, and the property affected by the levy, judgment, attachment or other lien, shall be deemed wholly discharged and released from the same."

It will be noted that this section nullifies all liens obtained within the four months' period, but leaves intact those obtained previous to it. There are two leading cases dealing with liens obtained prior to the four months' period—*Metcalf v. Barker,* and *Pickens v. Roy,* both decided by the Supreme Court of the United States. The litigation in the first case lasted over twelve years, and its history is as follows:

In 1889 Susan C. Dent (later Mrs. Roy) filed a suit in equity to set aside as fraudulent, a certain deed to trustees made by one Pickens in January of that year. In an amended bill Pickens' creditors joined with Susan C. Dent and it was alleged that Susan C. Dent was a *judgment creditor,* (the judgment making a lien) in the sum of $10,000.00. Ten years subsequent to the filing of this bill to set aside, that is on the 27th day of October, 1899, Pickens filed his petition in bankruptcy in the U. S. District Court for the District of West Virginia, and in due time, was adjudged a bankrupt, the suit in the Circuit Court being still undisposed of. In February, 1900, the State Court rendered its decree appointing a receiver and commissioner, who was proceeding to execute the decree, when Pickens filed a bill in the Federal Court asking for an injunction, and that the property

be turned over to the Trustee in Bankruptcy. This injunction was granted by the District Judge, but shortly thereafter dissolved, and Pickens' bill dismissed. From this order Pickens appealed, carried his case to the Circuit Court of Appeals, to the Supreme Court, where a decision was rendered against his appeal in the case of *Pickens v. Roy,* 187 U. S. 177 47 L. Ed. 128. (1902.)

The second case, *Metcalf Bros. & Co. vs. Barker,* 47 Law Ed. 122, was similarly an action brought by *Judgment Creditors* to enforce judgment lien, which action was begun more than four months before filing of the petition in bankruptcy, but on which judgment *enforcing* the lien was not rendered till after the four months' period. The court held the lien good under 67-f, in spite of the time of the rendering of the judgment. Stated as briefly as possible the facts in that case were as follows:

> On October 2nd, 1896, Lesser Bros. (partners) made certain fraudulent transfers to favored creditors, and got receivers appointed. October 22nd, 1896, Metcalf Bros. & Co. procured judgments against the Lesser Bros. for large amounts, on which executions were issued and returned unsatisfied. Then on December 17, 1896, Metcalf Bros. brought a number of judgment creditor's actions to set aside the fraudulent conveyances. While these actions were still undisposed of, on May 12, 1899, Lesser Bros. filed a voluntary petition in bankruptcy, and were adjudged bankrupts that day, and on June 9th, one Barker was appointed trustee in bankruptcy. On February 6, 1900, the State Court of Appeals handed down their decision in favor of Metcalf Bros. & Co. for the amount of their several judgments. On March 8th, the trustee in bankruptcy got an order from the District Court requiring Metcalf Bros. & Co. to show cause why a writ of injunction should not issue enjoining them from taking any further proceedings under any judgment in their creditors' action, and temporarily enjoining them.

On hearing the injunction was continued, and Metcalf Brothers filed a petition to revise proceedings. Chief Justice Fuller said:

> "The general rule is that the filing of a judgment creditors' bill and service of process creates a lien in equity on the judgment debtor's equitable assets." "Doubtless the lien created by a judgment creditors' bill is contingent in the sense that it might possibly be defeated by the event of the suit, but in itself, and so long as it exists, it is a charge, a specific lien, on the assets, not subject to being divested save by payment of the judgment

sought to be collected." "As Mr. Justice Swayne remarked, in *Miller vs. Sherry*, the commencement of the suit amounts to an equitable levy (2 Wall. 249, 17 L. Ed. 830), or in the language of Mr. Justice Matthews, in *Freedman's Sav. & T. Co. v. Earle*: "It is the execution first begun to be executed, unless otherwise regulated by statute, which is entitled to priority. . . . . The filing of the bill, in cases of equitable execution, is the beginning of executing it." "In our opinion the conclusion to be drawn from this language is that it is the lien created by a levy, or a judgment, or an attachment, or otherwise, that is invalidated, and that where the lien is obtained more than four months prior to the filing of the petition, it is not only not to be deemed to be null and void on adjudication, but its validity is recognized. When it is obtained within four months the property is discharged therefrom, but not otherwise. A judgment or decree in enforcement of an otherwise valid pre-existing lien is not the judgment denounced by the statute, which is plainly confined to judgments creating liens. If this were not so the date of the acquisition of a lien by attachment or creditors' bill would be entirely immaterial." "By Sec. 720 of the Revised Statutes, U. S. Comp. Stat. 1901, p. 581, 'the writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a state, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy." "We are of opinion that the jurisdiction of the District Court to make the injunction order in question cannot be maintained."

