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LANDLORDS' CLAIMS IN REORGANIZATIONS

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I.

THE use by tenants of bankruptcy and receivership to avoid leases has been in great vogue during the last few years. Most conspicuous has been their use by chain stores, the vast majority of whose store locations are leased, not owned.¹ But other tenants have likewise resorted to these devices to reduce overhead, until the whole procedure has been frequently condemned in popular thought as constituting nothing but a racket which ingenious counsel have devised as an avenue of escape from just obligations.

Abuses there undoubtedly have been. Yet back of many of these bankruptcies and receiverships is the grim economic necessity of reducing overhead. Certainly when the rent item soars to 25% of gross revenue (as has been true of some chain stores) insolvency becomes imminent. Falling prices and declining sales make necessary and in fact dictate a readjustment if the business is to continue as a going concern. Private negotiations failing, resort is had to other methods.

It has been commonly assumed among lawyers that bankruptcy—and to a lesser extent equity receivership—afforded the proper relief to tenants. With meticulous care the lawyers for the tenant saw to it that the rent was paid in advance just prior to the filing of the petition in bankruptcy. Accordingly it was concluded that at the time of the filing of the petition there was no provable claim.

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1. Smith, *Chain Stores and the Lease Plague* (1932) 58 *FINANCIAL WORLD* 367.

Provability of claims in bankruptcy is governed by statute.² And it had been held that the statute required the claim to be absolutely owing, though not necessarily liquidated, at the date of the filing of the petition.³ Accordingly, though the lessor might have a claim for rent or damages, such claim would arise after the filing of the petition and hence be not provable.⁴ And, though the doctrine of anticipatory repudiation would give a seller of personalty a provable claim against the estate of the bankrupt buyer,⁵ that doctrine (it was assumed) would not be applicable to a lease of realty. Leases of realty, it was said,⁶ were somewhat *sui generis*, different from

2. Bankruptcy Act § 63 (a) provides: "Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not . . .; (4) founded upon an open account, or upon a contract express or implied; . . ."

3. Perhaps the leading case giving this interpretation to § 63 is *In re Roth & Appel*, 181 Fed. 667 (C. C. A. 2d, 1910). For a recent review of the authorities see Schwabacker & Weinstein, *Rent Claims in Bankruptcy* (1933) 33 COL. L. REV. 213. And see Schmitt, *Rights of the Landlord* (1933) 5 MISS. L. J. 147.

4. *In re Roth & Appel*, *supra* note 3; *Slocum v. Soliday*, 183 Fed. 410 (C. C. A. 1st, 1910). *Contra: In re Caloris Mfg. Co.*, 179 Fed. 722 (E. D. Pa. 1910); *In re Schechter*, 39 F. (2d) 18 (C. C. A. 3d, 1930).

5. *Central Trust Co. v. Chicago Auditorium*, 240 U. S. 581 (1916).

6. The Supreme Court in *Central Trust Co. v. Chicago Auditorium*, *supra* note 5, took pains to point out the distinction between contracts respecting personalty and those involving the landlord tenant relationship. It said, at 590, "Cases of the latter class are distinguishable, because of the diversity between duties which touch realty, and the personalty," quoting *CO. LITT.* *292b, § 513. And as stated by Mr. Justice Holmes in *Gardiner v. Butler*, 245 U. S. 603, 605 (1918): ". . . the law as to leases is not a matter of logic *in vacuo*; it is a matter of history that has not forgotten Lord Coke." Coke in the passage quoted was not speaking of anticipatory repudiation. In fact the doctrine of anticipatory repudiation may be said to date from *Hochster v. De la Tour*, 2 E & B 678 (1853). Coke was speaking of releases which he said ". . . shall not barre the lessor of his rent, because it was neither *debitum* nor *solvendum* at the time of the release made; for if the land be evicted from the lessee before the rent became due, the rent is avoyded; for it is to be paid out of the profits of the land, and it is a thing not meereley in action, because it may be granted over." Space does not permit an elaboration of the theme that this conception of rent, though genuinely anachronistic when applied to leases of present day office buildings, was in many ways the essence of realism even before Coke's time. Several observations, however, may be made. (1) The law of leaseholds was developed on their modern basis in the agricultural economy of England in the sixteenth and seventeenth centuries. Down to the date of the industrial revolution agriculture was the most important form of industry. Hence "it is not surprising that the forms of other leases, such as building and mining leases, were not settled till the nineteenth century." 7 HOLDSWORTH, *HISTORY OF ENGLISH LAW* (1926) 241-242. (2)

bilateral contracts to which was applicable the doctrine of anticipatory repudiation by virtue of adjudication in bankruptcy, since they were founded on ancient rules of property law with roots in feudal England.⁷ Even in the presence of express covenants in the lease calling for payment of damages in the event of the lessee's bankruptcy, it was said that the claim was rarely provable. It was barred because, among other reasons, whether or not the lessor would stand on the lease, or reenter and terminate it, or elect to claim

The obligation of the land as expressed in the procedural device of distraint is well described by Maitland, "Into the land the rent owner enters; he takes the chattels that are found there; they may or may not be the chattels of the tenant; they are on the burdened land and that is enough. In such a case it is easy for us to picture the rent 'issuing out of' the land and encumbering the land." 2 POLLOCK & MATTLAND, HISTORY OF ENGLISH LAW (2d ed. 1905) 130. (3) In case of rent in fee the land was not only the principal debtor but the only debtor. The landlord could sue for his rent by real actions. He would claim rent as he would claim an estate in land. 7 HOLDSWORTH, *op. cit.* at 263; 2 POLLOCK & MATTLAND, *op. cit.* at 131-32. Thus it was that the basis of relationship between landlord and tenant was tenure and privity of estate, classified in the law of property not contracts. (4) In fact, though the action of debt lay for rent reserved on a lease for years (Co. Litt. *201 b) still the landlord here also had the right of distraint. 7 HOLDSWORTH, *op. cit.* at 268 *et seq.* And as Holdsworth says, ". . . the writ of debt was as much proprietary as contractual." 7 Holdsworth, *op. cit.* at 265.

The fact is that the law of landlord and tenant went through a profound development at a time when the law of contract was only nascent and the law of property dominant. It is but natural that its roots should be found in the latter. Yet this history should not bar courts from treating leases more realistically today. To assimilate leases of modern office buildings to feudal tenure in seventeenth century England is to disregard the essential elements of the bargain made, the present money economy, and the great development in contract law which has taken place since Coke wrote. This change in the entire perspective is evidenced by the decided trend in the last ten years to extend the doctrine of anticipatory repudiation to leases and to treat them as bilateral contracts for that purpose. See the cases *infra* note 117.

7. The lower federal courts in reliance upon the distinction made by the Supreme Court have uniformly held that a landlord has no claim provable in bankruptcy based upon anticipatory breach *provided, however*, that the common law obtains in the state whose law governs the lease. This has been held as to Ohio leases. *Wells v. Twenty-First St. Realty Co.*, 12 F. (2d) 237 (C. C. A. 6th, 1926); *In re McAllister-Mohler Co.*, 46 F. (2d) 91 (S. D. Ohio 1930). *Contra: In re Bissinger*, 5 F. (2d) 106 (N. D. Ohio 1925). The rule has also been applied to Massachusetts leases. *In re Service Appliance Co., Inc.*, 39 F. (2d) 632 (N. D. N. Y. 1930). And to Kansas leases. *Watson v. Merrill*, 136 Fed. 359 (C. C. A. 8th, 1905). For cases applying the doctrine of anticipatory repudiation to leases see note 117, *infra*. Since *Central Trust Co. v. Chicago Auditorium*, *supra* note 5, and *Wilson v. National Refining Co.*, 126 Kan 139, 266 Pac. 941 (1928) (extending the doctrine of anticipatory breach to leases), the case of *Watson v. Merrill*, *supra*, can no longer be said to represent bankruptcy law in Kansas.

damages under the covenant, was uncertain at the date of the filing of the petition.⁸ Hence, unless the covenant to pay damages was strictly a conditional limitation⁹ (and this is rare in modern leases), the claim was not provable in bankruptcy; and even if it were, the claim might not be.¹⁰

Provability in an equity (insolvency) receivership was deemed to be easier since there were no statutory restrictions.¹¹ The claim need not be absolutely owing at the time of the appointment of the receiver.¹² It was provable so long as it matured within the time fixed by the chancellor for filing of claims.¹³ Hence even rent maturing after the appointment of the receiver might be provable.¹⁴ And a claim for damages founded upon an express covenant was thus provable, provided the damages were liquidated in a manner "familiar and fair."¹⁵ But in absence of an express covenant to pay damages, there was no provable claim provided no default in payment of rent or in the performance of other covenants in the lease occurred prior to the end of the period for filing claims. Here as in the case of bankruptcy the doctrine of anticipatory repudiation¹⁶ was said to have no place.¹⁷ Hence the payment of rent and meticulous performance of all other covenants in the lease during the period when claims could be filed were often thought to be

8. *In re Roth & Appel*, *supra* note 3; *Slocum v. Soliday*, *supra* note 4.

9. See, for example, the clause construed as a conditional limitation in *R. C. Taylor Trust v. Kothe*, 30 F. (2d) 77 (C. C. A. 1st, 1929), *rev'd* on other grounds, *Kothe v. R. C. Taylor Trust*, 280 U. S. 224 (1930). And see *Slocum v. Soliday*, *supra* note 4.

10. *In re Wise Shoes, Inc.*, 2 Fed. Supp. 521 (S. D. N. Y. 1932), where the breach occurred before the filing of the petition but the liquidation of the claim could not be had under New York law until the end of the term. See discussion *infra*, pp. 1044 *et seq.*

11. *Wm. Filene's Sons Co. v. Weed*, 245 U. S. 597 (1918).

12. *Ibid.*

13. *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721 (C. C. A. 2d, 1912).

14. *Chicago Fire Place Co. v. Tait*, 58 Ill. App. 293 (1895); *Rogers v. United Grape Products, Inc.*, 2 Fed. Supp. 70 (W. D. N. Y. 1933).

15. *Wm. Filene's Sons Co. v. Weed*, *supra* note 11; *Gardiner v. Butler*, *supra* note 6; *International Paper Co. v. Priscilla Co.*, 183 N. E. 58 (Mass. 1932); *People v. St. Nicholas Bank*, 151 N. Y. 592, 45 N. E. 1129 (1897); *McGraw v. Union Trust Co.*, 135 Mich. 609, 98 N. W. 390 (1904).

16. *Napier v. Peoples Stores Co.*, 98 Conn. 414, 120 Atl. 295 (1923) holding that the appointment of a receiver for a buyer of personalty under a consent decree constituted anticipatory repudiation.

17. See *e.g.* *Pennsylvania Steel Co. v. New York City Ry. Co.*, *supra* note 13. *Cf.* *Rogers v. United Grape Products, Inc.*, *supra* note 14. *Contra*: *Leo v. Pearce Stores*, 54 F. (2d) 92 (E. D. Mich. 1931). And see cases *infra* note 117.

adequate safeguards to prevent the lessor from participating in the receivership.

It is seriously doubted if the generality of all of those conclusions can be sustained. But the reasons for this disagreement must be reserved for another occasion.¹⁸ Here it is important to note the consequences attributed to this general assumption of the non-provability of the landlord's claim. Since the claim was not provable in bankruptcy, it was not discharged.¹⁹ Thus in cases of individuals or partners, they would clearly be liable even though they had been released from all their other debts.²⁰ And since they could not be discharged again until another six years,²¹ the landlord could pursue them for satisfaction of his claim. And in case the resuscitated corporate lessee resumed business its discharge would likewise provide it with no greater immunity. But in case of corporate lessees the result of either bankruptcy or equity receivership is likely to be dissolution. If the business is continued, it is most apt to be by a new corporation which purchases the assets at a sale or pursuant to a composition agreement in case of bankruptcy. Hence by the time the landlord matures his claim and liquidates it, the assets of the tenant are either in process of distribution or in the hands of a new company which has purchased them under the protection of the court. By such methods it has been attempted either to bring landlords to terms so that new leases may be negotiated or to cut off completely their claims for rent or damages against the reorganized company.

That these methods could be so effectively used to discriminate against this class of creditors was ground for vigorous protest.

18. The reasons for this disagreement are primarily two-fold: (1) There has been a gross overstatement of the non-applicability of the doctrine of anticipatory repudiation to leases. The federal courts in this situation apply local law. See cases cited *supra* note 7, and *Leo. v. Pearce Stores*, *supra* note 17. If the law of the several states is examined, it will be observed that during the last decade there has been a decided and pronounced trend by state courts to extend the doctrine of anticipatory repudiation to leases. Furthermore the rule pronounced by Williston that there could be no anticipatory repudiation of a contract containing mutually independent covenants [WILLISTON, *CONTRACTS* (1920) § 1329] has not been adopted by the Restatement. See *CONTRACTS RESTATEMENT* (Am. L. Inst. 1930) § 318. And see note 6, *supra*. (2) The reasoning and language of the Supreme Court in *Maynard v. Elliott*, 283 U. S. 273 (1931) is directly contrary to the reasoning of the court in *In re Roth & Appel*, *supra* note 3, in the interpretation to be given to § 63 (a) (1) and § 63 (a) (4) of the Bankruptcy Act.

19. Bankruptcy Act § 17.

20. *In re Goldberg*, 52 F. (2d) 156 (S. D. N. Y. 1931).

21. Bankruptcy Act § 14 (b) (5). As to compositions *cf. In re Goldberg*, 53 F. (2d) 454 (C. C. A. 6th, 1931).

There was more than indignation. It was argued that no adjudication in bankruptcy or appointment of a receiver should be made when the end sought was the elimination of the landlord. Adjudications in bankruptcy at the request or with the consent of tenants and consent decrees in receivership were denounced. The now almost classic case of *May Hosiery Mills, Inc. v. F. & W. Grand 5-10-25 Cent Stores, Inc.*²² is illustrative of judicial indignation at its height. Judge Bourquin not only denied the petition for an ancillary receivership but also fined local counsel for the petitioner for contempt. The opinion, assailing the inequity of converting the "temple of justice" into a "place of injustice," decried the ". . . employment of the judicial club to beat off and hold up creditors until, wearied, they settle with or wait the pleasure of the debtor's executive vice-president receiver shielded by the judicial gown."²³ The issue in the case was much broader than the mere use of receivership to avoid leases; the court was dealing with the larger problem of consent decrees.²⁴ It is not to be denied that abuses in the system exist and explosions like that of Judge Bourquin may aid in eliminating them. But the fact remains that businesses need some expeditious method of financial rehabilitation. At heart the problem is a business and economic one. As indicated above, grim economic necessity requires that rent not exceed a certain percentage of gross revenue; in periods of falling prices, declining sales and deep economic depression, financial readjustment is a prime necessity.²⁵ Equity receivership and bankruptcy are most readily adapted to that end. To protect creditors²⁶ (and even stockholders) in the process of reorganization seems a more effective method of control than to deny resort to these reorganization devices.

