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CONSTITUTIONAL LAW - BANK REORGANIZATION LEGISLATION - COMPOSITION WITH DEPOSITORS AND OTHER CREDITORS

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COMMENTS

CONSTITUTIONAL LAW — BANK REORGANIZATION LEGISLATION — COMPOSITION WITH DEPOSITORS AND OTHER CREDITORS — Twenty States[1] and the federal government[2] now have laws permitting the reorganization and reopening of insolvent or failing banks. The usual statute provides for the reorganization of a bank upon some plan ap-

[1] Ala. Gen. Laws (extra sess. 1933), act 161, sec. 2, p. 148; Fla. Gen. Acts (1933), c. 15879, sec. 5, p. 49; Idaho Laws (1933), c. 44, p. 58; Kan. Laws (1933), c. 80, sec. 1, p. 137; Ky. Statutes (Carroll 1933 Supp.), sec. 165a-64; Mich. Pub. Acts (1933), act 32, secs. 7, 7a; Minn. Laws (1933), c. 39, sec. 1, p. 38; Miss. Laws (1932), c. 251, p. 563; Mo. Laws (1933), p. 405; Neb. Laws (1933),c. 16, sec. 1, p. 128; Nev. Statutes (1933), c. 190, secs. 75, 79, 80; N. C. Public Laws (1933), c. 271, secs. 2, 7; N. D. Laws (1933), c. 72, sec. 16; Ohio Gen. Code (Page 1933 Supp.), sec. 710-89a; Okla. Laws (1933), c. 44, secs. 2, 5; Pa. Laws (1931), act 118, sec. 28; S. C. Acts (1932), act 649, p. 1183; S. D. Laws (1933), c. 51, sec. 1; Utah Laws (1933), c. 5, p. 7; Wis. Laws (Sp. Sess. 1931-32), c. 10, sec. 9.

[2] 48 Stat. 3, 72 (1933), U. S. C. tit. 12, sec. 207 (1933 Supp.).

proved by a large majority of the general creditors of the institution;[3] the plan must also have the approval of state banking officials and of a court of general jurisdiction, although the last is by no means a universal requirement. The reorganization, when approved, becomes binding upon all depositors and general creditors of the bank regardless of consent.[4] By the terms of a few statutes, non-assenting creditors are entitled to have a proportionate share of the assets set aside for liquidation under the ordinary procedure.[5]

Such legislation has raised and will raise serious constitutional questions. Creditors who have participated in the reorganization proceedings cannot be heard to complain of the plan adopted.[6] And reorganization statutes are valid insolvency statutes for the depositor or creditor whose claim accrues after they have become a part of the law;[7] they do not impair the obligation of a contract which is incurred after

[3] The federal statute and several others place the requirement at 75 per cent of the outstanding liabilities.

Some require as high as 90 per cent (Minnesota, Pennsylvania and Wisconsin), and the 1933 statute in North Dakota permits a determination by the bare majority of 51 per cent. Fifty per cent of the outstanding indebtedness suffices in Nevada. Michigan and Ohio do not require any approval by creditors; non-assenting creditors must act to prevent the reopening on a plan which the banking department presents or be bound by their silence. In North Carolina the reorganization is binding unless one-third of the interested parties object.

[4] See statutes cited in n. 1, supra.

Most of the state laws attempt to bind only the depositors and general creditors. For this reason no attempt to consider the power to bind minority stockholders has been made. However, the federal act, 48 Stat. 372, U. S. C. tit. 12, sec. 207 (1933 Supp.), attempts to bind the stockholders whenever their consent becomes necessary to some reorganization plan.

[5] Ohio Gen. Code (Page 1933 Supp.), sec. 710-89a; N. C. Public Laws (1933), c. 271, sec. 5; Utah Laws (1933), c. 5, p. 7. The Michigan statute provides that the court may decree payment to objectors in cash or the allocation of assets to claimants, or it may decree that objectors abide by the reorganization plan. Mich. Pub. Acts (1933), act 32, sec. 7.

[6] Hunt v. Roosen, 87 Minn. 68, 91 N. W. 259 (1902) (reorganization void); Hagan v. First State Bank, 180 Minn. 113, 230 N. W. 267 (1930) (acceptance of a renewal certificate for an old deposit estopped the action); Sueltz v. Bank of Hazelton, 61 N. D. 528, 238 N. W. 649 (1931); Griffin v. Allendale Bank, 160 S. C. 502 at 508, 158 S. E. 813 (1931). See BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE, sec. 248 (1930).

