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BANKRUPTCY-RECEIVERSHIP AS BASIS FOR ACTION UNDER SECTION 77B

BANKRUPTCY — RECEIVERSHIP AS BASIS FOR ACTION UNDER SECTION 77B—The Bankruptcy Act, Section 77B(a),[1] provides that creditors with more than a fixed minimum of claims may file a petition proposing a corporate reorganization and stating "that such corporation is insolvent or unable to meet its debts as they mature and, if a prior proceeding in bankruptcy or equity receivership is not pending, that it has committed an act of bankruptcy within four months. . . ." On a petition which alleged no prior proceeding in bankruptcy nor any act of bankruptcy within four months but did allege the appointment of receivers in an action in the state court to foreclose a mortgage upon all of the debtor corporation's property, *held*, that the petition should be dismissed because this allegation did not show the existence of an equity receivership in the sense intended by the Bankruptcy Act. *In re 2168 Broadway Corp.*, (D. C. N. Y. 1935) 11 F. Supp. 404, affd., (C. C. A. 2d, 1935) 78 F. (2d) 678.

[1] 11 U. S. C., § 207(a).

The courts have not been in agreement as to the primary purpose of the so-called equity "consent" receivership as between liquidation and conservation. The federal courts appear to have taken the latter view.[2] A congressional committee appointed to examine the question leans in the same direction.[3] While there is general agreement that such receiverships look to a general administration of the assets of the corporation,[4] still the framers of the 1934 amendments to the Bankruptcy Act may have had in mind a certain fact situation rather than the precise connotation of a term when they employed the phrase "equity receivership." It is not unreasonable to argue that the situation contemplated was one in which some disposition of the whole property of the corporation was the primary aim of the receivership. In the instant case the mortgage was being foreclosed on the entire assets of the corporation.[5] Congress may very well have intended that this condition of affairs should not be met by the argument of the principal case that, though there was a receiver in equity, this was, nevertheless, not an equity receivership.[6] On the other hand, it is difficult to suppose that the appointment of a receiver in equity during foreclosure of a mortgage on property constituting ten per cent of the assets of a $10,000,000 corporation was intended to be a signal for creditors with aggregate claims in excess of $1000 to rush in and seek a reorganization.[7] Reason would indicate that the judge should exercise his discretion, refusing to take jurisdiction when it appears that the foreclosure proceedings for which a receiver has been appointed are of a temporary character and such that, when the proceedings are completed, the corporation will be able to continue business.[8] The courts do not appear willing,

[2] GLENN, LIQUIDATION, § 172 at p. 284 (1935).

[3] S. Rep. 365, 78 Cong. Rec. 3173, 3175 (1934). The phrase "if a prior proceeding in bankruptcy or equity receivership is not pending" was inserted by amendment to the proposed bill by Senator Hastings. 78 Cong. Rec. 7889 (1934). There was no discussion of the purpose with which this insertion was made. The original bill required insolvency in either the bankruptcy or equity sense plus an act of bankruptcy within four months. The insertion may be interpreted to mean that in such cases, an act of bankruptcy having been already committed as evidenced by the existence of a bankruptcy proceeding or an equity receivership, no act of bankruptcy need be alleged. Or, since it is not clear that the appointment of a receiver is an act of bankruptcy except where the debtor is insolvent in the bankruptcy sense of liabilities in excess of assets, it may be interpreted to mean that the existence of an equity receivership shall be grounds for jurisdiction though no act of bankruptcy has been committed. It is thus uncertain whether the insertion in the original bill was simply to clarify the existing expression or to actually amplify the grounds of jurisdiction.

[4] Glenn, "The Basis of the Federal Receivership," 25 COL. L. REV. 434-436 (1925).

[5] For a case involving most but not all of the corporate assets, see In re Draco Realty Corp., (D. C. N. Y. 1935) 11 F. Supp. 405.

[6] In re 2168 Broadway Corp., (C. C. A. 2d, 1935) 78 F. (2d) 678.

[7] For criticism on this point see Friendly, "Some Comments on the Corporate Reorganizations Act," 48 HARV. L. REV. 39 at 53 (1934).

[8] Such a discretion might well be employed under the provision of the Bankruptcy Act [§ 77B (a)] that the judge shall enter an order approving the petition if satisfied that it has been filed in good faith. See Sabel, "The Corporate Reorganizations Act," 19 MINN. L. REV. 34 at 51-52 (1934), and In re South Coast Co., (D. C. Del.

however, to distinguish between one foreclosure receivership and another. The cases either wholly include or wholly exclude the foreclosure receivership from the category of "equity receivership."[9] If one or the other of these positions must be chosen, the determination should be based upon several factors: (1) how often cases of foreclosure receiverships will arise like that in the principal case; (2) how likely the corporation itself will be to refuse to file a petition for reorganization, where this is desirable, if the creditor is denied the right to do so on a foreclosure receivership; (3) how much the purposes of Section 77B will be impaired if those cases in which the foreclosure receivership aims at the disposition of all or nearly all the corporation's assets are excluded from its operations. The problem is one which calls for clarification by a legislative expression of opinion. Preferably this would give the judge freedom to take or decline jurisdiction in cases of foreclosure receiverships according to whether or not the extent of the foreclosure indicates the need for general corporate reorganization.

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1934) 8 F. Supp. 43 at 44, holding that both a creditors' bill in equity and a petition for reorganization in bankruptcy are only brought in good faith when brought for the purpose of effecting a reorganization against a corporation in need of reorganization.

[9] Including the foreclosure receivership in equity receiverships: In re Granada Hotel Corp., (D. C. Ill. 1935) 9 F. Supp. 909, affd. in (C. C. A. 7th, 1935) 78 F. (2d) 409, holding that receiverships for dissolution of partnerships, for foreclosure of mortgages, for liquidation or conservation of assets are merely various species of the genus "equity receivership"; In re Surf Bldg. Corporation, (D. C. Ill. 1934) 11 F. Supp. 295; In re Flamingo Hotel Co., (D. C. E. D. Ill., Aug. 9, 1934), not reported. Excluding the foreclosure receivership as ground for jurisdiction (in addition to the principal case): In re Draco Realty Corp., (D. C. N. Y. 1935) 11 F. Supp. 405, arguing, as does the principal case, that only forms of receiverships looking toward liquidation are a basis for jurisdiction because "equity receivership" is used in the context in apposition to "proceeding in bankruptcy"; In re Broadway-Barclay Corp., (C. C. A. 2d, 1935) 78 F. (2d) 680, where receiver for foreclosure had not been appointed when creditors' petition was filed; and similarly In re Laclede Gas Light Co., (D. C. S. D. Mo., June 6, 1934), not reported, where the court thought that "pending" meant "in existence or going on." The implication of this latter case is that, if the receiver had been appointed before the petition was filed, there would have been a pending equity receivership. Favoring the view of the principal case, see Friendly, "Some Comments on the Corporate Reorganizations Act," 48 HARV. L. REV. 39 at 54, note 57 (1934). Drawing a distinction between foreclosure and equity receiverships in regard to acts of bankruptcy, Standard Accident Insurance Co. v. E. T. Sheftall & Co., (C. C. A. 5th, 1931) 53 F. (2d) 40.