If the general assumption is made that the landlord can be made to whistle for his rent or damages in the graveyards of dissolved corporate lessees, the attitude of Judge Bourquin is all the more understandable. If the law is that bankruptcy and receivership may be employed to exterminate the lessor, then appointments of receivers and adjudications in bankruptcy should be guarded jealously. Only when *in extremis* should a corporation be permitted to

22. 59 F. (2d) 218 (D. Mont. 1932).

23. *Id.*, at 220.

24. The recent amendments of the Bankruptcy Act, adding § 77 which provides for reorganization of railroads engaged in interstate commerce, make friendly receiverships no longer necessary as respects such railroads.

25. See the critical account in Stevens, *The Real Estate Bond Problem*, BULLETIN N. Y. STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS, July, 1932, at 3.

26. See Wham, *Consent Receiverships in the Federal Court* (1933) 19 A. B. A. J. 7.

take a step so fatal to that class of creditors. But it is submitted that the principles of reorganization law give the landlord protection to the same extent as other creditors, whenever stockholders participate in a reorganization. The assumption that he can be effectively barred through reorganization plans by mere failure to provide for him cannot be sustained. If the reorganization managers do not extend to him the same protection as is extended to other creditors, they proceed at the risk of the new corporation being liable to the landlord as, if and when his claim matures and becomes liquidated. This result is obvious if the landlord has a claim which is provable in bankruptcy²⁷ or receivership. It is equally true though the landlord has no claim satisfying the standard tests of provability, for he is entitled to participation under such reorganization plan despite the fact that at the time of the consummation of the plan by a sale of the assets to a new company his claim is wholly contingent.

II.

This result follows from the general equitable principles enunciated in the *Boyd* case²⁸ and applied to a number of analagous situations in a long line of prior and subsequent decisions in the Supreme Court and lower federal courts. *Boyd* was a creditor of the old Coeur

27. The recent amendments of the Bankruptcy Act make some changes in the rules of provability for claims of landlords. § 74 provides for compositions and extensions by "any person excepting a corporation". § 74 (a) provides: "The term 'creditor' shall include *for the purposes of an extension proposal* under this section all holders of claims of whatever character against the debtor or his property including a claim for future rent, whether or not such claims would otherwise constitute provable claims under this act. A claim for future rent shall constitute a provable debt and shall be liquidated under section 63 (b) of this act." Although the new section is worded ambiguously and is susceptible of several interpretations the following observations may be made: (1) The position of the landlord in corporate reorganizations is left untouched (a) since § 74 expressly excludes corporations and (b) since the sentence last quoted probably means that a "claim for future rent" is provable merely in a proceeding under § 74. (2) Provability of claims of landlords in compositions is probably permitted under the sentence last quoted above. The preceding sentence merely defines "creditor" under an extension. So, while a landlord by negative implication might be held not to be a creditor in a composition it would seem he would have a provable claim. Whether or not § 74 repeals in toto or partially the former composition sections is by no means clear. But it should be noted that § 73 purports to give additional jurisdiction only under § 74. The change in public policy which Congress indicates in these amendments might well be used by the courts as an analogy in equity receiverships. See Wyzanski, *The Effect of the 1933 Bankruptcy Legislation Upon the Rights of a Landlord* (1933) J. NAT. ASS'N. REF. B'K'PRCY. 107.

28. *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482 (1913).

D'Alene Railroad and Navigation Company. While his suit (which was brought by one Spaulding but title to which was later adjudged to be in Boyd) was pending, the Coeur D'Alene leased its property for 999 years to the Northern Pacific Railroad Company. The Railroad Company acquired the stock of the Coeur D'Alene paying for part of it out of the proceeds of bonds of the Coeur D'Alene issued pursuant to previous resolutions of the Coeur D'Alene stockholders and guaranteed by the Railroad Company. This transaction rendered the Coeur D'Alene insolvent.

Several years later, while Boyd was still engaged in perfecting his judgment against the Coeur D'Alene, receivers were appointed for the Railroad Company pursuant to a creditors' bill; the various mortgages were foreclosed (including those of the Coeur D'Alene); and subsequently the creditors' bill and the foreclosure actions were consolidated and the receivership continued under the consolidated causes. A reorganization plan was promulgated giving stockholders of the Railroad Company stock in a new company, to be formed, on payment of an assessment. Preferred stockholders of the old company were assessed \$10 and common stockholders \$15, for each old share of \$100. No provision was made in the plan for unsecured creditors of the old company. The bondholders of the old company received new bonds.

The court ordered the property to be sold under the reorganization plan. Notice by publication was made, pursuant to court order requiring all creditors to present their claims within a specified time on penalty of exclusion. At this stage one Paton and other unsecured creditors filed a bill alleging that the sale was the result of a conspiracy between bondholders and stockholders to exclude general creditors and that stockholders should not be allowed to participate until participation was first offered to creditors. The bill asked that the decree of foreclosure be opened; that the court formulate a fair plan; and that the sale be enjoined. The court denied the petition concluding that there was no reason why the old stockholders should not become stockholders in the new company since there was no equity in the property out of which creditors could be paid. No appeal was taken. Subsequently a sale of all the property was made pursuant to the plan at a price of \$86,000,000 less than the secured debts. The court confirmed the sale. The purchaser was the Northern Pacific Railway Company.

Ten years after the sale had been confirmed (and about twenty years after the suit ending in Boyd's judgment had been started) Boyd finally perfected his judgment against the Coeur D'Alene. There being no property of the Coeur D'Alene on which execution could be levied, Boyd brought a bill in equity against the Northern

Pacific Railroad Company and the Northern Pacific Railway Company. His theory of the liability of the Railroad Company was that it had become liable to creditors of the Coeur D'Alene by reason of the diversion of the proceeds of the Coeur D'Alene bonds which had been used to purchase part of the stock of the Coeur D'Alene. The Supreme Court sustained him in this contention. Being in legal effect a creditor of the Railroad Company, he claimed that the property of the old company in the hands of the new Railway company was subject to the payment of his debt. The Supreme Court held that the judicial sale pursuant to that reorganization plan constituted fraud in law against Boyd and affirmed a decree making his claim a lien upon the property of the Railroad company in the hands of the Railway company but subject to the mortgages placed thereon at the time of reorganization.

The salient points in the holding are as follows:

(1) A judicial sale made in good faith does not necessarily protect the purchaser. As against the non-assenting creditor, a sale to a new corporation *in which the old stockholders receive stock* is void "regardless of the motive with which it was made," the *judicial sale*, although entirely free from fraud, *being no more efficacious* than a private contract between bondholders and stockholders. The court said, "There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree."²⁹

(2) When stockholders participate in a reorganization plan without making provision for creditors, they are "in the position of a mortgagor buying at his own sale." Though the purchase was made "in good faith and in ignorance" of the creditor's claim, "they are none the less bound to recognize his superior right in the property, when, years later, his contingent claim was liquidated and established."³⁰

(3) The value of the property is immaterial in determining the validity or invalidity of the sale, when stockholders of the old company participate in securities of the new company formed pursuant to the reorganization receivership sale. The court said, "The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale, the property was insufficient to pay prior encumbrances."³¹

29. *Id.*, at 502 (italics supplied).

30. *Id.*, at 504.

31. *Id.*, at 507.

(4) An unsecured creditor need not be paid "in cash as a condition of stockholders retaining an interest in the reorganized company."³² His interest can be preserved by the issuance to him of new securities. He is entitled, however, to a "fair offer."

(5) In case no "fair offer" is made, the creditor "retains the right to subject the interest of the old stockholders in the property to the payment of his debt. If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities." In determining the value of the interest of the stockholders in the old company no definite rule is laid down. But the court said, "If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control."³³

(6) The Paton suit was not *res adjudicata* as to Boyd, since he was not a party to the record.

As has been noted elsewhere,³⁴ the result of the *Boyd* case was clearly foreshadowed in two earlier Supreme Court cases—the *Howard* case³⁵ in 1869 and the *Monon* case³⁶ in 1899. And as one of the writers has elsewhere indicated,³⁷ the doctrine of the *Boyd* case, so far as it permits the non-assenting creditor to reach the interest of the stockholders in the old company, is nothing more than an adaptation of the familiar rule of fraudulent conveyances originally expressed in the statute of 13 ELIZABETH. The heart of the decision is in the following statement of the court:

"For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. They were in the position of insolvent debtors who could not reserve an interest as against creditors. Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred

32. *Id.*, at 508.

33. *Ibid.*

34. Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 VA. L. REV. 541. See Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade* (1927) 27 COL. L. REV. 901.

35. *Railroad Co. v. Howard*, 7 Wall. 392 (U. S. 1869).

36. *Louisville Trust Co. v. Louisville Ry.*, 174 U. S. 674 (1899).

37. Frank, *supra* note 34; cf. GLENN, *THE LAW OF FRAUDULENT CONVEYANCES* (1931) 300-302.

before the creditor was invalid. Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale. If they did so in good faith and in ignorance of Boyd's claim, they were none the less bound to recognize his superior right in the property, when years later his contingent claim was liquidated and established."³⁸

Subsequent decisions³⁹ have somewhat amplified but have never altered this rule of the *Boyd* case. It is now clear that it is not a rule peculiar to railroad reorganization, but applicable as well to reorganizations of public utility and industrial corporations.⁴⁰ Furthermore, the rule is not peculiar to equity receiverships. It is clearly applicable to a sale in bankruptcy proceedings. Thus in *Kingston v. American Car & Foundry Co.*,⁴¹ plaintiff sued for specific performance of agreements alleged to have been made between him and two other stockholders of a bankrupt corporation to purchase certain assets of the corporation from the trustee in bankruptcy at a small price and reorganize the corporation, dividing the net profits among the three of them. It was alleged that the assets of the corporation were worth \$175,000, its debts were \$150,000 and the assets were bought at the sale for \$22,000. It was further alleged that these two stockholders acquired the assets at public sale and transferred them to defendant corporation and refused to allow plaintiff his agreed participation. The lower court denied relief on the ground that plaintiff had not sustained the burden of proving the various agreements alleged. The Circuit Court of Appeals, in sustaining this finding, observed that in any event specific performance would not lie, since the agreement would have been a "fraud upon the creditors" of the bankrupt corporation in violation of the principles of the *Boyd* case. Although this pronouncement was by way of dictum only, it is nevertheless entitled to great weight.

38. *Northern Pacific Ry. Co. v. Boyd*, *supra* note 28, at 504.

39. *Kansas City Terminal Ry. Co. v. Central Union Trust Co. of New York*, 271 U. S. 445 (1926); *Kansas City Southern Ry. Co. v. Guardian Trust Co.*, 240 U. S. 166 (1916). For collection of cases see DOUGLAS & SHANKS, *CASES & MATERIALS ON REORGANIZATION* (1931) 249-337. For discussions of this line of cases see articles in *SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION & REGULATION* (1931) 35-230; Swaine, *supra* note 34; Bonbright & Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization* (1928) 28 *COL. L. REV.* 127; Frank, *supra* note 34.

40. See *Safety Car Heating & Lighting Co. v. United States Light & Heat Co.*, 2 F. (2d) 384 (W. D. N. Y. 1924); *Mountain States Power Co. v. Jordan Lumber Co.*, 293 Fed. 502 (C. C. A. 9th, 1923), *cert. den.* 264 U. S. 582 (1923); *Okmulgee Window Glass Co. v. Frink*, 260 Fed. 159 (C. C. A. 8th, 1919).

41. 55 F. (2d) 132 (C. C. A. 8th, 1932); *cert. den.* 285 U. S. 560 (1932).

The court quoted as follows from the *Kansas City Terminal Ry. Co.* case:

"... any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.' *Louisville Trust Co. v. Louisville Railway Co.*, 174 U. S. 683, 684, 19 S. Ct. 827, 43 L. Ed. 1130.

"This doctrine is the 'fixed principle' according to which *Northern Pacific Railway Co. v. Boyd*, 228 U. S. p. 507, 33 S. Ct. 554, 57 L. Ed. 931, declares the character of reorganization agreements must be determined, and to it there should be rigid adherence."⁴²

Any other rule would countenance a so-called fraudulent conveyance of the kind condemned in the *Boyd* case. It may be admitted (though only for sake of argument) that Congress under its bankruptcy power could provide a different rule. The fact remains that it has not. Certainly a trustee's sale in bankruptcy is not more sacred than the judicial sale in equity receivership. The judicial sale in the *Boyd* case being void as to Boyd, it is reasonable to suppose that the trustee's sale in bankruptcy would on the same facts be equally void.

The composition section⁴³ of the Bankruptcy Act (at least before its recent amendment)⁴⁴ provides for application for confirmation of a composition after it has been accepted in writing "by a majority in number of all creditors whose claims have been allowed, which number must represent a majority in amount of such claims." The judge shall confirm a composition if satisfied, *inter alia*, that "it is for the best interests of the creditors." Thus the property is returned to the debtor on certain conditions. All statutory prerequisites having been satisfied, these creditors are bound to accept their distributive share of the composition consideration.⁴⁵ But as

42. *Id.*, at 136.

43. Bankruptcy Act § 12.

44. See note 27, *supra*.

45. In reorganizations in bankruptcy apart from the composition section it has been held that the dissenting creditor must be given a cash alternative. *In re Prudential Outfitting Co. of Delaware*, 250 Fed. 504 (S. D. N. Y. 1918); *In re J. B. & J. M. Cornell Co.*, 186 Fed. 859 (S. D. N. Y. 1911). And see *In re Northampton Portland Cement Co.*, 185 Fed. 542 (E. D. Pa. 1911). *Quaere*, as to the power of the bankruptcy court to confirm a composition under § 12 as against non-assenting creditors for whom no cash alternative has been offered. As stated in Comment (1933) 42 YALE L. J. 387, 393. "Although the original composition clause required settlement in 'money,' and although the consideration in practice is generally cash or notes, the language of the present composition provision is open to the interpretation

will be shown, landlords are entitled in spite of this section to protection against a violation of the principles of the *Boyd* case. Thus it is apparent that the doctrine of the *Boyd* case is not peculiar to equity receiverships.