[7] Hoff v. First State Bank of Watson, 174 Minn. 36, 218 N. W. 238 (1928); In re Farmers' Exchange Bank, 55 S. D. 190, 225 N. W. 307 (1929); Farmers' and Merchants' Bank v. Tomlinson et al., 55 S. D. 185, 225 N. W. 305 (1929); McConville v. Fort Pierce Bank and Trust Co., 101 Fla. 727 at 734, 135 So. 392 at 395 (1931), the court assuming that the contractual relation came into existence after the effective date of the law. See note, 28 MICH. L. REV. 1052 (1930); comment, 30 MICH. L. REV. 934 at 935 (1932).

their effective date;[8] they enter into and become a part of the contract.[9] But constitutional questions are presented by statutory reorganization plans[10] which involve reduction or change in bank liabilities to non-

[8] Denny v. Bennett, 128 U. S. 489 at 495, 9 Sup. Ct. 134 (1888); Brown v. Smart, 145 U. S. 454 at 458, 12 Sup. Ct. 958 (1892).

[9] See Farmers' and Merchants' Bank v. Federal Reserve Bank, 262 U. S. 649 at 659, 43 Sup. Ct. 651 (1923).

[10] Although beyond the scope of this comment, it is well to point out that in practice it is possible that the reorganization agreements may vary the double liability of bank stockholders provided by constitutional and statutory provisions in thirty-eight States and by Congress unless the statutes specifically deny that power, as in Michigan, Minnesota and Utah. Mich. Pub. Acts (1933), act 32, sec. 15; Minn. Laws (1933), c. 39, sec. 1; Utah Laws (1933), c. 5, p. 7. However, courts may construe such legislation not to affect the prior law concerning stockholder liability. Sneve v. Hagen & Patterson, (S. D. 1933) 1 U. S. LAW WEEK 86; see opinion of the Attorney General of Michigan, 12 MICH. S. B. J. *253 (1933).

Assuming that procedural processes have fixed liability, a problem which involves a study of the statutes of each State (see 2 MICHIE, BANKS AND BANKING, sec. 71 *ff.* (1931)), the enforcement of such an agreement involves questions of impairing the obligation of contract and due process of law.

It would seem clear that liability imposed by state constitutions could not be affected by such agreement. See Golden v. Cervenka, 278 Ill. 409, 116 N. E. 273 (1917); Smith v. Olson, 50 S. D. 81, 208 N. W. 585 (1926); State ex rel. Spillman v. Citizens State Bank, 118 Neb. 337, 224 N. W. 868 (1929); Bush v. Lien et al., 57 S. D. 501, 234 N. W. 29 (1930); 2 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 1229 (1927).

If the liability is statutory, there is a question whether a change in such liability impairs contractual obligations. See Bernheimer v. Converse, 206 U. S. 516 at 529, 27 Sup. Ct. 755 (1907); Hawthorne v. Calef, 2 Wall. (69 U. S.) 10 at 23 (1864); Knickerbocker Trust Co. v. Myers, (C. C. M. D. Pa. 1904) 133 Fed. 764 at 767, aff'd (C. C. A. 3d, 1905) 139 Fed. 111; 1 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 582 *ff.* (1927); Kauper, "What is a 'Contract' under the Contracts Clause of the Federal Constitution?," 31 MICH. L. REV. 187 at 199, 200 (1932); comment, 18 CORN. L. Q. 261 at 262, 263 (1933). See BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE, sec. 273, p. 813 (1930). Courts have recently refused to apply such agreements against non-assenters on the theory of impairment. See Bush v. Lien et al., 57 S. D. 501, 234 N. W. 29 (1930); Engelcke v. Farmers' State Bank of Canistota, (S. D. 1932) 246 N. W. 288.

Then again there is the possibility that the public interest involved in the rehabilitation of banking institutions (Noble State Bank v. Haskell, 219 U. S. 104 at 111, 31 Sup. Ct. 186 (1911); 3 MICHIE, BANKS AND BANKING, sec. 14, p. 31 (1931)) may be sufficiently strong to override the private interest of creditors, as has the police power in other fields. See Dillingham v. McLaughlin, 264 U. S. 370 at 374, 44 Sup. Ct. 362 (1924); Atlantic Coast Line Ry. v. Goldsboro, 232 U. S. 548 at 558, 34 Sup. Ct. 364 (1914); Sutter Butte Canal Co. v. Railroad Commission, 279 U. S. 125 at 138, 49 Sup. Ct. 325 (1929). However, it may be questioned whether the arbitrary release of stockholders regardless of ability to meet liability is not a denial of due process and not necessarily in the public interest.

