

1941

BANKRUPTCY -TEST OF INSOLVENCY - FAIR VALUATION OF DEBTOR'S ASSETS

William F. Hood
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Bankruptcy Law Commons](#)

Recommended Citation

William F. Hood, *BANKRUPTCY -TEST OF INSOLVENCY - FAIR VALUATION OF DEBTOR'S ASSETS*, 39 MICH. L. REV. 813 (1941).

Available at: <https://repository.law.umich.edu/mlr/vol39/iss5/9>

This Regular Feature is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

BANKRUPTCY — TEST OF INSOLVENCY — FAIR VALUATION OF DEBTOR'S ASSETS — An objecting creditor seeking to preserve his judgment lien appealed from an order adjudicating *B* a bankrupt. The alleged act of bankruptcy was that *B*, while insolvent, permitted the objecting creditor to obtain a lien on his property by judicial proceedings and failed to discharge it within thirty days. *B*'s principal asset was his interest in a spendthrift trust fund, valued at more than a million dollars, set up in favor of *B* and his brother. Under the terms of the trust each beneficiary was to receive one-half the approximately \$44,000 a year income until he reached the age of sixty, and was then to get one-half the principal. If either brother died before reaching sixty, his interest was to go to the survivor. *B* at the time of proceedings was forty-nine years of age. He refused to permit insurance on his life. *B*'s other assets amounted to \$154,000 and he had liabilities amounting to \$319,000. *Held*, that valuation for purposes of straight bankruptcy contemplates sale for payment of debts within a reasonable period of time, and "fair value" in the Bankruptcy Act means "fair market value." Since an assignment of the income by *B* would not be enforceable against the trustee of his mother's estate, the trial court's finding of no value for the income was not erroneous, and in view of *B*'s refusal to permit insurance on his life, the finding of \$50,000 as the value of *B*'s contingent remainder in the principal was also not erroneous. Under the "balance sheet test" prescribed by the Bankruptcy Act,¹ *B* was therefore insolvent. *Syracuse Engineering Co. v. Haight*, (C. C. A. 2d, 1940) 110 F. (2d) 468.

¹ "A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have

The decision that *B* should be adjudicated a bankrupt was justified by several factors appearing in the case.² The ruling that no value should be given *B*'s right to income, however, may properly be questioned. It seems clear that a person who can reasonably be expected to pay his debts if left to his own devices should not be declared a bankrupt. A right to receive an income of approximately \$22,000 a year, even though that right is good in the debtor alone, can reasonably be expected to help the debtor clear himself of his debts, and therefore should be taken into account in determining whether that debtor should be adjudicated a bankrupt. A liberal construction of the Bankruptcy Act's "balance sheet test" of insolvency might permit consideration of such a right, for the wording of the act does not expressly require valuation at "market" or "fair sale" price,³ but merely requires a "fair valuation." Property may have a fair value for debt-paying purposes without being salable, as is evidenced by *B*'s interest in the trust income in the principal case. That the appraisal need not, under the Bankruptcy Act, contemplate liquidation but may contemplate a continuance of the debtor's affairs is intimated by the fact that property exempt from execution is to be valued,⁴ though it would not be touched by liquidation,⁵ while fraudulently conveyed property is to be excluded⁶ though it could be reached by the trustee if a liquidation took place.⁷ By taking "fair valuation" to mean, then, the debt-paying value of the property assuming a continuance of the debtor's affairs, a personal right to \$22,000 a year would have value. In the face of what appears to

conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts." 52 Stat. L. 841 (1938), 11 U. S. C. (Supp. 1939), § 1 (19), reenacting 30 Stat. L. 544, § 1 (15) (1898).

² The creditors of *B* had been fighting over his estate for nine years, so it was time that the Bankruptcy Court called "time." Further, a prior appeal of the same case, *Syracuse Engineering Co. v. Haight*, (C. C. A. 2d, 1938) 97 F. (2d) 573, 37 Am. Bkcy. Rep. (N. S.) 316, discloses that Haight, the objecting creditor, had attached all of *B*'s property, and since his judgment was for \$131,641.97, it is quite possible that if the property were sold at a forced sale under that attachment, it would not yield more than enough to pay off the lien, even though the property's actual worth were a great deal more.