In the great majority of the cases the unsecured creditors who have sought the protection of the *Boyd* case have had claims in nowise contingent but absolutely owing at the time for filing of claims. Yet there has been no decision limiting the application of the *Boyd* case to that class of creditors. In fact *Boyd* was a creditor with a claim contingent in one sense at the date of the sale in July, 1896. It will be recalled that *Boyd's* claim was reduced to judgment by *Spaulding*—an adverse claimant—in 1896. But this judgment was against the *Coeur D'Alene*, *not* against the Northern Pacific Railroad Company, the old corporation. While the judgment was rendered against the *Coeur D'Alene* in 1896 it was not finally affirmed until November 26, 1897 by the Supreme Court of Idaho.⁴⁶ But even if it be assumed that the claim was sufficiently established by 1896 to permit its being recognized as a matured but unliquidated claim against the *Coeur D'Alene*, nevertheless it was far more than unliquidated against the Northern Pacific Railroad Company. As against the latter it was strictly contingent in the sense that it took the Supreme Court of the United States to determine whether or not as a matter of law the Railroad company was liable to *Boyd* because of the diversion of assets from the *Coeur D'Alene*. Hence, if the reorganization managers had decided to make provision in the plan for *Boyd*, they could not know for certain at that time if *Boyd's* claim against the Railroad company would ever be sustained. To be sure they would know the maximum amount of the claim, except for subsequently maturing interest. But the outcome of litigation is never certain. Hence, looking at the claim as of the date of 1896 and earlier it was a possible but by no means certain liability of the Railroad company. Doubtless for this reason the Supreme Court referred to *Boyd* as the holder of a "contingent claim."

Certain it is that this protection afforded such a contingent creditor is no anomaly in the law of fraudulent conveyances, for there is no doubt that the statute 13 ELIZABETH⁴⁷ did not exclude subsequent

that long-term notes or even corporate securities may be offered as consideration for a composition, and the meager court interpretations of this language have not settled the issue to the contrary."

46. *Spaulding v. Coeur D'Alene Ry. & Nav. Co.*, 5 Idaho 528, 51 Pac. 408 (1897).

47. 13 ELIZ. c. 5. (1571).

or contingent creditors from its protection.⁴⁸ Such creditors might be divided into four groups: First are those who have no claim whatsoever at the date of the transfer complained of nor any contract out of which a claim might arise.⁴⁹ Second are those who have a claim at the date of the alleged fraudulent conveyance, the claim being, however, not matured, though perhaps certain in amount.⁵⁰ Third are those who have a claim at the date of the conveyance complained of but who have not as yet liquidated it or perhaps not even established the legal liability of the debtor for it.⁵¹ Fourth are those creditors who at the date of the alleged fraudulent conveyance have a contract out of which a claim may or may not arise. At the time in question no claim has arisen and whether or not it will is dependent wholly on subsequent events. The great weight of authority is that even this class of creditor was protected against fraudulent conveyances of his debtor. As stated by the Court of Appeals of New York, in a case to set aside a fraudulent conveyance made by an agent who subsequently breached his agency contract: "It has been repeatedly adjudged that a party bound by a contract whereof he may become liable to the payment of money, although his liability be contingent, is a debtor within the meaning of the statute avoiding all grants made to hinder or delay creditors."⁵² Or as stated recently by the Supreme Court of Florida, "Whoever has a legal claim or demand of a contractual nature in existence at the time when an alleged fraudulent conveyance is made, is a 'creditor' within the meaning of the statute against fraudulent conveyances. . . . The holder of a contingent

48. GLENN, *THE LAW OF FRAUDULENT CONVEYANCES* (1931) c. XVIII; (1915) c. III, VIII. And see *Thomson v. Crane*, 73 Fed. 327 (D. Nev. 1896); *Combs v. Poulos*, 241 Ky. 617, 44 S. W. (2d) 571 (1931); *Friedel v. Wolfe*, 41 Ohio App. 561, 180 N. E. 738 (1931); Uniform Fraudulent Conveyance Act, §§ 1, 5, 6 and 7.

49. GLENN, *op. cit. supra* note 48, § 335 *et seq.*

50. *Kautz v. Sheridan*, 118 Me. 28, 105 Atl. 401 (1919); *Hillsboro National Bank v. Garbarino*, 82 Ore. 405, 161 Pac. 703 (1916); GLENN, *op. cit. supra* note 48, § 326.

51. *Burnwell Coal Co. v. Setzer*, 203 Ala. 395, 83 So. 139 (1919); *Benson v. Harriman*, 55 Cal. App. 483, 204 Pac. 255 (1921); *Griggs v. Crane's Trustee*, 179 Ky. 48, 200 S. W. 317 (1918). Similarly for creditors under a wholly executory contract. *Finlay v. Swirsky*, 103 Conn. 624, 131 Atl. 420 (1925). And see *Olwer v. Lewis*, 149 Ga. 763, 102 S. E. 146 (1920).

52. *Young v. Heermans*, 66 N. Y. 374, 384 (1876). Thus a receiver of a national bank has been granted the protection of the statute against fraudulent conveyances where a stockholder made a conveyance after the appointment of the receiver but before the levy of an assessment. *Duncan v. Freeman*, 152 Ga. 332, 110 S. E. 5 (1921); *Williams v. Travis*, 277 Fed. 134 (C. C. A. 5th, 1922).

claim is as fully protected by the statute as one that is absolute, and in cases of contingent liability, the liability, whenever happening, relates back to the date when it was originally incurred."⁵³

Under this doctrine the landlord has been held to have the protection of 13 ELIZABETH against transfers by his tenant. Thus in *Woodbury v. Sparrell Print*⁵⁴ the lessor brought a bill in equity to reach and apply in payment of a debt property alleged to have been fraudulently conveyed. The principal claim was for rent accruing under a lease for years *after the conveyance was made*. Defendants demurred on the ground, inter alia, that the statute afforded no protection to such claim. The court refused to sustain the demurrer on that ground, saying, "But it is familiar law that a conveyance fraudulent under the St. of 13 Eliz. c. 5, as against existing creditors at the time of its delivery, also may be avoided by subsequent creditors."⁵⁵

53. *Weathersbee v. Dekle*, 145 So. 198 (Fla. 1933). The Supreme Court of Michigan has said: "A conditional claim based on performance is as much under protection of the statute from the outset as a claim which is from its inception certain and absolute." The claim protected in that case was that of a railroad to which defendant promised to pay a sum of money when the road was extended to a certain point and the first train ran. The conveyance was made during the life of the contract but before completion of the road. *Detroit B. C. & W. R. R. v. Lavell*, 224 Mich. 572, 575, 195 N. W. 58, 59 (1923). And see *American Surety Co. of New York v. Marotta*, 53 Sup. Ct. 260, 262 (U. S. 1933) ". . . petitioner from the time it became surety on Mogliani's bond, was entitled as a creditor under the agreement to invoke that rule."—i.e. protection against fraudulent conveyances. Compare the statement of the Supreme Court of Alabama in an action to set aside as fraudulent a conveyance by a surety on an administrator's bond: "a contingent claim is as fully protected, as a claim that is certain and absolute." *Yeend v. Weeks*, 104 Ala. 331, 341, 16 So. 165, 169 (1893). Accord: *Carr v. Goldstein*, 210 Ala. 366, 98 So. 199 (1923) (conveyance of property by indorser of note). Though the surety is thus protected, he is normally denied relief against the fraudulent conveyance at least until he has paid the obligation. *Saunders v. Saunders*, 49 Idaho 733, 291 Pac. 1069 (1930).

54. 187 Mass. 426, 73 N. E. 547 (1905).

55. *Id.* at 428, 73 N. E. at 548. *Finger v. Kemp*, 163 Atl. 153 (N. J. Ch. 1932) though denying protection to the landlord, on the facts is not contrary to the general proposition advanced in the text. Prior to the end of a lease the partners (lessees) conveyed certain personal assets to their wives. About six months later there was a fire and the partners collected the insurance and liquidated their other business assets. All debts were paid, including the landlord up to the date of the fire. The landlord recovered judgments for subsequently maturing rent and brought a bill to set aside the prior conveyances as being fraudulent. In denying relief the court concluded: (1) the conveyances did render the partnership insolvent; (2) there was no preconceived intention "to defeat the lease and to evade the payment of the rent after the fire." The court said, at 154, "A tenant's contingent liability is adverted to, not

The various rules evolved as respects these four classes of creditors are not particularly relevant here.⁵⁶ Here we are primarily concerned with groups three and four. And, as will be seen, where the fraudulent conveyance is to a new corporation in which the old stockholders received stock, the creditors, to whom fair and reasonable offers of participation in the plan have not been made, will be allowed to reach the interest of the stockholders in the property transferred even though their claims fall in the third and fourth classes above. In other words the type of transaction involved in the *Boyd* case satisfies the tests of fraudulent conveyances laid down for the protection of contingent creditors of those classes.

As we have seen, *Boyd* had a claim of the third type discussed above, and if there was any doubt as to whether that type of claim was protected under the principles of the *Boyd* case, it was dispelled by a later decision of the same court. In *Pierce v. United States*⁵⁷ it appeared that the Waters Pierce Oil Company was in-

that it affords an escape to responsibility, but merely as indicating the greater difficulty of finding an actual intention to defraud creditors where the motive is remote than where a debt exists and the urge is present." And see *Conway v. Raphael*, 101 N. J. Eq. 495, 138 Atl. 691 (1927); *Severs v. Dodson*, 53 N. J. Eq. 633, 34 Atl. 7 (1895). Cf. *Thorp v. Leibrecht*, 56 N. J. Eq. 499, 39 Atl. 361 (1898). But see *Lawndale Sash & Door Co. v. West Side Trust & Savings Bank*, 207 Ill. App. 3 (1917) discussed *infra* note 72. While the four classes of subsequent or contingent creditors discussed in the text have received protection against fraudulent conveyances, the determinations of what constitute such conveyances have been by no means uniform. The cases have dealt with a great variety of situations. Those situations and the refinements in the different rules of law which have been evolved are of little relevancy here, for the following reasons. As indicated in the text, the corporate lessee is parting with all of its assets. After the reorganization it will either be dissolved or remain a propertyless entity. The existence of the claim of the landlord is known, though the amount may be uncertain. More than that the dominant or one of the primary motives in the bankruptcy or receivership is frequently to avoid that type of claim. If the landlord is not provided for or not allowed to proceed against the new company, while the stockholders of the old company acquire an interest in the new company, the result would be to permit a debtor to appropriate his assets to himself, leaving his creditors unpaid. To sanction this would be to permit the mortgagor to buy in at his own sale. The miscellaneous rules evolved in other situations to determine the rights of subsequent creditors can therefore be disregarded here. And as will be seen they have been so disregarded by the courts. The case of appropriation by a debtor of his assets to the exclusion of some of his creditors should satisfy the strictest criteria of fraudulent conveyances.

56. To be sure what is a fraudulent conveyance against one group is not necessarily such against another. See *Conway v. Raphael*, *supra* note 55; *Severs v. Dodson*, *supra* note 55; Uniform Fraudulent Conveyance Act §§ 1, 5, 6, and 7.

57. 255 U. S. 398 (1920). Cf. *Oehring v. Fox Typewriter Co.*, 272 Fed. 833 (C. C. A. 6th, 1921).

dicted in 1907 under the Elkins Act. In 1913 that company sold and transferred all of its property to another corporation. The proceeds were distributed among the stockholders of the Waters Pierce Oil Company. In 1914 the case under the Elkins Act was tried. The company was convicted and sentenced to pay a fine. Execution on the judgment was issued and returned nulla bona. The United States then brought a bill in equity to obtain satisfaction of the judgment out of the money received by the stockholders. The Supreme Court affirmed the judgment, except in a particular not material here. Mr. Justice Brandeis, writing for a unanimous court, said:

"It is contended that the right to bring a creditor's bill did not exist, because the judgment against the Company was not entered in the trial court until a year after the Company had divested itself of the property sought to be reached in this suit; and the Government did not become a creditor, at all events until after its claim for penalties had ripened into a judgment. But when a corporation divests itself of all its assets by distributing them among the stockholders, those having unsatisfied claims against it may follow the assets, although the claims were contested and unliquidated at the time when the assets were distributed. It is true that the bill to reach and apply the assets distributed among the stockholders cannot, as a matter of equity jurisdiction and procedure, be filed until the claim has been reduced to judgment and the execution thereon has been returned unsatisfied, *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371; but, as a matter of substantive law, the right to follow the distributed assets (see *Railroad Co. v. Howard*, 7 Wall. 392, 409; *Northern Pacific Ry. Co. v. Boyd*, 223 U. S. 482; *Kansas City Southern Ry. Co. v. Guardian Trust Co.*, 240 U. S. 166) applies not only to those who are creditors in the commercial sense, but to all who hold unsatisfied claims. A corporation cannot by divesting itself of all property leave remediless the holder of a contingent claim, or the obligee of an executory contract, *Baltimore & Ohio Telegraph Co. v. Interstate Telegraph Co.*, 54 Fed. Rep. 50, or the holder of a claim in tort, *Hastings v. Drew*, 76 N. Y. 9; *Jahn v. Champagne Lumber Co.*, 157 Fed. Rep. 407; and there is no good reason why the United States with a claim for penalties should be in a worse plight." ⁵⁸

Of course, the claim of a landlord might be contingent in quite a different sense than the claims in the *Boyd* and *Pierce* cases. In the latter cases all of the events on which liability was predicated had occurred prior to the consummation of the reorganization plan. In the case of a landlord the situation might be quite different. Several possibilities exist:

58. 255 U. S. at 402-403.

(1) Prior to the petition in bankruptcy or prior to the end of the period for filing claims in receivership the tenant might have breached the lease, thus giving the landlord a provable claim. The claim though unliquidated would clearly fall under the protection of the *Boyd* case.

(2) In case of a breach the landlord would normally have the option to terminate the lease by re-entry or acceptance of a surrender; or to stand on his lease and demand the rent as it matured under the lease; or to re-enter and claim for damages. If the landlord elects to terminate, he is pursuing a remedy comparable to rescission and thereupon is barred by his own act from participation in the reorganization.⁵⁹ He may, however, desire to stand on his lease and collect the rent as it matures.⁶⁰ Furthermore, for the protection of the estate the trustees or receivers have the option to adopt the lease,⁶¹ except against the exercise of a right of entry reserved.⁶² If they do adopt,⁶³ they ordinarily may sell.⁶⁴ And

59. For the common law rule that the landlord would have no further claim against the lessee in case of reentry and eviction in absence of the survival of an independent covenant, see *International Publications, Inc. v. Matchabelli*, 260 N. Y. 451, 184 N. E. 51 (1933); *Gardiner v. Butler*, *supra* note 6; *Cornwell v. Sandford*, 222 N. Y. 248, 118 N. E. 620 (1918); *Sutton v. Goodman*, 194 Mass. 389, 80 N. E. 608 (1907); *In re Rite's Clothes, Inc.*, 49 F. (2d) 393 (S. D. N. Y. 1931). The same result follows in case of an acceptance of an offer to surrender. *Gray v. Kaufman Dairy & Ice Cream Co.*, 162 N. Y. 388, 56 N. E. 903 (1900); *Bernard v. Renard*, 175 Cal. 230, 165 Pac. 694 (1917); *Underhill v. Collins*, 132 N. Y. 269, 30 N. E. 576 (1892); *Schnebley, Operative Facts in Surrenders* (1927) 22 ILL. L. REV. 23, 117; *McCormick, The Rights of the Landlord Upon Abandonment of the Premises by the Tenant* (1925) 23 MICH. L. REV. 211; *Updegraff, The Element of Intent in Surrender by Operation of Law* (1924) 38 HARV. L. REV. 64; *T. A. D. Jones Co. v. Winchester Repeating Arms Co.*, 55 F. (2d) 944 (D. Conn. 1932).