Still another problem is raised by federal legislation which is without the restraining effect of the obligation of the contracts clause (Legal Tender Cases, 12 Wall. (79 U. S.) 457 at 549 (1870)), although the Fifth Amendment does have a restraining effect similar to that on the States. The Sinking-Fund Cases, 99 U. S. 700 at

assenting creditors; such plans of reorganizing banks under state statutes must run the gauntlet of the contracts clause of the federal Constitution and the due process clause of the Fourteenth Amendment, while federal legislation of similar character must meet the test of the Fifth Amendment.

State Legislation

The clauses of state and federal constitutions forbidding the impairment of the obligation of contracts undoubtedly apply to the contractual relations between the bank and its creditors.[11] But banking is a business affected with a public interest, and is subject to regulation by the State.[12] Contracts in such a business may be subject to even more control in the public interest [13] than ordinary contractual rights between individuals which also must give way to some extent to laws intended for the public good.[14] The great public interest in restoring banking facilities and releasing credit to a large section of the population might be sufficient to override any private right to continue liquidation under the old laws and permit the alteration of the rights of non-assenting creditors of insolvent banks.

From the purpose and effect of such reorganization statutes, it is evident that they are insolvency laws. It is generally declared that state insolvency laws can have only prospective effect because of the obligation of contracts clause.[15] But it is possible to argue that the essential

718 (1878). Such legislation may raise a question as to the bankruptcy power granted in Art. I, sec. 8, to deal with the rights and liabilities of stockholders some of whom are solvent and able to meet their liabilities. See Garrison, "The Power of Congress over Corporate Reorganizations," 19 VA. L. REV. 343 at 344-346 (1933).

[11] Such laws relative to state banks are deemed to be insolvency or bankruptcy laws, and may be given prospective application, affecting those rights accruing after the laws become effective. See cases cited in n. 7, supra; Edwards v. Kearzey, 96 U. S. 595 at 603 (1877); Denny v. Bennett, 128 U. S. 489 at 495, 9 Sup. Ct. 134 (1888).

But insolvency statutes cannot be applied in ordinary cases to contracts existing at the time that the legislation was enacted. International Shoe Co. v. Pinkus, 278 U. S. 261 at 263, 49 Sup. Ct. 108 (1929). See 1 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 600 (1927).

[12] See discussion in Noble State Bank v. Haskell, 219 U. S. 104 at 111, 113, 31 Sup. Ct. 186 (1911).

[13] Atlantic Coast Line Ry. v. Goldsboro, 232 U. S. 548 at 558, 34 Sup. Ct. 364 (1914); Denver and Rio Grande R. R. v. Denver, 250 U. S. 241 at 243, 39 Sup. Ct. 450 (1919); Producers' Transportation Co. v. Railroad Commission, 251 U. S. 228 at 232, 40 Sup. Ct. 131 (1920); Arkansas Natural Gas Co. v. Arkansas Railroad Commission, 261 U. S. 379 at 382, 43 Sup. Ct. 387 (1923); Dillingham v. McLaughlin, 264 U. S. 370 at 374, 44 Sup. Ct. 362 (1924); Sutter Butte Canal Co. v. Railroad Commission, 279 U. S. 125 at 138, 49 Sup. Ct. 325 (1929). See 32 COL. L. REV. 476 at 479 (1932).

[14] Manigault v. Springs, 199 U. S. 473 at 480, 26 Sup. Ct. 127 (1905).

[15] Ogden v. Saunders, 12 Wheat. (25 U. S.) 212 at 295 (1827). 1 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 600 (1927).

contractual obligation is actually unimpaired by such statutory plans as those in question. These are provisions of a procedural character for the liquidation of insolvent banks. The Supreme Court has held that the obligation of a contract does not include the then existing remedies which are afforded for the enforcement of the contract rights; contracts are made with reference to the power to change methods of procedure.[16] It is true that changes in the remedy may be so fundamental as to impair the obligation.[17] But it must also be remembered that many of the early decisions on the validity of state insolvency laws were made with reference to cases where private rights alone were involved, and where there was no need to consider the effect which the presence of a strong public interest might have.

