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## Bankruptcy: Proceedings Under Section 77B: Voluntary Petition Filed by a Dissolved Corporation

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settled; but the grouping of the facts under a stated theory may be difficult. "The essential point in this regard is that the article should reach the ultimate consumer or user subject to the same defect as it had when it left the manufacturer . . . At most, there might in other cases be a greater difficulty of proof of the fact."<sup>80</sup> Once the legal relations are adequately proved, there is more than ample authority to believe that recovery will lie.

CHESTER JOHN NIEBLER.

**BANKRUPTCY—PROCEEDINGS UNDER SECTION 77B—VOLUNTARY PETITION FILED BY A DISSOLVED CORPORATION.**—Section 77B of the Bankruptcy Act has been in effect for almost four years.<sup>1</sup> Section 77 was adopted a year earlier.<sup>2</sup> The general scheme of each section is the same. Bankruptcy courts are authorized to protect the assets of certain corporation-debtors from the processes usually available to creditors, not merely as a preliminary step in a controlled liquidation of assets, but to preserve the assets and to permit the working out of a plan for reorganization which may include participation by stockholder groups in the future operation of the properties.<sup>3</sup> Each court has wide territorial jurisdiction.<sup>4</sup> Eventually the particular court will have to consider the fairness of any proposed plan for reorganization and must confirm it before the plan can be put into effect. The constitutionality of this general scheme was considered in *Continental Bank v. C. R. I. & P. Ry. Co.*<sup>5</sup> The Supreme Court held that Section 77 was a bankruptcy

<sup>80</sup> Grant v. Australian Knitting Mills, [1936] A.C. 85, 106. See, Bourcheix v. Willowbrook Dairy, 268 N.Y. 1, 196 N.E. 617 (1935).

<sup>1</sup> 48 STAT. 912 (1934), 49 STAT. 965 (1935), 50 STAT. 622 (1937), 11 U.S.C.A. § 207 (1937).

<sup>2</sup> 47 STAT. 1474 (1933), 49 STAT. 911 (1935), 49 STAT. 1969 (1936), 11 U.S.C.A. § 205 (1937).

<sup>3</sup> The principal reason for enacting Section 77B was probably to provide a scheme for preserving stockholders' equities. But the Section has been used by creditors as well as by stockholders and to promote reorganizations in which stockholder groups have not been interested. It has been used by secured creditor groups to facilitate their reaching the properties covered by their security devices and to permit them to avoid having to resort to the usual processes of foreclosure. *In re Church Street Bldg. Corp'n.*, 299 U.S. 24 (1936); *In re Witherbee Court Corp'n.*, 88 F. (2d) 251 (C.C.A. 2d, 1937). It has been used by one group of creditors to force recognition by other groups of creditors of interests which might have been endangered by a foreclosure sale or by a continuation of the foreclosure receivership. *In re Knickerbocker Hotel Co.*, 81 F. (2d) 981 (C.C.A. 7th, 1936).

<sup>4</sup> See Subsection (a) of the statute; see also (1937) 21 MARQ. L. REV. 87; Texas Co. v. Hauptman, 91 F. (2d) 449 (C.C.A. 9th, 1937).

<sup>5</sup> 294 U.S. 648 (1935). The statute provides in Subsection (b) that any plan must be submitted before confirmation for approval by prescribed majorities of each class of creditors and stockholders that will be affected by the plan. In any event no plan is to be confirmed which is not fair and feasible. [Subsection (f).] Provision is also made for approval on condition where the prescribed majorities do not consent. [Subsection (b) (4) and (5).] It is suggested here that protests against confirmation of particular plans are not likely to be decided on "constitutional" grounds. See *Downtown Investment Co. v. Boston Metropolitan Bldg.*, 81 F. (2d) 314, 323 (C.C.A. 1st, 1936). The Court has already approved the general plan of the Section. The confirming of any plan that is not fair and feasible is an abuse of discretion. See *Tennessee Publishing Co. v. American Nat'l Bank*, 299 U.S. 18 (1936).

statute and that it was covered by the bankruptcy clause of the Constitution. That decision anticipated and settled the same question of constitutionality as it might have been presented in a case under Section 77B.

Recently the Supreme Court has decided that a dissolved corporation lacks capacity to file a voluntary original petition to put this scheme in motion.<sup>6</sup> In the particular case the debtor-corporation had been dissolved by the local courts on a motion by a state official because the corporation had failed to pay its franchise tax.<sup>7</sup> When the original petition was filed for approval the corporation's properties were still in the control of a receiver appointed by a state court in a foreclosure action. The two-year period prescribed by the local statute for the winding up of the corporation's affairs had expired. The court which had approved the debtor's original petition appointed a temporary trustee to administer the property and refused to dismiss the proceedings on the motion of certain secured creditors. The court's order was affirmed by the circuit court of appeals. The decree of the appellate court was reversed by the Supreme Court. Mr. Justice Sutherland, speaking for the Court, said that a corporation which had been "put to death by the state" could not be recognized by the bankruptcy courts on a voluntary petition filed under Section 77B.

The Court did not consider what the record showed with respect to the "good faith" of the stockholder groups who had caused the petition to be filed. Nor did the Court consider the matter of penalizing a corporate group where dissolution had been brought about because the corporation had violated some local regulatory statute. The Court was not impressed by the showing that the old corporate assets were still undisposed of and still within the reach of the court which had approved the debtor's petition.