60. That the landlord, who elects to stand on his lease, is in general under no duty to relet but may hold the tenant liable for rent as it becomes due, see *McCormick, supra* note 59; *Goldman v. Broyles*, 141 S. W. 283 (Tex. Civ. App. 1911); *Heighes v. Porterfield*, 28 N. M. 445, 214 Pac. 323 (1923); *Merrill v. Willis*, 51 Neb. 162, 70 N. W. 914 (1897); *National Exchange Bank v. Hann*, 33 Okla. 516, 126 Pac. 554 (1911); *Auer v. Penn*, 99 Pa. 370 (1882). But see *Note* (1927) 6 N. C. L. REV. 68; *Roberts v. Watson*, 196 Ia. 816, 195 N. W. 211 (1923); *Brown v. Cairns*, 63 Kan. 584, 66 Pac. 639 (1901); *Martin v. Siegley*, 123 Wash. 683, 212 Pac. 1057 (1923). See generally *Note* (1926) 40 A. L. R. 190.

61. *In re Frazin*, 183 Fed. 28 (C. C. A. 2d, 1910) (bankruptcy); *In re Kreiger*, 15 F. (2d) 90 (W. D. Pa. 1926) (bankruptcy); *Oscar Heineman Corp. v. Nat Levy & Co.* 6 F. (2d) 970 (C. C. A. 2d, 1925) (equity receivership); *Stokes v. Hoffman House*, 167 N. Y. 554, 60 N. E. 667 (1901) (equity receivership).

62. *Cassidy v. E. M. T. Coal Co.*, 204 Ky. 278, 264 S. W. 744 (1924) (bankruptcy); *In re Elk Brook Coal Co.*, 261 Fed. 445 (M. D. Pa. 1919)

the lessor gets the benefit of an assumption of obligations by the assignee, who, in case of a reorganization, would likely be the new company. In such event the lessor is in a position somewhat comparable to a mortgagee whose underlying mortgage is not disturbed by the bankruptcy or receivership. If, however, the trustee or receiver disaffirms and the landlord elects to re-enter and claim for damages, he would be in the position of a creditor with an unliquidated claim.

(3) In the latter event or in case he elects to stand on his lease and claim for rent as it matures, his claim might not be provable either in bankruptcy or receivership. For example, in jurisdictions which adhere to the rule of *In re Roth & Appel*⁶⁵ the lessee may have seen to it that at the filing of the bankruptcy petition rent was paid in advance. The breach would occur subsequently, too late to satisfy the test of provability under that decision. Or in case of equity receivership the rent may have been paid regularly up to the date of the confirmation of the sale. In either case it may be assumed that there was no provable claim in bankruptcy or equity receivership. Under these circumstances the claim would be contingent—at the points of time at issue—in a sense quite different from the contingent nature of the claims in the *Boyd* and *Pierce* cases. In the latter cases all events on which liability was predicated had occurred. In the landlord case they had not. To be sure the contract on which a claim is subsequently asserted was in existence; but whether or not a claim would ever arise was

(bankruptcy); *Empress Theatre Co. v. Horton*, 266 Fed. 657 (C. C. A. 8th, 1920). See Note (1925) 38 HARV. L. REV. 390; Note (1920) 33 HARV. L. REV. 709; Note (1920) 29 YALE L. J. 562; Note (1915) 28 HARV. L. REV. 328. That such power of reentry was valid at common law as against assignees under a bankruptcy commission, see *Roe v. Galliers*, 2 T. R. 133 (K. B. 1787); GRAY, *RESTRAINTS ON THE ALIENATION OF PROPERTY* (2d ed. 1895) § 101.

63. Adoption by a *statutory* receiver or a trustee in bankruptcy is said to create a privity of estate between him and the lessor making him liable on the covenant to pay rent. *Woodruff v. Erie Ry. Co.*, 93 N. Y. 609 (1883) (statutory receiver); *Summerville v. Kelliher*, 144 Cal. 155, 77 Pac. 889 (1904) (bankruptcy); *Ex parte Faxon*, Fed. Cas. No. 4704 (C. D. Mass. 1869) (bankruptcy). But in case of a *chancery* receiver it has been held that no such privity of estate can be created between him and the lessor by which he can become liable on the covenant to pay rent. *Stokes v. Hoffman House*, *supra* note 61. And see *Durand & Co. v. Howard & Co.*, 216 Fed. 585, 591 (C. C. A. 2d, 1914); *In re Monticello Veneer Co.*, 2 Fed. Supp. 27 (S. D. Miss. 1933). But see *United States Trust Co. v. Wabash Western Ry. Co.*, 150 U. S. 287 (1893).

64. See *In re Sherwoods, Inc.*, 210 Fed. 754 (C. C. A. 2d, 1913); *Gazlay v. Williams*, 210 U. S. 41 (1908); *Kirstein Holding Co. v. Bangor Veritas, Inc.*, 163 Atl. 655 (Me. 1933).

65. Note 3, *supra*.

unknown. Thus there is the difference between (1) a claim contingent in the sense of being unliquidated and contested, and (2) a claim contingent in the sense that it may never arise. But as we have seen above, creditors of the latter class have been brought within the protection of the statutes against fraudulent conveyances. Hence it is no surprise to find them being protected under the principles of the *Boyd* case.

In *Hamer v. New York Rys. Co.*⁶⁶ the lessor of a street railway issued bonds guaranteed by the lessee. In 1907 the lessee-guarantor went into receivership and default was made on the bonds. A foreclosure suit was brought and a deficiency judgment entered against the lessee February 20, 1912. Meanwhile, however, the assets of the lessee had been sold to a new company pursuant to a reorganization plan. The plan made no provision for the claims of bondholders on the guaranty. In fact the federal district court refused to allow the claim for the deficiency judgment to be proved in the receivership of the lessee-guarantor because the date as of which claims against the property were ordered to be proved was January 15, 1908, and on that date the claim on the guaranty was "contingent merely." In 1913 the bondholders brought suit against the new company to enforce the liability of the old company. The case involved procedural matters not material here. Mr. Justice Brandeis noted, however, that the "bill set forth facts to bring the case within the rule declared" in the *Boyd* and *Kansas City Southern* cases. Thus it is assumed without emphasis that the *Boyd* case extends to this class of creditor. What happened in the *Hamer* case is likely to happen in cases of landlords. The claim may mature after the time for provability but nevertheless before the reorganization is consummated. Normally the trustee in bankruptcy or equity receiver would adopt or disaffirm leases within a reasonable time. Yet a disaffirmance would not make a claim for rent or damages automatically provable. The *Hamer* case indicates that provability is immaterial and that non-provability is not per se a bar to an action by a creditor to reach the assets transferred to the new company.

An even stronger case for liability of the new company is *Howard v. Maxwell Motor Co., Inc.*⁶⁷ The case involved the contingent claim of a landlord and is of such importance that it deserves extended comment. In 1909 plaintiffs leased to the Maxwell-Briscoe Chicago Company (hereafter called the Chicago Company) realty for a term of 20 years. The lease was guaranteed by the Maxwell-Briscoe Motor

66. 244 U. S. 266 (1917).

67. 269 Fed. 292 (S. D. N. Y. 1920).

Company (hereafter called the Motor Company) of which the Chicago Company was a sales subsidiary. In 1912 equity receivers were appointed under a consent decree for the Motor Company and for its parent (the United States Motor Company) and other affiliates, but not for the Chicago Company. A reorganization plan was formulated which made no provision for plaintiffs. It did, however, provide for participation by stockholders of the United States Motor Company (among whom was the Motor Company) on payment of an assessment. A sale pursuant to the reorganization plan was made to the Maxwell Motor Company. A decree confirming the sale was entered January 11, 1913. The decree of sale gave the purchaser 60 days to elect whether or not to "adopt or assume any lease, agreement, or other contract which may be included in the property sold." On the last day of the 60 day period (March 11, 1913), defendant gave notice of intention not to assume the Motor Company's guaranty of plaintiffs' lease. But during the whole course of the receivership the rent had been paid promptly and in advance. In fact on March 10, 1913 quarterly rent had been paid in advance until the next rent day, June 10, 1913. Rent falling due then was not paid. On June 24, 1913 the Chicago Company (the lessee) filed a voluntary petition in bankruptcy and on June 27, 1913 was adjudicated. After paying a small percentage on its debts, it was discharged. In August, 1913 plaintiffs brought suit against the Motor Company on its guaranty. Final judgment was entered in 1917 and after execution was returned unsatisfied a bill in equity was brought to satisfy the judgment out of the assets of the Maxwell Motor Company, Incorporated.

The special master found that there was no actual fraud but that the old stockholders had an equity in the property out of which unsecured creditors such as plaintiffs could be paid. The report of the special master recommending that plaintiffs have a decree was sustained and a decree entered. Judge Mayer observed that though provisions for the other unsecured creditors were fair, nevertheless a single creditor not paid or provided for in the reorganization was entitled to protection under the *Boyd* case. The measure of recovery here as in the *Boyd* case was the interest of the stockholders in the property in an amount not exceeding, of course, the plaintiffs' claim.

Judge Mayer's conclusions on the contingent nature of the claim are of peculiar interest. He stated, as did the special master, that the plaintiffs' claim did not satisfy the tests of provability in equity receiverships but went on to indicate that the ordinary tests of provability are applicable only to creditors' reorganizations, or

dissolution proceedings, in which stockholders do not participate. On that point he said:

"If, therefore, this estate had been wound up prior to March 11, 1913, without a stockholders' reorganization, this claim would not have been provable, and would have been barred.

"In such cases there is a fund for distribution, and the necessity for ascertaining claims 'at a time consistent with the expeditious settlement' of estates is the reason for holding as nonprovable those claims 'which are so uncertain that their worth cannot be ascertained,' even if such claims be 'highly meritorious' . . . " ⁶⁸

In other words, where the liquidation or reorganization concerns creditors only, contingent claims of the type of plaintiffs' need not be recognized.⁶⁹

But where stockholders participate, the law of fraudulent conveyances transcends all rules of provability. To state it another way, equity will not permit a debtor to avail itself of judicial protection in order to appropriate to itself property out of which its obligations should first be satisfied. As Judge Mayer stated:

"But where, as here, there is a stockholders' reorganization, and the new company by its own act sets in motion the default which matures a contingent into an absolute liability, a court of equity cannot permit it to benefit by that act.

"If defendant Maxwell Motor Company, Incorporated, had let March 11, 1913, go by without filing its intention not to assume the lease, it would have been liable to plaintiffs. When it became the owner of the property of Maxwell-Briscoe Motor Company, it knew or ought to have known the latter's contingent liability in respect of this lease, and it would be strange if a court of equity would permit a creditor to be so positioned as to prevent him from proving his claim or participating in a reorganization, while at the same time leaving him remediless by virtue of the act of a corporation created as a part of the plan of reorganization; for it must not be forgotten that the March rent was paid after the decree of sale and after the delivery of the property thereunder to Maxwell Motor Company, Incorporated.

"It is suggested that, if the conclusions of the special master be sustained, difficulties will arise in working out the plans of beneficial reorganizations; but I think this is a needless fear. Equity usually succeeds in molding its decrees to the requirements of the situation with which it deals, and finds a way to practical as well as just results." ⁷⁰

68. *Id.* at 305.

69. *Cf.* pp. 1036 *et seq.* discussing the cases which disregard the ordinary tests of provability where the corporate lessee is being dissolved.

70. 269 Fed. at 305-306.

This decision was affirmed by the Circuit Court of Appeals in a *per curiam* opinion.⁷¹ There is no contrary decision;⁷² nor have the reasoning and result of the *Howard* case ever been questioned in subsequent decisions.

If the lessee rather than the guarantor were being reorganized in equity receivership, it would usually be difficult, if not impossible, to prevent the landlord's claim from maturing (though perhaps not from being liquidated) prior to the end of the period for proof of claims. The receiver would normally be allowed a reasonable time to disaffirm or to adopt;⁷³ and that period would usually antedate the final date for filing. But in case of bankruptcy, if the rule of provability announced in *In re Roth & Appel*⁷⁴ is followed, a disaffirmance of the lease by the trustee would not make the landlord's claim provable even though the time for filing claims had not run. Hence, by careful engineering, counsel for lessees could keep the landlord's damage claim wholly contingent and make it non-provable. In that event, however, the claim would be no less secure than that of plaintiffs' in the *Howard* case. In fact the engineering of the claim in case of bankruptcy of the lessee could

71. 275 Fed. 53 (C. C. A. 2d, 1921).

72. *Lawndale Sash & Door Co. v. West Side Trust & Savings Bank*, 207 Ill. App. 3 (1917) is the only case found which even implies a result *contra* to that of the *Howard* case. But the case is not reported in full and the facts are not recited. The only reported opinion is in the form of a headnote abstract. What apparently happened was a transfer of assets by one corporation to another corporation, the latter issuing stock to old stockholders and assuming all debts of the transferor. The plaintiff was a landlord of the transferor. No rent was due at the time of the transfer. For rent maturing thereafter the landlord garnisheed funds (apparently accounts receivable) which had been transferred to the new corporation. Judgment dismissing the suit was affirmed. One head note said, "One who leases premises to a corporation is not a creditor of a corporation at the time of the sale of the business of the corporation to another, where there is no rent due under the lease at the time of the sale." The fraudulent conveyance statute and its use of the term "other persons" was said to refer "to persons having a substantial existing claim against parties or property sought to be brought within the terms of the statute." This interpretation is not in accord with the great weight of authority. See cases, *supra* notes 48-53. Whether the *Boyd* case was argued does not appear. But apparently the theory of the garnishment was not the liability of the stockholder's interest in the old company. Similarly, see *Apex Leasing Co. Inc. v. Litke*, 173 App. Div. 323, 159 N. Y. Supp. 707 (1st Dept. 1916) holding the landlord not a creditor under the Bulk Sales Act. It seems likely in that case that the lessee was the controlling stockholder in the corporation to which the assets were transferred. No reference was made to the *Boyd* case nor to its reasoning. Apparently the sole strategy of the case was to bring the landlord into the word "creditors" in the Bulk Sales Act.