[16] Oshkosh Waterworks Co. v. Oshkosh, 187 U. S. 437 at 439, 23 Sup. Ct. 234 (1903):

"It is well settled that while, in a general sense, the laws in force at the time a contract is made enter into its obligation, parties have no vested right in the particular remedies or modes of procedure then existing. It is true that the Legislature may not withdraw all remedies, and thus, in effect, destroy the contract; nor may it impose such new restrictions or conditions as would materially delay or embarrass the enforcement of rights under the contract according to the usual course of justice as established when the contract was made. Neither could be done without impairing the obligation of the contract. But it is equally well settled that the Legislature may modify or change existing remedies or prescribe new modes of procedure, without impairing the obligations of contracts, provided a substantial or efficacious remedy remains or is given, by means of which a party can enforce his rights under the contract."

In Henley v. Myers, 215 U. S. 373 at 385, 30 Sup. Ct. 148 at 152 (1910), it was said:

"Equally without merit is the contention that the statute of 1899 impaired the obligations of the stockholders' contract, in that it substituted for individual actions against them a suit in equity by a receiver appointed after judgment against the corporation. In becoming stockholders the defendants did not acquire a vested right in any particular mode of procedure adopted for the purpose of enforcing their liability as stockholders. It is a well-established doctrine that mere methods of procedure in actions on contract that do not affect the substantial rights of parties are always within the control of the State. It is to be assumed that parties make their contracts with reference to the existence of such power in the State."

Since this comment was written, the Supreme Court has sustained an attack, based upon the Fourteenth Amendment, against a South Carolina Emergency Banking Act which materially altered the procedural processes for the control and liquidation of banks; the bases for the decision were that there is no property in any particular form of remedy, and that there was no showing of an impairment of substantive rights which existed under old laws. Gibbs v. Zimmerman, (U. S. Sup. Ct. 1933) 1 U. S. LAW WEEK 236.

[17] Bronson v. Kinzie et al., 1 How. (42 U. S.) 311 at 319 (1843); Edwards v. Kearzey, 96 U. S. 595 at 607 (1877). The question in each case was whether the change in remedy was so vital as to impair the obligation. The principle holds good today, but it may be doubted whether the same literal interpretation would be given; the growing recognition of the public's interest has been a vital, if not all-important factor, in the decisions of recent years.

Some modern decisions take the view that such statutes impair the obligation of contracts. Their viewpoint seems very technical; they refuse to recognize the possibility that a change in the method of liquidation through a reorganization may cause no loss to the creditors; the slightest change is deemed sufficient to condemn the legislation.[18] Other courts have taken the position that the creditors have no absolute right to continue liquidation if that procedure is unnecessary to secure their rights. Their position is that the bank is already insolvent and unable to meet its obligations, that each creditor has a claim against the assets, that the creditor is confronted with a possible loss, that the purpose of such statutes is to afford an opportunity to mitigate losses as a whole and thereby lessen the loss of each depositor.[19] Viewed in this manner, a change of remedy which in fact offers a chance that everyone will lose less from the fact of insolvency is reasonable and perhaps a change which does not even technically impair the obligation of contracts. Even if partial impairment is conceded, the great public interest attached to such important legislation[20] for the pub-

[18] Engelcke v. Farmers' State Bank of Canistota, (S. D. 1932) 246 N. W. 288 at 291:

> "The defendants urge that there is nothing to indicate as a matter of fact that the plaintiffs have suffered any loss by reason of the reorganization agreement; that whatever loss the depositors will suffer has been caused by reason of the insolvency of the bank, and not by any action to reinstate the bank as a going concern. This, however, is not the test. If there is any encroachment 'in any respect on its obligation, dispensing with any part of its force,' it constitutes impairment of the obligation of the contract."

See Hessen Siak Shams v. Nebraska State Bank, (D. C. Neb. 1931) 48 F. (2d) 894. This decision cannot definitely be classed with the narrow view expressed above because various other factors, among them the fact that the creditor was a non-resident, influenced the decision.

[19] Dorman v. Dell, 245 Ky. 34 at 39, 52 S. W. (2d) 892 (1932); Milner v. Gibson, 61 S. W. (2d) 273 at 277 *ff.* (1933). See McConville v. Fort Pierce Bank and Trust Co., 101 Fla. 727, 135 So. 392 (1931), which intimates that the police power is competent to make such changes, although it was assumed that the particular plaintiff's rights did not accrue prior to the statute.