There are statements in the opinion which indicate that the stockholder groups, who had purported to act for the debtor, had never been interested in the corporation when it was a going concern. They had "purchased" the old stockholders' interests after the corporation had been dissolved, after the receiver had been appointed in the foreclosure proceedings, and after Section 77B was enacted by Congress. A petition filed by a debtor dominated by speculators perhaps has not been filed in good faith.<sup>8</sup> Although the original petition has been

<sup>6</sup> *Chicago T. & T. Co. v. Forty-One Thirty-Six W. Bldg. Corp'n.*, 58 Sup. Ct. 125 (1937), with a dissenting opinion by Mr. Justice Cardozo.

<sup>7</sup> See the opinion of the circuit court of appeals in the same case. *In re Forty-One Thirty-Six Wilcox Bldg. Corp'n.*, 86 F. (2d) 667, 668 (C.C.A. 7th, 1937).

<sup>8</sup> See Subsection (a) of the statute. Cf. *In re Knickerbocker Hotel Co.*, 81 F. (2d) 981 (C.C.A. 7th, 1936).

<sup>9</sup> When the question of "good faith" is raised in connection with the approval of the original petition the court is not concerned with the feasibility of any proposed plan. If there is any probability that the debtor may realize anything out of future operations the opportunity should be afforded the stockholder groups to make the attempt to reorganize. *R. L. Witters Ass'n. v. Ebsary Gypsum Co.*, 93 F. (2d) 746 (C.C.A. 5th, 1938). Nor does the court after approving the petition have to permit the debtor to operate the properties, particularly if they are already in the control of a state court receiver. See *In re Tennessee Publishing Co.*, 81 F. (2d) 463 (C.C.A. 6th, 1936). But the court may be sufficiently well informed of the company's condition when the original petition is filed for approval that the court will conclude that reorganization by stockholder groups is hopeless. *In re Griggsby-Grunow Co.*, 77 F. (2d) 200

approved *ex parte*, on a motion by petitioning creditors and the showing of these facts, the court would be justified in dismissing the proceedings. In any event, even if the stockholder groups, now interested in the debtor, had been stockholders when the concern was a going concern, the court which had originally approved the petition might upon motion of the petitioning creditors dismiss the proceedings. The court might feel that no stockholder group would ever be able to gain consent of any considerable number of creditors to any plan of reorganization with recognition of stockholder interests. Even at this time the court might be satisfied that no such plan would be fair.<sup>9</sup> Moreover, as a matter of policy, the court which had approved the petition might have chosen to dismiss the proceedings, or the Supreme Court might have directed a dismissal, because it would be ready to decide that a corporation which had been dissolved for violation of a regulatory statute might be penalized although the corporation's assets were still unliquidated and although the statutory period for administration had not yet expired.

It was "too easy" for the Court to decide the case as it did. A "dead" corporation cannot act! The Court was willing to concede that creditor groups might choose to have the unliquidated assets of a dissolved corporation preserved in a proceeding under Section 77B. Involuntary original petitions have been approved.<sup>10</sup> Experience in bankruptcy cases under the older provisions of the Act indicates that a dissolved corporation may be insolvent and that its director-administrators may have committed acts of bankruptcy.<sup>11</sup> A dissolved corporation has been adjudged a bankrupt even on a voluntary petition under the older provisions of the Act.<sup>12</sup> However, a proceeding under Section 77B is not purportedly a liquidating proceeding. The probability of a successful preservation and reorganization with advantages for stockholders where a dissolved corporation is also insolvent is not great. A solvent corporation's assets perhaps should be liquidated when

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(C.C.A. 7th, 1935). Or the court may discover that the debtor's properties are beyond reach of its process and may then dismiss the proceedings before any plan is proposed. *Manati Sugar v. Mack*, 75 F. (2d) 284 (C.C.A. 2d, 1935).

<sup>10</sup> *In re* 211 East Delaware Place Bldg. Corporation, 76 F. (2d) 834 (C.C.A. 7th, 1935). In a case like the principal case the probability of the court's being able to approve an involuntary petition over opposition of other creditors or stockholders is not great. The debtor could hardly have committed an act of bankruptcy within the prescribed time, and the existing foreclosure receivership would not be an equity receivership within the meaning of the statute. *Duparquet v. Evans*, 297 U.S. 216 (1936). Two of the circuit courts of appeals have been willing to uphold approval by district courts of voluntary petitions filed by dissolved corporations under Section 77B. In neither case was there any statutory time limit on the period for administration of the dissolved corporation's assets. *Capital Endowment Co. v. Kroeger*, 86 F. (2d) 976 (C.C.A. 6th, 1936); *Old Fort Improvement Co. v. Lea*, 89 F. (2d) 286 (C.C.A. 4th, 1937).

<sup>11</sup> See *Hammond v. Lyon Realty Co.*, 59 F. (2d) 592 (C.C.A. 4th, 1932); *Austin v. Thomas*, 78 F. (2d) 602 (C.C.A. 6th, 1935), discussed in (1935) 20 MARQ. L. REV. 42.

<sup>12</sup> *Partan v. Niemi*, 288 Mass. 111, 192 N.E. 527, 97 A.L.R. 473 (1934). Where the dissolution was voluntary and when the corporation was purportedly solvent the directors cannot thereafter have the corporation adjudicated a bankrupt on its voluntary petition. *Vassar Foundry Co. v. Whiting Corporation*, 2 F. (2d) 241 (C.C.A. 6th, 1924).

the corporation has been dissolved for cause. But to declare that the corporation is ineligible to file a voluntary petition because it is "dead" is to overlook the problems in the case, and to fix a precedent which the Court will limit in future decisions. In the state where this corporation was organized and where it did business its "existence" could have been preserved until the state court had finally disposed of the foreclosure action.<sup>13</sup>

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<sup>13</sup> *Singer & Talcott Stone Co. v. Hutchinson*, 176 Ill. 48, 51 N.E. 622 (1898); *Graham & Morton Transportation Co. v. Owens*, 165 Ill. App. 100 (1911).