73. See cases cited *supra* note 61.

74. Note 3, *supra*.

not normally be so prolonged as in the *Howard* case. Ordinarily the trustee would have to move with reasonable dispatch to disaffirm or adopt. In case of disaffirmance the landlord's damage claim could ordinarily be matured (though perhaps not liquidated) prior to the consummation of the plan.⁷⁵ Hence both in equity receivership and bankruptcy where a corporate lessee is being reorganized under a plan permitting participation by old stockholders of the lessee, the presence of the landlord's claim for damages normally can be asserted prior to the date of consummation of the plan. In other words, the *Howard* case is doubtless one of the most extreme cases likely to arise. If the *Boyd* case applies to such a case, *a fortiori* it would apply where the landlord matures his damage claim at an earlier period.

It might be insisted of course that the design of the guarantor in the *Howard* case to prevent the claim from maturing earlier was so conspicuous and the intent to bar or defraud the landlord so apparent that the decision is of rather limited application. To this two answers may be made. In the first place where the desire to avoid leases is the dominant or a major motivation for bankruptcy or receivership the design to bar the landlord is as conspicuous as in the *Howard* case. Certainly the meticulous care which counsel for tenants have employed in many cases to keep the claim of the landlord from becoming provable supplies the element of intent present in the *Howard* case. In the second place, however, such intent is not a necessary element. Though the avoidance of the lease is merely an incidental feature of the reorganization procedure the principles of the *Boyd* case are equally applicable. As noted above it is not necessarily actual fraud that vitiates a transaction like that in the *Boyd* case. Constructive fraud alone is sufficient. Clear and obvious machinations are not necessary. The existence of a contract out of which a claim is likely to arise is wholly adequate.

It has been before noted that the *Boyd* case applies as well to reorganizations in bankruptcy as to those in equity receivership. Congress has not legislated otherwise. The only relevant section of the Bankruptcy Act is that relating to discharges. To be sure the corporate lessee in bankruptcy may be granted its discharge; but the discharge would affect only provable claims. The landlord having by hypothesis a non-provable claim would remain unaffected. He would accordingly have a claim against the lessee which would come under the protection of the *Boyd* case. This result follows

75. See discussion *infra* pp. 1044 *et seq.* concerning rules of law in some states preventing suit against the tenant until the end of the term.

even though the lessee has effected a composition in bankruptcy. Thus in *Friend v. Talcott*,⁷⁶ decided at the same term as the *Boyd* case, defendant offered a composition in bankruptcy which was confirmed. His discharge was thereby granted. Plaintiff was at the time a creditor for goods sold and delivered. He participated in the composition, receiving dividends on his claim. Thereafter he sued in deceit for damages in procuring the sale of goods on credit, the damages sought being the difference between the price of the goods and the dividends paid upon the composition. The Supreme Court affirmed a judgment for plaintiff holding that, because a claim based on deceit is not barred by a discharge in bankruptcy, plaintiff's cause of action was exempted from the discharge effected through the composition, and that by proving in the composition he had not elected to waive the cause of action for deceit.

Thus property returned to the debtor as a result of the composition or subsequently acquired by him may be reached by creditors who do not have claims affected by the discharge. The composition consideration reserved for creditors who participate in the bankruptcy proceedings may not, it is true, be reached by other creditors. But all other property in which the debtor has an interest may be reached in the same manner as if he had never gone through bankruptcy. This is illustrated by *In re Frischknecht*.⁷⁷ A lessee of realty was adjudicated a bankrupt. At the time of the filing of the petition rent had been paid in advance. Under the rule in the Second Circuit the landlord therefore had no provable claim. After adjudication the lessee offered a composition to his creditors, which was confirmed. The composition consideration was deposited by the trustee for payment to creditors under the composition. The compensation and expenses of the attorneys were not, however, included in that consideration, the attorneys having waived in writing the deposit of a sum sufficient to pay their fees. The day after the composition was confirmed the lessor brought suit for rent accruing after the filing of the petition. In that action he attached a sum owing the bankrupt lessee by a third party. The trustee in bankruptcy moved to vacate the attachment on the ground, *inter alia*, that the sum attached was vested in the trustee and being in *custodia legis* was not subject to attachment. Judgment denying the motion was affirmed. The court said:

" . . . we have no authority under the law to grant the petition of the trustee. We do not agree with him in thinking that the moneys or the

76. 228 U. S. 27 (1913). *Cf.* *Myers v. International Trust Co.*, 263 U. S. 64 (1923).

77. 223 Fed. 417 (C. C. A. 2d, 1915).

accounts in the hands of these bankers, which they obtained from this bankrupt prior to his bankruptcy, were in custodia legis at the time of the attachment. When the court confirmed the composition, the title to these moneys and accounts under the Bankruptcy Act at once reverted in the bankrupt; and such moneys and accounts might have been forthwith handed over to the bankrupt by the bankers without asking the permission of the trustee, or the bankrupt without the consent of the trustee could have maintained an action against the bankers to recover the same. We cannot import into the act what Congress left out of it. The language of the act is that upon confirmation of a composition the title of the bankrupt to his property shall 'thereupon revert in him.'

"The funds which have been attached, and which the trustee is seeking to reach, have never been in the actual custody of the trustee, and formed no part of the sum deposited in the composition proceeding, and the trustee has no right now to reduce them into his possession. The confirmation of the composition operated to supersede the proceedings in bankruptcy, and the Bankruptcy Act operated automatically to revert the bankrupt with the title to his property."⁷⁸

From this line of cases it follows that if the corporate lessee effects a reorganization in bankruptcy—whether or not by means of a composition—and the stockholders participate therein, a landlord who is offered no participation in the plan may subsequently, on maturing and liquidating his claim, reach the interest of the stockholders in the old company under the principle of the *Boyd* case. It is clear, as noted above, that discharge in bankruptcy in nowise affects claims that are not provable. Creditors holding such claims may still reach the assets of the debtor corporation, whether those returned to it under the composition or those subsequently acquired. Since those assets are liable for the payment of such undischarged claims, any transaction which transfers those assets to a new company in which the debtor's stockholders participate is as much a fraudulent conveyance as the transaction involved in the *Boyd* case.

*Aetna Casualty & Surety Co. v. Tramley, Inc.*⁷⁹ is not necessarily contrary to this result. There the creditors of a corporate lessee (a one man corporation) filed a petition in bankruptcy against it. Plaintiff was a surety on several bonds given to secure the payment of rent upon various leases of real property held by the corporation. But since the rent was fully paid at the time of the filing of the petition, plaintiff had not become a creditor of the lessee with a

78. *Id.* at 420-421. And see *Zavelo v. Reeves*, 227 U. S. 625 (1913); *Wilmot v. Mudge*, 103 U. S. 217 (1880); *Wheeling Structural Steel Co. v. Moss*, 62 F. (2d) 37 (C. C. A. 4th, 1932).

79. 260 N. Y. 280, 183 N. E. 425 (1932).

provable claim. A composition offered by the lessee to its creditors was confirmed. All provable claims were to receive 15% in cash; 15% in notes of a new company to which the assets were to be transferred, the notes being guaranteed by the stockholder and secured by the common stock of the new company; and 20% in preferred stock of the new company. The new corporation was formed; the assets were transferred to it; and the composition consideration was distributed to the creditors. The old stockholder became the sole common stockholder of the new corporation. Meanwhile plaintiff's claim against the old corporation had matured and been liquidated. Judgment was recovered and execution returned unsatisfied. Action was then brought against the new company on the grounds of a fraudulent conveyance. The Appellate Division affirmed a judgment of the Special Term establishing a lien on the assets of the new company for satisfaction of the judgment. The Court of Appeals reversed the judgment and dismissed the complaint.

Mention need not be made of the deficiencies in the complaint since the court did not make the decision turn on them. Several factors mentioned by the court should, however, be noted.

(1) To the conclusion of the Special Term that the transfer was fraudulent, the Court of Appeals took exception. It said that "not a fact may be adduced which impugns the good faith of the composition or the transfer provided therein."⁸⁰ As noted, however, the presence of good faith is absolutely immaterial and irrelevant under the doctrine of the *Boyd* case. The Supreme Court made clear that it was the "constructive," and not the actual fraud involved in the Northern Pacific reorganization that made it void as against *Boyd*. In the *Tramley* case the Court went on to say: "It could not have been fraudulent unless we are prepared to say that the District Court which approved it, was a participant in the fraud."⁸¹ The Supreme Court in the *Boyd* case did not hesitate to override a judicial sale made by an eminently honest and upright court. There is thus no such sanctity in a judicial sale that it can withstand all attack except that of actual fraud. On this point then the line of reasoning of the Court of Appeals is contrary to some of the most fundamental concepts of reorganization law.

(2) The Court of Appeals concluded that "plaintiff was a party to the bankruptcy proceedings through the notices published to all creditors" and that the proceeding being in rem the "District Court had adequate and exclusive power to make disposal of the res . . .

80. *Id.* at 286, 183 N. E. at 426.

81. *Id.* at 287, 183 N. E. at 426.

and to pass unassailable title to such assets.”⁸² It is clear, however, that under the rules of the *Talcott* case and *In re Frischknecht* the bankruptcy court does not have the power to bar suits by creditors with non-provable claims; but that they may sue after the composition discharge and reach any assets then owned by the debtor.⁸³ The only “unassailable title” that the bankruptcy court can pass is the composition consideration. It is clear that plaintiff could not reach that but could reach assets title to which was in the debtor.

(3) The Court of Appeals went on to say: “The transfer, made in compliance with the composition, could have defrauded no creditor, since only those creditors entitled to share in the transferred assets, of whom the plaintiff was not one, were the sole beneficiaries thereof, and expressly gave their consent thereto.”⁸⁴ If the court means that, as respects the composition consideration, plaintiff cannot reach it, the result is obviously sound. But for the court to speak of the composition creditors as the “sole beneficiaries” is contrary to fact. The record shows,⁸⁵ as has been noted, that the old stockholder participated in the new company by taking all of its common stock. So far the situation is a typical creditors-stockholders reorganization including some but not all creditors. Substitute a composition for a judicial sale and a small corporation for a big corporation and you have in the *Tramley* case substantially a duplicate of the *Boyd* and *Howard* cases. Now, the Supreme Court has said that the creditor is entitled to reach the stockholders’ interest in the old company. What was that interest in the *Tramley* case? The stock was pledged to secure notes given to the creditors under the composition.⁸⁶ The stockholder therefore had, at the time of suit, only the interest of a stockholder who has pledged his shares. But that interest might or might not be valuable. Hence

82. *Ibid.*, 183 N. E. at 427. In view of the lack of jurisdiction of the Bankruptcy court over plaintiff’s claim the situation is in no way comparable to that in *St. Louis & San Francisco R.R. v. Spiller*, 274 U. S. 304 (1927). See discussion of that case in Frank, *supra* note 34—second installment, to appear in (May, 1933) 17 VA. L. REV. —.

Technically, the property under the composition reverted in the bankrupt which in turn conveyed to the new company. *In re Frischknecht*, *supra* note 77.

83. Cf. *International Life Insurance Co. v. Sherman*, 262 U. S. 346 (1923). Certainly plaintiff in the *Tramley* case was no more a party to the proceedings than was Boyd in the *Boyd* case. See discussion of the *International Life Insurance* case in Frank, *supra* note 82. As to jurisdiction of the bankruptcy court over plaintiff see *infra*, pp. 1032 *et seq.*

84. 260 N. Y. at 287, 183 N. E. at 426.

85. Record on Appeal, p. 30, fol. 89.

86. *Id.* p. 22, fol. 65; p. 30, fol. 89; pp. 51-54, fols. 150-162.

it is impossible to agree with the court that the creditors were the sole beneficiaries.

(4) The measure of recovery granted by the lower courts was denounced by the Court of Appeals which said:

"The Special Term, although finding that the transfer authorized by the composition, and approved by the Federal Court, was fraudulent and void, made no provision for the restoration of the *status quo* before the transfer, the ordinary result flowing from a rescission for fraud. Instead, it provided that the assets of Lucy Lou Shops, Inc., remaining in the hands of Tramley, Inc., be and remain subject to a lien in favor of the plaintiff for the security of its judgment. Under the composition agreement, the creditors were to receive satisfaction of their claims to the extent of twenty per cent thereof in the form of preferred stock of Tramley, Inc. The preferred stock to be paid over was stock in a corporation the assets of which were unincumbered by any lien. Thus, it is apparent that when the Special Term declared the assets of Tramley, Inc., subject to a lien in favor of the plaintiff, it made an attempt not only to alter the terms of an agreement, as made between the parties, but as well to amend the terms of an order of the Federal court confirming the agreement. If valid, this strange result would have followed: The plaintiff, not having in bankruptcy a provable claim, even as a general creditor, through a composition arising in bankruptcy, but modified by the Special Term, would have become a preferred creditor, having a right to distribution superior to all creditors whose claims had been allowed by the bankruptcy court . . . " ⁸⁷

On this point the Court of Appeals is clearly right. The recovery awarded cuts under the composition-consideration. Neither the Bankruptcy Act nor the *Boyd* case would permit that. But because plaintiff received too much does not warrant dismissal of the complaint. Under the doctrine of the *Boyd* case he is entitled to reach the stockholders' interest. Here that was an interest of a pledgor of shares. How valuable it was does not appear. The fact of the matter is that the line of decisions represented by the *Boyd* case were not even mentioned or discussed in the briefs nor, so we have been advised, were they even referred to in argument. The Court of Appeals in its reasoning seems oblivious of the fact that there was a *Boyd* case. In refusing to allow the plaintiff to reach the interest of the creditors in the new company it proceeded consistently with the rules of the *Boyd* case. But in failing to examine the composition as providing a retention by the debtor of an interest in his property as against a non-participating creditor it in effect condoned what the United States Supreme Court has repeatedly condemned.

87. 260 N. Y. at 288-289, 183 N. E. at 427.

(5) The essence of the decision, however, is apparently a jurisdictional point. The court said, "The Special Term had no jurisdiction to declare the transfer fraudulent. The Bankruptcy Act makes an exclusive provision whereby a composition may be set aside . . ." (quoting Section 13). It then proceeded to state that in "matters relating to bankruptcy" the power of the federal courts "is paramount" and "essentially exclusive," and cited various texts on bankruptcy to the effect that an order of confirmation of a composition in bankruptcy "cannot be assailed collaterally in any other court even for fraud in procuring it."⁸⁸

That is fundamental in the law of bankruptcy.⁸⁹ But the cases establishing that rule relate solely to attacks on the validity or effi-

88. *Id.* at 287-288, 183 N. E. at 427.

89. *Abbott v. Anderson*, 31 Am. B. Rep. 877 (Ill. App. 1914); *Turner v. Hudson*, 105 Me. 476, 75 Atl. 45 (1909); *Loeffler v. Wright*, 13 Cal. App. 224, 109 Pac. 269 (1910). And see *In re Roukous*, 128 Fed. 648 (D. R. I. 1904).

§ 21 (f) provides: "A certified copy of an order confirming or setting aside a composition, or granting or setting aside a discharge, not revoked, shall be evidence of the jurisdiction of the court, the regularity of the proceedings, and of the fact that the order was made."