[20] It is also important to bear in mind that circumstances of time and place may render valid regulations which would be inappropriate at other times; indeed the public need for the legislation in view of an existing emergency may be of great importance in determining whether legislation is constitutional. In the Legal Tender Cases, 12 Wall. (79 U. S.) 457 at 540 (1870), it was expressed this way:

> "This brings us to the inquiry whether they were, when enacted, appropriate instrumentalities for carrying into effect, or executing any of the known powers of Congress, or of any department of the government. *Plainly to this inquiry, a consideration of the time when they were enacted, and of the circumstances in which the government then stood, is important. It is not to be denied that acts may be adapted to the exercise of lawful power, and appropriate to it, in seasons of exigency, which would be inappropriate at other times.*" (Italics by the writer).

lic good seems sufficient to justify the exercise of the police power.[21]

Perhaps not every reorganization plan could be justified on this basis. A particular scheme may be arbitrary and unreasonable under its circumstances, and, without the support of public interest, would fall before the claims of private right. Some of the reorganization statutes provide that approval of both the state banking department and a court of general jurisdiction is necessary; others only require the approval of an administrative official. For example, one scheme authorized by the Michigan statute provides for imposition of a reorganization plan by the banking commissioner acting alone, which shall be binding on creditors unless objection is made in a court within thirty days after notice of the plan is given.[22] But whether there is provision for judicial review either before or after a plan is adopted is immaterial, due process seems satisfied in either instance; the legislature has considerable discretion in determining at what stage in the proceedings a hearing shall take place and the manner of its conduct,[23] provided an adequate op-

See Wilson v. New, 243 U. S. 332 at 348, 37 Sup. Ct. 298 (1917); comments, 32 MICH. L. REV. 63 at 67 (1933); 32 MICH. L. REV. 71 at 74 (1933).

On the other hand we must obey the injunction of Mr. Justice Holmes that a strong public desire is not enough to warrant a disregard of the Constitution: "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. As long recognized some values are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits or the contract and due process clauses are gone." And again, in speaking of the prohibitions against taking property without compensation under the Fifth and Fourteenth Amendments: "When this seemingly absolute protection is found to be qualified by the police power, the natural tendency of human nature is to extend the qualification more and more until at last private property disappears. But that cannot be accomplished in this way under the Constitution of the United States." Pennsylvania Coal Co. v. Mahon, 260 U. S. 393 at 413, 415, 43 Sup. Ct. 158 at 159, 160 (1922).

[21] Milner v. Gibson, 61 S. W. (2d) 273 at 278 (1933):

> "When the public welfare demands the exercise of the sovereign right of the government for its protection, and private contracts intervene, they must yield to the right of the sovereign to exercise the police power. . . . While exercising the police power, the state may alter, enlarge, modify, or limit existing methods of procedure, or substitute or provide others without impairing contracts, if a sufficient one be left or provided. . . . Parties to contracts have no right in the protection of remedies existing at the time of entering into the contract, and the state may at liberty change them if a substantial, efficacious remedy remains, or is given, by means of which a party to it may enforce his rights under the contract."

[22] Mich. Pub. Acts (1933), act 32, sec. 7.

[23] Even with respect to statutes which make no provision for a judicial review, that fact alone is not a denial of due process; it is not necessary that every determination of law or fact which may result in a deprivation of liberty or property be made by a judicial tribunal. Den ex dem. Murray v. Hoboken Land and Improvement Co., 18 How. (59 U. S.) 272 at 280 (1855); Springer v. United States, 102 U. S. 586 (1880); Bates and Guild Co. v. Payne, 194 U. S. 106 at 109, 24 Sup. Ct. 595 (1904); United States v. Ju Toy, 198 U. S. 253, 25 Sup. Ct. 644 (1905).

portunity is afforded before final judgment.[24] As pointed out above,[25] the usual requirement is that three-fourths or more of the creditors agree upon a plan before it may be approved. Any plan which secures the approval of so large a group must have elements of reasonableness,[26] though of necessity some compromise is likely. But it does not seem unreasonable that a reorganization plan drawn up by a state banking official, as in Michigan,[27] after consultation with the creditors would be as fair as one approved by a majority of the creditors, and doubtless the time element in securing a reopening by this method favors it. With an opportunity for judicially testing the adopted plan for reasonableness, either procedure does not seem arbitrary. Rather it seems more unreasonable to permit a minority to thwart the efforts of officials and a majority of the creditors to effect a plan which promises to mitigate losses.

