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BANKRUPTCY-JURISDICTION OF BANKRUPTCY COURT TO DETERMINE STOCKHOLDERS' VOTE NECESSARY TO APPROVE PROPOSED SALE OF CORPORATION'S ASSETS TO DEBTOR IN REORGANIZATION

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BANKRUPTCY—JURISDICTION OF BANKRUPTCY COURT TO DETERMINE STOCKHOLDERS' VOTE NECESSARY TO APPROVE PROPOSED SALE OF CORPORATION'S ASSETS TO DEBTOR IN REORGANIZATION—Lessee railroad, which had leased and operated property of lessor railroad for many years, entered reorganization under section 77 of the Bankruptcy Act.¹ Under the plan of reorganization promulgated by the Interstate Commerce Commission and approved by the bankruptcy court, lessor was given the alternative of selling its property to the reorganized railroad or having the lease disaffirmed by the debtor and its property returned. This proposal was submitted for acceptance by a majority vote of lessor's stockholders. Respondents, stockholders of lessor, sought an injunction in a state court of Georgia to restrain lessor's officers from certifying the acceptance in the event that a majority approved the sale, on the theory that state law prevented the sale of all corporate assets without unanimous approval by the stockholders. Before the state court acted, a majority of lessor's stockholders voted to approve the sale. The bankruptcy court then confirmed the plan, found the acceptance valid under state law and enjoined respondents from further prosecution of the action in the state court. Despite this, the state court enjoined lessor's officers from selling its property. The bankruptcy court then permanently enjoined prosecution of the state action and declared the state court injunction void. This decree was reversed by the circuit court of appeals.² On certiorari to the United States Supreme Court, *held*, affirmed (two justices dissenting). The bankruptcy court had no jurisdiction to enjoin the suit in the state court, since the controversy did not involve property of the debtor within the exclusive jurisdiction of the court under section 77. *Callaway v. Benton*, 336 U. S. 132, 69 S. Ct. 435 (1949).

The Court was unanimous in holding that state law should apply, since the bankruptcy court has no statutory authority to apply federal law to a question like the one presented in the principal case.³ The important question facing the Court was whether the bankruptcy court had exclusive jurisdiction to inter-

¹ 49 Stat. L. 911 (1935), 11 U.S.C.A. (Supp. 1948) §205.

² *Benton v. Callaway*, (C.C.A. 5th, 1948) 165 F. (2d) 877.

³ See *Palmer v. Massachusetts*, 308 U.S. 79, 60 S.Ct. 34 (1939); *Seaboard Air Line R. Co. v. Daniel*, 333 U.S. 118, 68 S.Ct. 426 (1948); and cf. *Schwabacher v. United States*, 334 U.S. 182, 68 S.Ct. 958 (1948), where federal law was applied rather than state law. See Meck, "The Problems of the Leased Line," 7 LAW AND CONT. PROB. 509 (1940).

pret the applicable state law. Under section 77a, the bankruptcy court has exclusive jurisdiction over the debtor and its property in a reorganization proceeding.⁴ The courts have applied traditional concepts in defining the term property to include the debtor's estate in its actual or constructive possession; thus the court may determine all claims and rights pertaining thereto.⁵ But the exclusive jurisdiction of the bankruptcy court does not include all controversies that in some way affect the debtor's estate.⁶ In the principal case, the majority of the Court held that since the controversy involved the reversion in fee, the bankruptcy court lacked jurisdiction; a question of internal management of the lessor railroad was presented, rather than a controversy concerning property of the lessee under section 77a.⁷ Petitioner further argued that the injunction was valid because the bankruptcy court has the power to enjoin any action which delays the formulation or promulgation of a reorganization plan.⁸ There was, however, no finding by the bankruptcy court of any delay resulting from the state court action. In the strong dissent of Justice Douglas, in which Justice Rutledge joined, it was argued that section 77 gives the bankruptcy court exclusive jurisdiction over acceptance and confirmation of the plan in all its phases, and that it was not the intent of Congress to restrict the court's exclusive jurisdiction to protection of the debtor's property. It is difficult to find a basis for this contention in the statute. Justice Douglas' position is based on language in section 77e⁹ which deals, not with a sale by a corporation to the debtor in reorganization, but with acceptances of the plan by creditors of the debtor who have properly filed claims under section

⁴ See note 1, *supra*.

⁵ *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478, 60 S.Ct. 628 (1940); 6 COLLIER ON BANKRUPTCY, 14th ed., ¶3.05 (1947). For cases interpreting sec. 77a, see *Ex parte Baldwin*, 291 U.S. 610, 54 S.Ct. 551 (1934); *Warren v. Palmer*, 310 U.S. 132, 60 S.Ct. 865 (1940); *New York Trust Co. v. New York & Greenwood Lake Ry. Co.*, (C.C.A. 3d, 1946), 156 F. (2d) 701. In *re Pittsburgh Rys. Co.*, (C.C.A. 3d, 1946) 155 F. (2d) 477, the lessor was brought into the reorganization proceeding because the lessor and lessee were treated as one corporation, so that jurisdiction over the lessee also embraced the lessor. From the facts in the principal case there is some basis for arguing that the transportation system should have been treated as an entity, since it was operated as a single unit for many years.

⁶ *Arkansas Corp. Comm. v. Thompson*, 313 U.S. 132, 61 S.Ct. 888 (1941); In *re Central R. Co.*, (C.C.A. 3d, 1944) 163 F. (2d) 44; *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467 (1947); *Thompson v. Terminal Shares, Inc.*, (C.C.A. 8th, 1939) 104 F. (2d) 1.

⁷ See *Group of Institutional Investors v. Chi., M. St.P. & P.R. Co.*, 318 U.S. 523, 63 S.Ct. 727 (1942). Although the Court there stated that the bankruptcy court had not treated lessor's property as property of the lessee debtor for reorganization purposes, the question of the court's power to do so was not raised.

⁸ This power rests on the inherent powers of a court of equity to prevent the defeat or impairment of its jurisdiction, under 28 U.S.C.A. (Supp. 1948) §1651; and under §2 (15) of the Bankruptcy Act, 11 U.S.C.A. §11 (191) 1927, which gives the bankruptcy court power to issue such orders as may be necessary to enforce the provisions of the act. See *Continental Ill. Natl. Bk. & Trust Co. of Chi. v. Chi., R. I. P. R. Co.*, 294 U.S. 648, 55 S.Ct. 595 (1935); In *re Boston Terminal* (D.C. Mass. 1947) 71 F. Supp. 472; *Thompson v. Tex. Mex. R. Co.*, 328 U.S. 134, 66 S.Ct. 937 (1946).

⁹ Note 1, *supra*. This section states that the judge shall confirm the plan if it has been accepted by creditors holding two-thirds in amount of the total allowed claims and if such acceptances have not been made or procured by any means forbidden by law.

77c.¹⁰ It seems clear that Congress did not intend to give the court broad power over all problems affecting the reorganization proceedings,¹¹ and there appears to be no reason why the bankruptcy court should determine matters concerning the internal management of a corporation which are involved in the reorganization proceedings only because of past business transactions with the debtor.

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¹⁰ Note 1, *supra*. Lessor is a creditor in the proceedings only by virtue of its claims against the debtor under the lease and for the breach of the lease. Principal case at 146-147.

¹¹ See *Leiman v. Guttman*, 336 U.S. 1, 69 S.Ct. 371 (1949), where broad power was given to the reorganization court, including authority over all fee agreements payable out of non-estate funds.