§ 13 provides: "The judge may, upon the application of parties in interest made at any time within six months after a composition has been confirmed, set the same aside and reinstate the case if it shall be made to appear upon a trial that fraud was practiced in the procuring of such composition, and that the knowledge thereof has come to the petitioners since the confirmation of such composition."

By § 2 (9): "courts of bankruptcy" are empowered to "confirm or reject compositions between debtors and their creditors, and set aside compositions and reinstate the cases."

Under these sections it is clear that if the composition is to be set aside and creditors are to be restored to their original position, application must be made to the court confirming the composition. In addition to the cases *supra*, see *In re Ennis*, 183 Fed. 859 (S. D. N. Y. 1910).

Analogous situations are attacks on sales by trustees not satisfying certain statutory requirements but which cannot be attacked collaterally. *Robertson v. Howard*, 229 U. S. 254 (1913). And collateral attacks on a discharge by creditors with provable claims who seek to show irregularities in the bankruptcy proceedings but who are barred from doing so in such proceedings. *Harris v. Steinwax*, 205 App. Div. 317, 199 N. Y. Supp. 447 (1st Dept. 1923); *Kreitlein v. Ferger*, 238 U. S. 21 (1915).

But even if petition is made to the bankruptcy court to set aside the composition it is held that § 13 "sets forth the only grounds for setting aside an order confirming a composition." *In re Isidor Klein, Inc.*, 22 F. (2d) 906 (C. C. A. 2d, 1927). And see *In re Vandeweghe*, 49 F. (2d) 939 (S. D. N. Y. 1931); *In re Graff*, 242 Fed. 577 (E. D. N. Y. 1917); *In re Eisenberg*, 148 Fed. 325 (S. D. N. Y. 1906).

Even jurisdiction to determine conflicting claims of right to participate in composition fund has been denied the bankruptcy court after confirmation of composition. *In re Converse-Hough & Co., Inc.*, 27 F. (2d) 368 (W. D.

cacy of the composition by parties to it.⁹⁰ They do not establish the rule that a creditor not a party to the composition, and over whose claim the court has no jurisdiction may not subsequently reach the *debtor's interest* in the property revested in him by the composition. In fact, under the composition section it seems that the federal court has no jurisdiction to include in a composition creditors who do not have provable claims. Section 12 provides for acceptance by a majority in number (and majority in amount) of all "creditors whose claims have been allowed."⁹¹ Participation is reserved to those with provable claims, with the result that a creditor with a non-provable claim would have no power to set aside a composition under Section 13 of the Bankruptcy Act.⁹² This

N. Y. 1928). Cf. *Fulton National Bank v. Hozier*, 267 U. S. 276 (1925); *California Conserving Co. v. D'Avanzo*, 62 F. (2d) 528 (C. C. A. 2d, 1933).

90. See cases cited note 89, *supra*.

91. The power is given the bankrupt by § 12 to offer either before or after adjudication "terms of composition to his creditors." The word "creditor" as used throughout the act "shall, unless the same be inconsistent with the context, be construed" to "include anyone who owns a demand or claim provable in bankruptcy . . ." § 1 (9). Cf. *American Surety Co. of New York v. Marotta*, *supra* note 53.

It is implicit in the composition cases that only those with provable claims are entitled to participate in the composition. See *c. g. In re Yamini Dry Goods Co.*, 295 Fed. 733 (N. D. Tex. 1923); *In re Frischknecht*, *supra* note 77, at 420; *In re Adler*, 103 Fed. 444, 447-448 (W. D. Tenn. 1900). Of course, unliquidated and even disputed and contested claims must be provided for in the deposit of the consideration. *In re Everick Art Corp.*, 39 F. (2d) 765 (C. C. A. 2d, 1930). Cf. *Phelan v. Parsons*, 23 F. (2d) 7 (C. C. A. 1st, 1927).

92. This is indicated not only because of the construction of "creditors" in § 12 as indicated *supra* note 91, but for the following reasons as well:

(1) While scheduled claims may be permitted to participate in the composition though not filed within the statutory period provided for filing [*Nassau Smelting & Refining Works, Ltd. v. Brightwood Bronze Foundry Co.*, 265 U. S. 269 (1924)], even provable claims filed after the meeting of creditors to vote on the composition cannot be counted in determining whether or not a majority of creditors approve the composition. *Miller's Apparel, Inc. v. H. Simonoff & Son, Inc.*, 29 F. (2d) 507 (C. C. A. 1st, 1928). *A fortiori*, creditors without provable claims would have no vote on the composition.

(2) § 13 of the Bankruptcy Act provides for setting aside of a composition "upon the application of parties in interest." It seems clear that a creditor without a provable claim and therefore one whose claim would not be discharged by the composition is not a party "in interest." Under § 14 similar language is used respecting the right to oppose a discharge. The granting of a discharge may be opposed "by the trustee or other parties in interest." And some courts have held that a creditor whose claim is not dischargeable (though provable) is not entitled to oppose the discharge or to have it revoked. *In re Servis*, 140 Fed. 222 (N. D. Ia. 1905); *In re Main*, 205 Fed. 421 (N. D. Ia. 1913); *In re Chandler*, 138 Fed. 637 (C. C. A. 7th, 1905); *In re Gara*, 190 Fed. 112 (E. D. Pa. 1911); *In re Menzin*, 233 Fed.

reasoning would by negative implication deprive the federal court of the power to bar non-provable claims. As established by the *Talcott* and *Frischknecht* cases the creditor with a non-provable (or otherwise undischarged) claim remains unaffected in the sense that he may still reach assets to which his debtor has title when he brings suit. Following the reasoning of the court in the *Tramley* case, the *Talcott* and *Frischknecht* cases were wrongly decided. They were no more "collateral attacks" on the composition than was the *Tramley* case. In fact it is a misnomer to call suits of that character "collateral attacks" on the composition. They were attempts to reach assets of the debtor remaining after the consummation of a composition—not to reach the composition consideration. And the complaint in the *Tramley* case was susceptible of the same interpretation.

It is evident on a reading of the *Talcott* and *Frischknecht* cases that it was not necessary for those creditors to apply to the court having jurisdiction over the composition in order to reach assets of

333 (S. D. N. Y. 1916). But see *Ex parte Traphagen*, Fed. Cas. No. 14140 (S. D. N. Y. 1842). Cf. *In re Maples*, 105 Fed. 919 (D. Mont. 1901) (voluntary petition scheduling no non-exempt property and only one debt, and that non-dischargeable, is no basis for adjudication). Others have held he may oppose the discharge even if his claim is not dischargeable provided it is provable. *In re Feuer*, 4 F. (2d) 892 (C. C. A. 2d, 1925); *In re Armstrong*, 248 Fed. 292 (S. D. Cal. 1918); *In re Lewis*, 163 Fed. 137 (E. D. N. Y. 1908); *In re Reed*, 191 Fed. 920 (W. D. Okla. 1911). And see *In re Tebbetts*, Fed. Cas. No. 13817 (C. C. D. Mass. 1842) under bankruptcy act of 1841; *In re Perelstine*, 15 F. (2d) 64 (W. D. Pa. 1926).

Likewise he may if his claim was provable though not proved. *In re Bimberg*, 121 Fed. 942 (S. D. N. Y. 1903); *In re Conroy*, 134 Fed. 764 (E. D. Pa. 1905); *In re Nathanson*, 155 Fed. 645 (E. D. N. Y. 1907).

There is good sense in permitting a creditor with a provable but not dischargeable claim to oppose the discharge. At the time of the hearing on the discharge it may be uncertain whether or not he can later establish his claim as being non-dischargeable. This uncertainty would clearly exist in actions for fraud and deceit. If he can defeat the discharge he strengthens his chances of getting judgment. For this reason the court in *In re Feuer*, *supra*, said "there is no good reason for saying he may not have two strings to his bow."

The close similarity in language between the sections providing for opposition to a discharge and application for setting aside a composition indicate that the foregoing cases would be applicable in interpreting "parties in interest" in § 13. Cf. *In re Downtown Wet Wash Laundry, Inc.*, 53 F. (2d) 133, (S. D. N. Y. 1931).

While *In re Feuer*, *supra*, said that "parties in interest" includes "any creditor" no case has been found where a creditor with a non-provable claim has been held to be included in "parties in interest" entitled to oppose a discharge under § 14 or to have a composition set aside under § 13. But see *In re Tebbetts*, *supra*.

the debtor. This is apparent in *Meyers v. International Trust Co.*⁹³ In that case there was a composition between a bankrupt partnership and the partnership creditors only and in respect only of partnership debts. After confirmation of the composition, suit was brought against the partners individually as endorers of partnership notes. It was held that the composition did not discharge the partners as individuals from their separate obligations as endorers. The action was brought in the state court. The Supreme Court permitted the suit without question. That suit did not affect or disturb in any way the bargain expressed in the composition.⁹⁴ By the same token plaintiff's action in the *Tramley* case to reach the interest of the stockholder would in nowise affect or override the composition there made. Hence a proceeding under Section 13 of the Bankruptcy Act to set aside the composition would be clearly unnecessary. In fact, as indicated above, it is by no means clear that the bankruptcy court would have jurisdiction, under the composition sections, to entertain plaintiff's complaint of being excluded. In any event, until it is held that the bankruptcy court has such jurisdiction, creditors in the class of plaintiff might well be accorded the protection to which they are entitled in any court where personal jurisdiction over defendant can be obtained. In this respect the argument for sustaining such an alleged "collateral attack" is much stronger than that which existed for sustaining the attack in the *Boyd* case. In the *Boyd* case the federal court in the Eastern District of Wisconsin had jurisdiction over the sale.⁹⁵ It had the power to require a fair offer to Boyd. Yet the Supreme Court did not compel Boyd to apply to that court for permission to attack the reorganization or to attack it in that court. Boyd brought his action in the Eastern

93. 273 U. S. 380 (1927). Cf. *Farley & Co. v. Stoll*, 250 Mich. 495, 231 N. W. 71 (1930).

94. The nature of a composition is well described in the *Meyers* case, at 383: "... a composition is 'a settlement of the bankrupt with his creditors'—in a measure superseding and outside of the bankruptcy proceedings—which originates in a voluntary offer by the bankrupt and results, in the main, from voluntary acceptance by his creditors; that the respective rights of the bankrupt and the creditors are fixed by the terms of the offer; and that upon the confirmation of the composition they get what they 'bargained for,' and no more."

By the same reasoning the "bargain" in the *Tramley* case would in no way affect the plaintiff, and his pursuit of the old stockholder's interest would in no way affect the composition, any more than would a composition between creditors and a corporation necessarily affect the rights of the creditors against the stockholders for watered stock. *In re Berler Shoe Co., Inc.*, 246 Fed. 1018 (S. D. N. Y. 1917).

95. 228 U. S., at 487.

District of Washington.⁹⁶ And there is no doubt that such action would have lain in any court where Boyd could have obtained jurisdiction of the defendants. Such suit being allowed in the *Boyd* case, *a fortiori* it should be allowed in such a case as the *Tramley* case.

A totally different result would, of course, follow if Congress had extended the composition sections to include creditors of the class of plaintiff in the *Tramley* case. But Congress has not. Hence the *Tramley* case cannot be sustained on any of the grounds on which it was placed, except that relating to the measure of recovery.⁹⁷ To be consistent with other cases in the law of compositions and reorganization the court should have reversed with directions to establish a lien on the old stockholder's equity in the pledged common stock.

There is another line of reasoning which reaches the same result. The great majority of bankruptcy cases holding that the landlord had no provable claim involved individual or partnership lessees. To rank the landlord as the holder of a non-provable claim in these cases is not to cut him off completely, for, as noted, he may pursue the lessee even after discharge. But when a corporate lessee is being wound up and dissolved in receivership or is using bankruptcy as a stage in the dissolution process, quite different considerations prevail. To bar the landlord then is to bar him forever, unless, of course, the lessee is being reorganized. Consequently in the few cases which have arisen in which the point has been argued, there has been a decided tendency in the direction of eliminating the technical barriers against provability and of allowing the claim, though it falls short of satisfying the ordinary standards of provability.

96. 170 Fed. 779 (E. D. Wash. 1909).

97. One other point should be noted, though it was not mentioned by the Court of Appeals. It might have been argued that the proper party defendant was the stockholder not the corporation. In cases like the *Boyd* case where there are many stockholders the simple direct remedy is against the assets of the new company. In case of a one-man corporation it might be thought that the remedy should be against the stockholder individually in which action his interest in the company would be reached. It should be noted, however, that normally there would be no personal liability of the stockholder. Cf. *In re Alamac Operating Corp.*, 42 F. (2d) 120 (C. C. A. 2d, 1930). The action is in rem. But the same result could be reached as in the *Boyd* case by impounding the common stock allocated to the old stockholder subject of course to the lien of the creditors under the composition. This variation in procedure hardly seems important. Whether the action is brought against the corporation or the stockholder the lien established by the judgment would reach the common stock. See also Frank, *supra* note 82.

In *Kalkhoff v. Nelson*⁹⁸ the stockholders petitioned for a dissolution under a state dissolution statute. Dissolution was allowed and a receiver was appointed. The corporation at the time was insolvent. Prior to dissolution the corporation had entered into a ten year lease with appellants calling for monthly rentals. At the time of the appointment of the receiver the lease had about seven years to run. The receiver declined to accept the benefits of the lease and abandoned it as an asset of the corporation. The appellants apparently did not accept the offer to surrender and accordingly filed a claim for damages sustained by reason of the breach of the covenant of the lessee to pay rent at the stipulated rate for the full term. The claims were disallowed. An order denying appellants' motion for a new trial was reversed by the Supreme Court of Minnesota. The court applied the rule of anticipatory breach applicable to contracts involving personalty.⁹⁹ In adverting to cases under its insolvency statute, it stated that those lessees "continued liable for rent notwithstanding the insolvency proceedings" but went on to say that,

" . . . in the case at bar the corporation has, by its voluntary dissolution, practically committed suicide, and when its estate is administered it ceases to exist. Therefore, if the corporation cannot be held liable for a total breach of its executory contracts, the law has armed it, and all other domestic corporations, with the power to repudiate all the obligations of their executory contracts, by simply instituting proceedings by its stockholders for a voluntary dissolution."¹⁰⁰

The court added that

" . . . all discussions of what claims may or may not be proved against the estate of an insolvent under bankrupt and insolvency laws, and all decisions of courts in cases arising under such laws, are not relevant to this case.¹⁰¹ The construction of this statute must be the same whether the corporation is solvent or insolvent, and any construction which would permit the distribution of the assets of a solvent corporation to its stockholders without full payment of all its legal liabilities including damages

98. 60 Minn. 284, 62 N. W. 332 (1895).