An interesting procedure is afforded by a few States[28] which permit non-assenting creditors to have a proportionate share of the assets of the insolvent banks set aside for liquidation under ordinary, existing methods. No room is left for this class to complain that their contract with the bank is being impaired because of a material change in the remedy affecting liquidation of insolvent banks.

So far in the discussion, no attempt has been made to distinguish between resident and non-resident creditors. The reorganization statutes do not attempt to confine their application to residents, but recently a state court refused to apply its statute to a non-resident creditor.[29] The reason given for the decision has a long history, apparently beginning with the idea that the extension of a State's power beyond its boundaries is incompatible with the rights of other States,[30] that the laws of one State can have no force or application beyond its own limits.[31]

[24] Clark v. Mitchell, 64 Mo. 564 (1877); Davis v. Florida Power Co., 64 Fla. 246, 60 So. 759 (1912); Shealy v. Seaboard Air Line Ry., 131 S. C. 144, 126 S. E. 622 (1924); Backus v. Fort Street Union Depot Co., 169 U. S. 557 at 569, 18 Sup. Ct. 445 (1898); People v. Webb, 16 Hun. (N. Y.) 42 (1878).

[25] See n. 3, supra.

[26] Where the approving court requires that the reorganization plan be reasonable, due process seems satisfied. Amos v. Conkling, 99 Fla. 206 at 220, 221, 126 So. 283 (1930); Dorman v. Dell, 245 Ky. 34 at 39, 52 S. W. (2d) 892 (1932).

[27] Even under the Michigan statute, an objector may challenge the reopening plan, and it must be assumed that its reasonableness will be determined or its operation will be enjoined. See n. 22, supra.

[28] Ohio Gen. Code (Page 1933 Supp.), sec. 710-89a; N. C. Public Laws (1933), c. 271, sec. 5; Utah Laws (1933), c. 5, p. 7; Mich. Pub. Acts (1933), act 32, sec. 7, at discretion of the court.

[29] Hornick, More & Porterfield v. Farmers' and Merchants' Bank, 56 S. D. 18, 227 N. W. 375 (1929); note, 43 HARV. L. REV. 1154 (1930).

[30] Ogden v. Saunders, 12 Wheat. (25 U. S.) 213 at 366-369 (1827).

[31] Cook v. Moffat et al., 5 How. (46 U. S.) 295 at 310 (1847).

But it is well to consider the nature of the reorganization statutes. They seem clearly to be insolvency laws, and there is practically no distinction now between insolvency and bankruptcy laws.[32] Congress as yet has passed no law for bankrupt banks, so that the States are free to enact and enforce laws in this field until Congress acts.[33] What, then, is the nature of a proceeding in bankruptcy? Is it a personal action or is it rather in the nature of a proceeding *in rem*? If it is a personal action which seeks to settle the rights of creditors beyond the state boundaries, concededly it cannot affect the rights of non-assenting non-residents.[34] However, the Supreme Court has consistently said that proceedings in bankruptcy are in the nature of proceedings *in rem*[35] which determine the status of the debtor.[36] Thus the bankruptcy or insolvency law, which purports to discharge absolutely, should not be judged by the jurisdictional standards set up for personal actions. Despite the long line of statements to the effect that insolvency laws cannot discharge the debt held by a citizen of another State since they have no extra-territorial effect,[37] it seems that these declarations fail to recog-

[32] See JONES, INSOLVENT AND FAILING CORPORATIONS, sec. 21, p. 20 (1908).

[33] Sturges v. Crowninshield, 4 Wheat. (17 U. S.) 122 at 196 (1819); Ogden v. Saunders, 12 Wheat. (25 U. S.) 213 at 281, 313, 357 (1827).

[34] Pennoyer v. Neff, 95 U. S. 714 (1877).

[35] Shawhan v. Wherritt, 7 How. (48 U. S.) 627 at 643 (1849); New Lamp Chimney Co. v. Ansonia Brass and Copper Co., 91 U. S. 656 at 661 (1875).