³ In § 67d of the act, 52 Stat. L. 875 (1938), 11 U. S. C. (Supp. 1939), § 107d dealing exclusively with fraudulent conveyances, the words "fair salable value" appear in the insolvency definition. It is doubtful, however, that much importance can be attached to the different wording since § 67d was not added to the act until 1938, long after "fair valuation" in § 1 (19) was interpreted to mean "sale value." In addition the definition in § 67d was copied from the Uniform Fraudulent Conveyance Act and perhaps the draftsmen failed to notice the difference.

⁴ Bonbright and Pickett, "Valuation to Determine Solvency under the Bankruptcy Act," 29 COL. L. REV. 582 at 590 (1929) and cases cited; 1 COLLIER, BANKRUPTCY, 14th ed. 71-72 (1940) and cases cited.

⁵ Sec. 6 of the Bankruptcy Act, 52 Stat. L. 847 (1938), 11 U. S. C. (Supp. 1939), § 24.

⁶ It is expressly excluded by § 1 (19) of the Bankruptcy Act, quoted in note 1.

⁷ Sec. 67d of the Bankruptcy Act, 52 Stat. L. 875 (1938), 11 U. S. C. (Supp. 1939), § 107d.

be the established view that "fair value" means "fair sale price,"⁸ it is too much to expect, however, that the courts will change to a more liberal interpretation of the "balance sheet test." And even with such a liberal construction the "balance sheet test" would still work injustice where the debtor, though his liabilities exceed the value of his property at the present time, shows every indication that he can pay off his debts if left alone. Under the present act such a debtor must rely on the wisdom of his creditors to keep out of the bankruptcy court. If three, or in some cases one,⁹ of his creditors, however unreasonably, decided to file a bankruptcy petition, the court would have no choice but to adjudicate the debtor a bankrupt. It is submitted that there should be substituted for the "balance sheet test" of insolvency a definition that not only would require consideration of all property that has debt-paying value regardless of its salability, but would in every case more nearly perform the true function of the test—that of determining whether a debtor should be adjudicated a bankrupt. Such a definition is the one suggested by Bonbright and Pickett, that "a person is insolvent who cannot fairly be expected, if left to his own devices, to pay off his debts . . . within a reasonable period of time."¹⁰

William F. Hood

⁸ 1 COLLIER, BANKRUPTCY, 14th ed., 76 (1940); *Irving Trust Co. v. Manufacturers' Trust Co.*, (D. C. N. Y. 1934) 6 F. Supp. 185, 25 Am. Bkcy. Rep. (N. S.) 503; *In re Hines*, (D. C. Ore. 1906) 144 F. 142, 16 Am. Bkcy. Rep. 295. "If the assets will not sell on the market within a reasonable time for enough to liquidate the debts, insolvency exists." *In re Studebaker Corp.*, (D. C. Ind. 1935) 9 F. Supp. 426 at 427, 27 Am. Bkcy. Rep. (N. S.) 616. But in the case of *In re Crystal Ice & Fuel Co.*, (D. C. Mont. 1922) 283 F. 1007 at 1009-1010, 49 Am. Bkcy. Rep. 396, the court said, "Salable value and fair valuation are not synonymous, and the conclusion 'wholly insolvent' because of the fact that the 'salable value' of the company's property was less than its debts may be and is proven to be not at all the insolvency of the Bankruptcy Act, viz. insufficiency of its property at fair valuation to pay its debts."

⁹ Sec. 59b of the Bankruptcy Act, 52 Stat. L. 868 (1938), 11 U. S. C. (Supp. 1939), § 95b, provides that if the debtor has less than twelve creditors, one creditor having a provable claim of \$500 or over may file a petition to have the debtor adjudged a bankrupt.

¹⁰ Bonbright and Pickett, "Valuation to Determine Solvency Under the Bankruptcy Act," 29 COL. L. REV. 582 at 621-622 (1929).