99. *Laybourn v. Seymour*, 53 Minn. 105, 54 N. W. 941 (1893); *Bowe v. Minnesota Milk Co.*, 44 Minn. 460, 47 N. W. 151 (1890).

100. 60 Minn. at 288, 62 N. W. at 333.

101. See *e. g.* *Wilder v. Peabody*, 37 Minn. 248, 33 N. W. 852 (1887), disallowing claim for future rent against assignee under state insolvency statute. The court distinguishes this case (1) on the ground that the claim was for rent, not damages for total breach; (2) because the lessees were individuals who had not incapacitated themselves from ever performing the obligations of the lease.

for breaches of its executory contracts, must be rejected, unless its words and manifest meaning forbid it."¹⁰²

The other case is *In re Mullings Clothing Co.*,¹⁰³ decided by the Circuit Court of Appeals for the Second Circuit. Shortly before the commencement of a five year renewal lease, the stockholders of the corporate lessee voted to wind up its affairs. Accordingly, a petition was filed in the state court in Connecticut asking for the appointment of a receiver under the statutes and praying for a dissolution and winding up. The receiver was appointed. He repudiated the lease. The lease gave the lessor the right to recover possession through summary process on specified default in rent. After repudiation of the lease by the receiver the corporate lessee filed a voluntary petition in bankruptcy and was adjudicated. The trustee in bankruptcy also repudiated the lease. The lessor then relet the premises for the balance of the term at a reduced rental and sought to prove in bankruptcy for the amount of the deficiency. The order dismissing the petition for liquidation of the claim was reversed. The court stated that though the dissolution of a corporation does not terminate a lease,¹⁰⁴ nevertheless

"In voting to wind up, and in taking steps to dissolve and securing the appointment of a receiver in the state court for that purpose, the corporation lessee renounced the lease and at the same time disabled itself from performing it. . . . And the law is well settled that, where a party to an executory contract¹⁰⁵ puts it out of his own power to perform it, there is an anticipatory breach, which gives the other party an immediate right of action for damages."¹⁰⁶

The plaintiff-lessor therefore had such right of action. The court added that "If that were not true, he would be remediless; the corporation being insolvent and determined to cease business and go out of existence."¹⁰⁷

102. 60 Minn. at 290, 62 N. W. at 334.

103. 238 Fed. 58 (C. C. A. 2d, 1916).

104. *People v. National Trust Co.*, 82 N. Y. 283 (1880); *Cumington Realty Associates v. Whitten*, 239 Mass. 313, 132 N. E. 53 (1921). *Contra*: *Hastings Corp. v. Letton* [1908] 1 K. B. 378 under the Companies Act of 1862. See cases Note (1922) 17 A. L. R. 532. As to the effect of death of an individual lessee, see Note (1930) 68 A. L. R. 590.

105. In a subsequent case, *In re Barnett*, 12 F. (2d) 73 (C. C. A. 2d, 1926) the same court said respecting the *Mullins* case, "We do not regard it as having decided that a lease is an ordinary bilateral contract." The question involved in the *Barnett* case was whether or not the covenants in a lease for payment of rent were independent or dependent. And see *In re Wise Shoes, Inc.*, *supra* note 10; *In re Marshall's Garage, Inc.*, 63 F. (2d) 759 (C. C. A. 2d, 1933).

106. 238 Fed. at 63.

107. *Id.*, at 64.

The claim was held provable in bankruptcy since it matured on repudiation by the state receiver and hence was both a claim existing at the date of the filing of the petition as well as a claim under Section 63 (a) (4). But the important part of the case is the court's differentiation of this case from its earlier cases holding such claims not provable. It said:

"It has no analogy to a case of ordinary bankruptcy of an insolvent tenant. The filing of the petition in bankruptcy in such a case does not terminate the relation of landlord and tenant, but the tenant remains liable for the future rent as it accrues. It does not end the capacity of the tenant to engage in future business and to acquire other assets which can be reached by the lessee in subsequent proceedings for the payment of the rent which subsequently accrues. It does not involve an abandonment of the lease, and does not disable the tenant from afterwards performing its covenants."¹⁰⁸

Here, then, are two cases—one in receivership and one in bankruptcy—applying a different rule on provability of landlords' claims when dissolution of the corporate lessee has been effected or in process.¹⁰⁹ The fact that these courts admit the proof in this type of case and not in the ordinary case of individuals, partners or corporations not in process of dissolution indicates once more the implied assumption in the latter cases that no great hardship is being done the landlord. For in the latter type of case the landlord

108. *Id.*, at 68.

109. There are supporting authorities. Thus in *People v. National Trust Co.*, *supra* note 104, before the end of the term a receiver was appointed for the corporate lessee on application of stockholders and the attorney general commenced an action for the forfeiture of the franchise and dissolution. A decree of dissolution was entered. The receiver refused to pay subsequently accruing rent. But he had in his possession more than enough funds to pay all creditors including rent to the landlord for the balance of the term. The landlord petitioned for an order directing the receiver to pay the rent then due. The orders denying the petition were reversed. The court denied the contention that dissolution terminated the lease. It said, at 287: "Under the statutes of this State, on the dissolution of a corporation, its assets become a trust fund for the payment of its debts, and these include debts to mature as well as accrued indebtedness, and all engagements entered into by the corporation, which have not been fully satisfied or cancelled. These cannot be cancelled without the consent of the party holding them, and receivers of dissolved corporations are authorized to retain out of their assets a sufficient amount to cancel and discharge such open and subsisting engagements." On the basis of this dictum the same result would follow in New York as in the case of *Kalkhoff v. Nelson*, *supra* note 98. The rule of the latter case was applied in *Minneapolis Baseball Co. v. City Bank*, 74 Minn. 98, 76 N. W. 1024 (1898) where a statutory receiver had been appointed for a bank on petition of creditors.

has his claim against the discharged or rehabilitated person or corporation after bankruptcy or receivership is terminated.

In but few cases has this analysis received either favorable or unfavorable consideration. *Fidelity Safe Deposit & Trust Co. v. Armstrong*,¹¹⁰ decided by a federal circuit court in Ohio in 1888, is one case taking a contrary position. The corporate lessee was a national bank taken over by the comptroller of the currency under the national banking act. A receiver was appointed and the charter of the bank was forfeited. The claim of the landlord was disallowed. The type of argument used in *Kalkhoff v. Nelson* and *In re Mullings Clothing Co.* was apparently presented to this court. The court's answer was that the statute permitting a forfeiture of the charter was in force at the time the lease was made and that these contingencies should have been taken into account by the lessor when he made his contract and "if not satisfied to rely upon the bank itself, the only other course would have been to insist upon security for the performance of the conditions of the lease."¹¹¹ It is not clear from the case whether the claim was for future rent or for damages. Apparently it was for rent. But rent reserved would not be the measure of recovery on anticipatory breach any more than would the price under an ordinary sales contract.¹¹² Hence the case may be distinguished on that ground. If the reason for the decision is that there can be no anticipatory breach of a lease the case is, of course, not without support. Yet on its facts it lays down a rule much less persuasive than the two later cases opposed to it. Certainly it should make no difference that in this case the dissolution was caused by the intervention of the comptroller of the currency while in *Kalkhoff v. Nelson* and *In re Mullings Clothing Co.* the dissolution was effected through the initiative of the corporations and their stockholders. The Supreme Court has made no such distinction in treating bankruptcy as an anticipatory breach; the rule of the *Chicago Auditorium* case¹¹³ is applicable to involuntary as well as voluntary bankruptcies.

In the foregoing cases there was no corporate reorganization contemplated. The effect of a reorganization, however, would be exactly the same under present procedures. The old corporation would be dissolved and the assets acquired by another. To leave the landlord with a claim against a propertyless entity would in

110. 35 Fed. 567 (C. C. S. D. Ohio 1888). Cf. *In re Wise Shoes, Inc.*, *supra* note 10; *Pacific States Corp. v. Rosenshine*, 113 Cal. App. 266, 298 Pac. 155 (1931); *Towle v. Commissioner of Banks*, 246 Mass. 161, 140 N. E. 747 (1923).

111. 35 Fed. at 569.

112. WILLISTON, *CONTRACTS* (1920) § 1329.

113. Note 5, *supra*.

effect be to accomplish the very thing that the *Boyd* case and its 13 ELIZABETH background vitiate.

The *Kalkhoff* case and *In re Mullins* lead by different roads to the same result as the *Howard* case. They alter the rule of provability and make the landlord's claim matured, though perhaps unliquidated, in the event of corporate dissolution. The *Howard* case admits its non-provability but grants it protection against the appropriation by stockholders of the assets of the debtor. Courts need not extend the doctrine of anticipatory repudiation to leases in order to give the landlord participation in a reorganization plan which allows participation by the old stockholders in the new company. Adoption of the rule of anticipatory repudiation merely aids in the problem of valuation of the landlord's claim for purposes of participation in the plan. It is no sine qua non for protection under the *Boyd* case.

III.

The difficult problem of valuation of the landlord's claim remains. That issue was not involved in the *Howard* case because of a stipulation as to damages. And, of course, if the landlord is not offered participation in the plan no peculiar or unique question as to valuation need arise. He can mature his claim in the ordinary and usual way and sue the new company when his judgment is obtained. That might be one year or twenty years after the reorganization. As long as he moves promptly after his claim matures, he would not be barred by laches any more than was *Boyd*. But since the rules of the *Boyd* case give the landlord protection, reorganization managers will be confronted with the difficult problem of valuing the claim to determine what cash provision should be made or what other participation under the plan should be reserved for him. In general two types of situations will arise: (1) In case of a reorganization of a guarantor (the lessee remaining a going concern) it would be wholly uncertain at all stages of the reorganization whether or not the guarantor would ever be liable, or if liable, what the extent of the liability would be; (2) In case of a reorganization of the lessee whether in bankruptcy or receivership, the lease normally would be adopted or disaffirmed within a reasonable time¹¹⁴ after the initiation of the proceedings.

In the first place if the lease, or, in case of a reorganization of the guarantor, the guaranty, is adopted it would normally be assumed by the new corporation. That obviously would be protection and

114. See cases cited note 61, *supra*.

participation of the lessor sufficient to satisfy all requirements of the *Boyd* case.

If the guaranty is not assumed, then we have substantially the situation in the *Howard* case. In that case counsel urged that "difficulties will arise in working out the plans of beneficial reorganizations" if landlords must be provided for in reorganization plans. But Judge Mayer replied that "Equity usually succeeds in molding its decrees to the requirements of the situation with which it deals, and finds a way to practical as well as just results."¹¹⁵ With that point of view it is not difficult to devise a procedure consistent with the requirements of the *Howard* case. These requirements are to make a fair and equitable offer to the landlord in the reorganization of the guarantor. Clearly he is not entitled immediately to receipt of cash or securities. He may never be entitled to them, since the lessee may never default. It is known, however, what the maximum amount of the liability of the guarantor will be from the date of the consummation of the plan to the end of the lease. It may be less; it will never be more. Precision in estimating it is impossible since no cause of action has matured. The maximum amount can be taken as if it were a presently liquidated sum. Cash or securities can be reserved for the maximum amount of that claim. And the court should have the power to force the landlord to elect which of those alternatives he will choose. Having chosen, he is forever bound. No cash or securities will be delivered to him immediately but they will be impounded for his benefit. As, if and when his claim matures he must liquidate it. Once liquidated the amount of his participation will be finally determined. If the claim is less than the estimated maximum, the participation will be reduced proportionately.

It may be argued that such method hopelessly delays the whole reorganization and holds in abeyance for an almost interminable period the final distribution of cash or securities. In case of long term leases guaranteed by the defendant this might be true. From the viewpoint of the new company, however, it is a choice of equally undesirable alternatives. In case no provision is made for the landlord, he may later sue the new company. How much his recovery will be, if any, or when he may sue is also uncertain. Reorganization managers may choose the latter alternative as the preferable one. In either event the ascertainment of the ultimate liability will be held in abeyance. Consequently there seems to be nothing particularly undesirable in giving the landlord contingent protection under the plan. To allow the court to have that power

115. 269 Fed. at 306.

certainly prevents the landlord from later obtaining an undue preference over other creditors. Viewed from the position of the reorganization managers, much the same difficulty was present in the *Boyd* case. At the date of the sale, which occurred in 1896, it was still uncertain what the amount of the claim against the Coeur D'Alene would be. The Supreme Court of Idaho did not finally decide the question until 1897.¹¹⁶ When decided it was by no means certain what the liability, if any, of the Northern Pacific Railroad Company would be. If it was not liable, no provision at all need be made for Boyd. In requiring reorganization managers to provide for creditors like Boyd, the Supreme Court forces the adoption of an administrative rule which will afford protection to "as, if, and when" creditors. The requirement of the *Howard* case is hardly more exacting.

The claim of the landlord (or in case of payment under the guaranty, the claim of the guarantor) in the reorganization of the lessee raises problems equally unsettled. The liability of the lessee to the landlord may be governed: (1) by no express covenant in the lease; (2) by an express covenant in the lease which stipulates how the damages are to be measured but not when they are to be paid; (3) by an express covenant stipulating not only the measure of damages but also the time of their payment. For purposes of convenience (1) and (2) may be treated together. In those jurisdictions¹¹⁷ which permit an action for damages for anticipatory repudiation of a lease the measure of damages is normally taken to be the difference between rent reserved and the fair rental value of the premises for the balance of the term.¹¹⁸ The jury is allowed to estimate that sum. The degree of guesswork involved obviously increases as the length of the balance of the term becomes greater. But the elements of speculation and guesswork are no barriers to an assessment. As stated by one court:

116. Note 46, *supra*.

117. *Wilson v. National Refining Co.*, *supra* note 7; *Grayson v. Nixon*, 176 Ark. 1123, 5 S. W. (2d) 312 (1928); *Curran v. Smith-Zollinger Co.*, 157 Atl. 432 (Del. 1931); *Leo v. Pearce Stores Co.*, 57 F. (2d) 340 (E. D. Mich. 1932); *Womble v. Leigh*, 195 N. C. 282, 142 S. E. 17 (1928); *In re Reading Iron Works*, 150 Pa. 369, 24 Atl. 617 (1892). And see Note (1927) 6 N. C. L. Rev. 63; Note, *Id.* 495 (1928); *Novak v. Fontaine Furniture Co.*, 84 N. H. 93, 146 Atl. 525 (1929); *Weir v. Cooper*, 122 Miss. 225, 84 So. 184 (1920).

118. *Grayson v. Nixon*, *supra* note 117; *Wilson v. National Refining Co.*, *supra* note 7. In case of a reletting for the balance of the term the claim would be for the deficiency. *In re Mullins Clothing Co.*, *supra* note 103; *Curran v. Smith-Zollinger Co.*, *supra* note 117. On burden of proving fair rental value cf. *Leo v. Pearce Stores Co.* and *Womble v. Leigh*, both *supra* note 117.