[36] Hanover Nat. Bank v. Moyses, 186 U. S. 181 at 192, 22 Sup. Ct. 857 at 862 (1902):

> "Proceedings in bankruptcy are, generally speaking, in the nature of proceedings *in rem* . . . it was ruled that a decree adjudging a corporation bankrupt is in the nature of a decree *in rem* as respects the *status* of the corporation. Creditors are bound by the proceedings in distribution on notice by publication and mail, and when jurisdiction has attached and been exercised to that extent, the court has jurisdiction to decree discharge, if sufficient opportunity to show cause to the contrary is afforded, on notice given in the same way. The determination of the *status* of the honest and unfortunate debtor by his liberation from encumbrances on future exertion is matter of public concern, and Congress has power to accomplish it throughout the United States by proceedings at the debtor's domicil. If such notice to those who may be interested in opposing discharge, as the nature of the proceeding admits, is provided to be given, that is sufficient. Service of process or personal notice is not essential to the binding force of the decree."

[37] Cook v. Moffat, 5 How. (46 U. S.) 295 at 310 (1847); Baldwin v. Hale, 1 Wall. (68 U. S.) 223 at 234 (1863), in which it is said that legal notice cannot be given, and there can be no obligation to appear, or any legal default; Denny v. Bennett, 128 U. S. 489 at 497, 9 Sup. Ct. 134 (1888); Brown v. Smart, 145 U. S. 454 at 457, 12 Sup. Ct. 958 (1892). See International Shoe Co. v. Pinkus, 278 U. S. 261 at 263, 49 Sup. Ct. 108 (1829), where the statement is gratuitously repeated.

In Gilman v. Lockwood, 4 Wall. (71 U. S.) 409 at 411 (1866), the following reason was given: "Insolvent laws of one State cannot discharge the contracts of citizens of other States; because such laws have no extra territorial operation, and consequently the tribunal sitting under them, unless in cases where a citizen of such other State voluntarily becomes a party to the proceedings, has no jurisdiction of the case."

nize the bankruptcy proceeding in its true nature as an *in rem* action.[38] It seems that the judges who made these statements failed to distinguish between the problem of jurisdiction and the problem of due process in giving notice. If the proceeding is *in rem*, the status to be determined, the condition of the insolvent debtor is something within the jurisdiction of the local court; the court has the power to determine the status for all purposes and as against all persons. Due process of procedure, however, requires that notice of the proceeding be given to non-residents (among others) by such means as are reasonable under the circumstances. As it works out, jurisdiction is obtained, and notice is sent to the non-resident creditor of that fact. Actually there is no attempt to enforce the laws of the debtor's State at the residence of the non-assenting creditor; his rights may be affected, but not because of the application of the laws of another State, rather because it is necessary to the determination of a status over which the court of the debtor's State has jurisdiction.

In a well-known case the Supreme Court recognized as a matter of comity that a corporate reorganization carried out under the terms of a Canadian statute, in the nature of a special bankruptcy act, was binding upon the creditors of the Canadian corporation in the United States.[39] The Court admitted that the laws of Canada could have no extra-territorial force, but recognized that things done under authority of law in one country may be of binding effect in another country. However, the decision might be distinguished on the narrow ground that the contract was made with reference to the laws of the State of incorporation;[40] indeed, the Court made this point.[41] If the dissenting opinion[42] of Mr. Justice Harlan correctly interprets the actual *ratio*

[38] Bailey, in an able discussion, "A Discharge in Insolvency; and its Effect on Non-residents," 6 HARV. L. REV. 349, esp. pp. 358, 360, 362, 364 (1893), contends that the action is a determination of status, an *in rem* proceeding which does not require the same type of notice as a personal action. The problem is carefully discussed by KENNERLY, JUDICIAL CONTROL OF CORPORATE REORGANIZATIONS IN CONNECTION WITH RECEIVERSHIP AND FORECLOSURE PROCEEDINGS 247-254 (1933) (unpublished thesis in the Library of the University of Michigan Law School).

[39] Canada Southern Ry. v. Gebhard, 109 U. S. 527 at 539, 3 Sup. Ct. 363 (1883). *Cf.* the early decision in McMillan v. McNeill, 4 Wheat. (17 U. S.) 209 (1819).

[40] Note, 43 HARV. L. REV. 1154 (1930).

[41] Canada Southern Ry. v. Gebhard, 109 U. S. 527 at 538, 3 Sup. Ct. 363 at 370 (1883):

> "He is conclusively presumed to have contracted with a view to such laws of that government, because the corporation must of necessity be controlled by them, and it has no power to contract with a view to any other laws with which they are not in entire harmony. It follows, therefore, that anything done at the legal home of the corporation, under the authority of such laws, which discharges it from liability there, discharges it everywhere."