The Federal Court can, of course, stay the proceedings where they are begun in the State Court within the four months' period, even where the suit is for the enforcement of a valid lien, and it was held in *New River Coal Co. vs. Ruffner Bros.*, 105 Fed. 881, that a District Court has exclusive power to determine whether a suit in a State Court should be stayed or not. So that under the bankruptcy act which makes the appointment of a receiver because of insolvency an act of bankruptcy, a State Court cannot, by the appointment of a receiver on such ground, obtain priority of jurisdiction to administer the property of the debtor to the exclusion of a court of bankruptcy.

In general, an adjudication of bankruptcy vests the bankruptcy court with exclusive jurisdiction to administer the property of the bankrupt as against any State Court which may have obtained possession of such property through proceedings instituted within four

months prior to the adjudication, and it is immaterial that the proceedings of the State Court were for the enforcement of valid liens not affected by the bankruptcy act. (*In re Knight*, 125 Fed. 35.)

We come now to that class of cases where proceedings in the State Court are not to enforce a lien of any kind, and we will find that in such cases the jurisdiction in the Federal Courts, once invoked, is exclusive. The case of *Bank of Andrews vs. Gudger*, 212 Fed. 49 (1914) is of this order, and the facts in that case are as follows:

By a summons dated April 21, 1913, and complaint April 30, 1913, in the Superior Court of North Carolina, four minority stockholders of the Cherokee Tanning Extract Company brought action against the corporation and certain individuals, alleging fraudulent mismanagement by the majority stockholders and directors. The caption of the complaint included as plaintiffs "and all others, the stockholders and creditors of the Cherokee Co., who will come in and make themselves parties and contribute to the cost of the suit." Insolvency was not alleged. The relief asked for was the appointment of a receiver, to take charge of the property and bring suits against certain individuals for their acts. On May 5, 1913, a judge of the Superior Court appointed a receiver, the order requiring the defendant to show cause at a future day why a receiver should not be appointed.

On the 25th of September, 1913, the stockholders of the corporation by resolution admitted its inability to pay its debts caused by the differences between its stockholders and on September 30, 1913, three creditors filed an involuntary petition against the corporation. On October 28th, the District Judge adjudged the corporation bankrupt, the president of the corporation admitting the allegation of the petition, and consented to the adjudication.

A motion to discharge the State Court's receiver was heard by the Superior Court in the November term and refused.

The temporary receiver, and one Fain, who had been appointed permanent receiver by the State Court, styling themselves "creditors," appeared in the bankruptcy proceedings by answer filed November 7th, 1913, setting up the proceedings in the State Court, the appointment of receivers, and possession of the property as such, and moved to set aside the adjudication in bankruptcy. The motion was denied and on November 10th, 1913, the District Judge made an order appointing a receiver, ordering him to take charge of the property, and restraining the State Court from disposing of the property in their

hands. The receivers appointed by the State Court refused to turn over the property. After hearing the return, containing all proceedings in State Court, the District Judge ordered Fain, the permanent receiver, to turn over the corporate property to the Federal receiver.

On hearing of a petition for revision of proceedings of the District Court, Woods, Circuit Judge, stated the case as follows:

> "The case then comes to this: Does the pendency of a suit in a State Court instituted against a corporation by stockholders for the protection of their rights, and the possession of the corporate property by a receiver appointed in such suit, deprive creditors of the corporation of the superior right conferred on them by the Federal statute to have the corporate assets brought into the Federal Court for administration under an adjudication in bankruptcy when they have duly asserted the right and had the corporation declared bankrupt as soon as it was known to be insolvent and had committed an act of bankruptcy? It seems clear that to this question there can be only a negative answer. An affirmative answer would mean that the stockholders of a corporation or the members of a partnership could at their will deprive creditors of the right conferred upon them by the Federal statute to have the property of an insolvent debtor administered by the bankruptcy court.
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> "Such a case is entirely apart from those cases in which a creditor has gone into the State Court and established or acquired by his suit a legal or equitable lien on the property in the hands of the court four months before the filing of the petition in bankruptcy. In such cases the courts have held that the creditor is entitled to enforce his lien in the first court that acquired jurisdiction. The distinction is also evident between this case and those cases where the State Court held the property by its receiver and there was no question of the subsequent coming into existence of facts giving rise to the right to invoke the exclusive jurisdiction of the Federal Court."

The same court reached the same conclusion in a case decided by it in November, 1916—the case of *Graham Mfg. Co. vs. Davy*, 38 American Bankruptcy Reports 118, and the Court of Appeals for the Fifth Circuit reached the same conclusion upon the principles involved though upon a different state of facts, in the case of *Rogers vs. Levert Co.*, 38 American Bankruptcy Reports 240, 1916. To the same effect is *Commercial Trust & Savings Bank vs. Busch Grace Co.*, 228 Fed. 300.

C. E. K., JR.