[42] 109 U. S. 527 at 544, 3 Sup. Ct. 363 at 375 (1883), where he cites Baldwin

decidendi of the majority, the Court intended to give full effect to the Canadian composition in bankruptcy in a larger sense. Quite apart from this decision, treating the insolvency or bankruptcy proceedings with reference to an insolvent corporation as an action *in rem*, there is every reason of practical policy why such a determination should have the same effect in other States[43] as any other *in rem* proceeding, despite the line of judicial statements mentioned above.[44]

Federal Legislation

The reorganization provisions of Section 207 of the Federal Banking Act are no less destructive of contract rights of depositor and creditor than are those of the state legislation. Any plan approved by the Comptroller and by three-fourths of the creditors may become binding upon the remaining creditors regardless of consent.[45] Although the federal government is not forbidden by the Constitution to impair the obligation of contracts, the due process clause of the Fifth Amendment offers a protection to bank creditors comparable to that against arbitrary state action.[46] On the other hand, every argument of public interest already made in favor of state reorganization plans is equally applicable to support the power of Congress to control and regulate the national banking system and need not be repeated here.

However, it does not seem essential for Congress to rely solely upon its fiscal powers. There is a constitutional grant of power over bankruptcies to Congress; and it is obvious that Congress may impair the obligation of existing contracts by passing a bankruptcy statute.[47] Under the present bankruptcy law, banking corporations are not among those who may become bankrupts.[48] A law does not have to be labeled under a definite constitutional provision in order to be authorized; it is the effect of the law and the possibility of sustaining it under some recognized basis of power in the federal Constitution which is import-

v. Hale, 1 Wall. (68 U. S.) 223 (1863), Story, and Chancellor Kent for the proposition that a discharge under a state law will not discharge a debt due to a citizen of another State not a voluntary party to the proceeding.

[43] If these bank reorganization acts may be applied to existing contracts, the nonresident should be affected equally with the resident. Unless the debtor is able to start free from all obligations everywhere he is seriously handicapped.

[44] See cases cited in n. 37, supra.

[45] 48 Stat. 3, 72 (1933), U. S. C. tit. 12, sec. 207 (1933 Supp.).

[46] Legal Tender Cases, 12 Wall. (79 U. S.) 457 at 550, 551 (1870). See United States v. Northern Pacific Ry., 256 U. S. 51 at 64, 41 Sup. Ct. 439 (1921).

[47] Legal Tender Cases, 12 Wall. (79 U. S.) 457 at 549 (1870):

"Nor can it be truly asserted that Congress may not, by its action, indirectly impair the obligation of contracts, if by the expression be meant rendering contracts fruitless, or partially fruitless. Directly it may, confessedly, by passing a bankrupt act, embracing past as well as future transactions."

[48] 30 Stat. 547 (1898), U. S. C. tit. 11, sec. 22 (1926).

ant.[49] The federal bank reorganization statute provides for an arrangement with creditors which is essentially a composition in bankruptcy and the return of the bank to active business according to the terms of the reopening plan;[50] all creditors are bound by the agreement reached by the majority. It operates as a bankruptcy law for national banks.[51] If this conclusion is correct, this act of Congress is warranted both by its power to legislate concerning the banking system and by its bankruptcy power.

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[49] Notable cases in which the Supreme Court found a basis of power to which Congress made no reference in its legislation are: McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316 at 407 *ff.* (1819); Legal Tender Cases, 12 Wall. (79 U. S.) 457 at 539, 540 (1870); Julliard v. Greenman, 110 U. S. 421 at 447-450, 4 Sup. Ct. 122 (1884).

[50] The result sought reaches the purpose of the bankruptcy laws — to make distribution to the creditors and permit the debtor a fresh start free from crushing burdens. Williams et al. v. United States Fidelity & Guaranty Co., 236 U. S. 549 at 554, 35 Sup. Ct. 289 (1915).

[51] That Congress has this power seems to be unquestioned. See Garrison, "The Power of Congress over Corporate Reorganizations," 19 VA. L. REV. 343 (1933).

Although it is not within the scope of this comment, the above-mentioned article ventures a prediction that Congress under its bankruptcy powers may bind minority stockholders to the reorganization agreement. Section 207 of the banking act provides that two-thirds of the outstanding capital stock shall bind all others.

As to the bankruptcy power over stockholders and creditors generally, see ROSENBERG, CORPORATE REORGANIZATION AND THE FEDERAL COURT 12-27 (1924).