"It is true, the damages are unliquidated, and that it cannot be shown with absolute certainty that the appellants, except for the breach of the contract by the corporation, would have completely executed the contract on their part, so as to become entitled to its full benefits; but the same difficulties are presented in a greater or less degree in all actions for the recovery of damages for the breach of executory contracts. Any difficulties, real or supposed, in ascertaining the damages in this case, cannot defeat the action."¹¹⁹

And analogies can be supplied on end.¹²⁰ In jurisdictions having the rule of anticipatory repudiation the claim would be liquidated and the participation under the plan determined accordingly.

Some jurisdictions, however, have adopted a different rule both in cases where there is no express covenant and in cases where the covenant is silent as to the time when damages are recoverable. One leading case is *Hermitage Co. v. Levine*.¹²¹ In that case the lessor re-entered and relet the premises pursuant to a covenant providing that "the tenant shall remain liable for all damages which the landlord may sustain by any such breach of this agreement, or through such entry or reletting." The new leases were for terms substantially less than the balance of the term of the defendant. The lessee was not being liquidated or reorganized. The action was for damages suffered by the landlord through deficiency of rents computed to the date of commencement of the action. The Court of Appeals reversed

119. *Kalkhoff v. Nelson*, *supra* note 98, at 288. And see *Leo v. Pearce Stores Co.*, *supra* note 117.

120. Thus in an action for damages for breach of a contract to lease realty damages may be recovered at once. *Branning Mfg. Co. v. Norfolk Southern RR. Co.*, 138 Va. 43, 121 S. E. 74 (1924); *Bondy v. Harvey*, 218 App. Div. 126, 217 N. Y. Supp. 877 (1st Dept. 1926); *Oldfield v. Angeles Brewing & Malting Co.*, 62 Wash. 260, 113 Pac. 630 (1911); *Addieg v. Tull*, 187 Fed. 101 (C. C. A. 2d, 1911). In *Bondy v. Harvey*, *supra*, the agreement was for a 99 year lease. As to the measure of damages the court said, at 126, 217 N. Y. Supp. at 873: "The court charged the jury that it could fix the present value of the lease by multiplying the difference between the rent reserved and the rental value by ninety-nine, the number of years that the lease had to run. While this is the rule applied in valuing short term leases where the present value of the payment is not in serious issue, this rule cannot be applied to an assessment of damages which results from a breach of a contract to lease where the payment or benefit from the payment would not accrue at the longest term under the lease for ninety-nine years. It is obviously the correct rule that such damage as the plaintiff suffered by reason of not securing the lease and losing the benefit of the difference between its value and the rent reserved, is the present value of such sum arrived at by making such proper abatement as would give the present value of such difference for the period specified in the lease."

121. 248 N. Y. 333, 162 N. E. 97 (1928).

a judgment of the Appellate Division for plaintiff and affirmed a judgment of the Trial Term dismissing the complaint. Chief Judge Cardozo said:

" . . . in the absence of a provision that points with reasonable clearness to a different construction, a liability for damages resulting from a reletting is single and entire, not multiple and several. The deficiency is to be ascertained when the term is at an end. . . . The tenant when ejected ceases to be a tenant. What he covenants to pay is the damage, not the rent. To hold him for monthly deficits is to charge him with the obligations of a tenant without any of the privileges. He must pay in the lean months, without recouping in the fat ones. He must do this, though it may turn out in the end that there has been a gain and not a loss. A liability so heavy may not rest upon uncertain inference.

"We do not overlook the hardship to the landlord in postponing the cause of action until October, 1945. The hardship is so great as to give force to the argument that postponement to a date so distant may not reasonably be held to have been intended by the parties. There is no reason to suppose, however, that the landlord was expectant of so early a default or so heavy a deficiency. It had in its possession a deposit of cash security in the sum of \$30,000. Very likely this was supposed to be enough to make default improbable and the risk of loss remote. If the damage clause as drawn gives inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future ended with the cancellation of the lease except in so far as he bound himself by covenant to liability thereafter."¹²²

On the basis of this decision no action can be brought until the end of the term. If the *Hermitage* case is to be followed in reorganizations so as to make it impossible to liquidate the claim presently, the difficulties of providing for the landlord in the reorganization plan will be as acute here as in the case of the guarantor discussed above. The *Hermitage* case has some support.¹²³ Other jurisdictions adhering to the doctrine of anticipatory repudiation would hold otherwise¹²⁴ and permit immediate liquidation. But the cases establishing the rule laid down in the *Hermitage* case did not have their origin in reorganizations. In any event the reorganization court should

122. *Id.* at 338-39, 162 N. E. at 100, 101. *Cf.* Mann v. Munch Brewery, 225 N. Y. 189, 121 N. E. 746 (1919).

123. Providence Building Co. v. Atlantic National Bank, 228 Fed. 814 (D. R. I. 1916); Woodbury v. Sparrell Print, *supra* note 54; Phillips-Hollman v. Peerless Stages, 210 Cal. 253, 291 Pac. 178 (1930); Treff v. Gulko, 297 Pac. 978 (Cal. App. 1931), *aff'd.*, 214 Cal. 591, 7 P. (2d) 697 (1932).

124. In addition to the cases *supra* note 117, see Stott Realty Co. v. United Amusement Co., 195 Mich. 684, 162 N. W. 283 (1917). *Cf.* John Church Co. v. Martinez, 204 S. W. 486 (Tex. Civ. App. 1918).

not permit them to stand in the way of an expeditious and early adjudication of the claim of the landlord. To delay the ultimate distribution of the securities or the cash under the plan in order to satisfy the technical requirements of the *Hermitage* case is undesirable. Insofar as possible, administrative rules in this connection should be devised to accelerate the consummation of the plan. As Swaine has said, "receiverships are always expensive luxuries."¹²⁵ The chancellor should shape the decrees to meet the exigencies of the situation. The claim could be referred to a master for liquidation and adjudicated once and for all. It is far more sensible to liquidate it presently in a manner "familiar and fair" than to let it survive the reorganization and be imposed on the new company at a distant date, as it could be under the rule of the *Howard* case. We are here passing on unanswered legal questions. The urge is for an administrative rule that will determine with finality the rights of all parties. In terms of effective reorganizations this pragmatism has strong appeal. To requote Judge Mayer, "Equity usually . . . finds a way to practical as well as just results."¹²⁶ In a court of equity the procedure recommended should find ready adoption.

Reference has been made above to claims of the landlord for rent maturing after a disaffirmance by the trustee or receiver of the lessee. It is doubtful if proof of all future rent under an acceleration clause would be allowed in bankruptcy or receivership. It would violate the spirit of the bankruptcy act and of receivership. Though there is not much authority, what there is indicates that the landlord's claim would not be evaluated at his option in terms of future rent.¹²⁷

125. Swaine, *supra* note 34, at 921.

126. 269 Fed. at 306.

127. *Kothe v. R. C. Taylor Trust*, 280 U. S. 224 (1930). And see *McKinnon v. Cohen*, 7 Alb. L. Rep. 317 (1914) arising under the Assignment Act of 1907. For other cases see Note (1929) 58 A. L. R. 300, 302, 314. But see *Rosenblum v. Uber*, 256 Fed. 584 (C. C. A. 3d, 1919). It should be noted that in the *Kothe* case the only event accelerating the due date of the rent was the filing of a petition in bankruptcy. If other events as well would accelerate the rent and the breach of any of them would cause losses uncertain and not out of all proportion to the amount of accelerated rent [*Kemble v. Farron*, 6 Bing. 141 (K. B. 1829)], it might be argued that such provision was valid even in bankruptcy. At least it would be less apparent that the "real design" was to insure to the lessor preferential treatment in the event of bankruptcy as in the *Kothe* case. If, however, a broader view of liquidated damages were taken and so far as bankruptcy or receivership is concerned the test of intent discarded, the same result as in the *Kothe* case would be reached. To allow such claims would in some cases practically amount to exclusion of other creditors. Furthermore, it would thrust the lease upon the receiver or trustee willy-nilly with no power to refuse to adopt it, with the necessity perhaps of liquidating it on a reletting over a long period of years. This would follow

He would be entitled to his leasehold and his damages and nothing more.

In case the landlord chooses to stand on his lease and collect future rent as it matures—a right he clearly possesses apart from reorganization¹²⁸—the reorganization court should have power to deal with him effectively. To put it beyond the power of a court of equity to make him a fair offer under the plan and hence bar him forever is highly undesirable. Two procedures are possible. The first is to provide for his participation as the rent becomes due during the balance of the term by setting aside securities deliverable on rent days; the second is to liquidate at once his claim for damages and to give him present participation to the full amount of his claim. The first is out of the question. It delays the reorganization and thrusts the lease upon the new company even against the better judgment of the reorganization managers and the court. The second is clearly the only practicable alternative. "Fair offer" under the *Boyd* case permits of discretion on the part of the court. It by no means requires the court to follow all the niceties of technical rules of law developed in other situations. Accordingly the equity court has the power to protect the new company against renewed and continuing demands of the landlord in his claim for rent as it matures, by giving him an offer that is "fair" when judged in light of the exigencies of the situation. That calls for liquidation of his claim in terms of damages, not rent, in all cases where the new company does not adopt the lease.

Other rules of law have arisen respecting the valuation of the landlord's claim but which have no appropriate place in reorganizations. Thus, it has been held that in absence of a reletting for the balance of the term¹²⁹ or, in lieu of that, a showing that a reasonable effort has been made but without success,¹³⁰ the claim is

since a landlord could not have his land and rent it too. The adoption of the rule of the *Kothe* case in all bankruptcy and receivership cases no matter how the covenant is worded or conditioned makes for more equitable treatment of all creditors and avoids the likelihood of giving the landlord a preferred position (in fact though not in law).

128. See cases *supra* note 60.

129. For cases permitting proof in receivership where there has been a reletting for the balance of the term, see *People v. St. Nicholas Bank*, 151 N. Y. 592, 45 N. E. 1129 (1897) [especially the opinion below 3 App. Div. 544, 547, 38 N. Y. Supp. 379, 381 (1st Dept. 1896)]; *McGraw v. Union Trust Co.*, 135 Mich. 609, 98 N. W. 390 (1904). The same result is reached under a general assignment. *Smith v. Goodman*, 149 Ill. 75, 36 N. E. 621 (1893).

130. In such event the claim has been held non-provable in receivership. *International Trust Co. v. Weeks*, 203 U. S. 364 (1906). *Contra*: where he has made an honest and reasonable but unsuccessful attempt to relet. *Woodland v. Wise*, 112 Md. 35, 76 Atl. 502 (1910).

not provable in receivership nor is it maintainable against the lessee apart from receivership or bankruptcy. How far reorganization courts will go in applying that rule is undecided. But here as in the other situations discussed above the call is for a direct and simple method of liquidation, so as to adjudicate once and for all the rights of the parties and to permit the new company insofar as possible to begin business with a clean slate. The reorganization procedure may afford ample time for the lessor to make reasonable efforts to relet for the balance of the term. Or again it may not. Or he may be able to relet for only a part of the balance. The procedure to be adopted should be moulded to the requirements of the case. No technical rule of law should stand in the way of the chancellor effecting substantial justice for all and taking such short cuts as are desirable in avoidance of rules which make impossible a timely readjustment of the claims of all creditors.

This requirement is forcibly demonstrated in the third group of cases listed above. Frequently covenants specify that the damages are to be computed and paid monthly, or at other stated periods. If those covenants are enforced literally, as they normally would be,¹³¹ the landlord under the *Howard* case would be in a position to pursue the new company for the deficiencies month after month over a period of years. Those rules, developed out of other situations, certainly have no place in reorganization procedure. The demand here as in the other cases is to devise an administrative procedure which will bring as large a degree of finality as possible into liquidation of claims for participation in plans. The equity of the situation clearly calls for that protection to landlords which is afforded by the *Howard* case. It also calls as clearly for a formulation of a procedure which will give no undue advantage to the landlord and produce no long delays in consummation of the plan.

The alternative to overriding the technical requirements of the *Hermitage* case would be to provide a contingent participation for the landlord as in the case of the guarantor. The disadvantages of that are so apparent as to need no further mention. They should be avoided where possible. They can hardly be avoided in many cases of guarantors because of the insuperable difficulty of determining intelligently whether or not the lessee will ever default. Once a default is made, however, the difficulty is present but not so great. The value of the leasehold is much more readily and objectively determinable in

131. *McCready v. Lindenborn*, 172 N. Y. 400, 65 N. E. 208 (1902); *Underhill v. Collins*, 132 N. Y. 269, 30 N. E. 576 (1892); *Jones v. Rushmore*, 67 N. J. L. 157, 50 Atl. 587 (1901); *Miller v. Benton*, 55 Conn. 529, 13 Atl. 678 (1887); *Kottler v. New York Bargain House, Inc.*, 242 N. Y. 28, 150 N. E. 591 (1926).

such a case than is the claim of the landlord against the guarantor in case the lessee at some unknown and undeterminable future time defaults.

IV.

As stated above there has been considerable condemnation of the employment by lessees of bankruptcy and receivership to avoid leases, and a growing insistence where that was the dominant motive that adjudication in bankruptcy and appointment of receivers should be at least zealously guarded or even denied. If the state of the law permitted the lessee to rid itself of the landlord so easily and to reorganize under the protection of the court without regard to claims of the landlord, the insistence upon guarded uses of legal methods to accomplish that result would be justified. The need for reduction of fixed charges, however, is so insistent and the desirability of financial rehabilitation is so great that the problem from the viewpoint of the law is not to make it difficult to reorganize but to guarantee that reorganizations be conducted fairly and equitably. The scrutiny of courts should be most severe at the stage where the reorganization plan is being formulated. At that juncture should landlords receive their protection. And a recognition of the applicability of the *Boyd* case to this situation will give landlords everything to which they are entitled. They are not entitled to the preferred position which they would have if, regardless of the judicial sale or composition, they could sue the new company; nor can their exclusion from the plan be justified on any legal or business grounds.

Landlords are as much in business with their tenants as any other creditors.¹³² In reorganizations they should be accorded the same treatment as any other creditor. The feudal aspects of their legal rights and duties should not obscure the dominant business and economic characteristics of their position.¹³³ As frequently as not they are in as precarious financial position as their tenants, having equally unbearable burdens of overhead. In fact, in innumerable instances the so-called landlord is none other than a group of bondholders who have financed the building. It is the interest of those bondholders that is ultimately at stake; and pitted against that interest is the interest of the lessee which in turn represents the investments of other creditors, bondholders and stockholders. The problem becomes, then, one of wholesale reorganization with dis-

132. More so, in fact, under the forms of percentage leases used somewhat in the past and now apparently more in vogue. See N. Y. World-Telegram, December 16, 1932, at 36.

133. See note 6, *supra*.

crimination against no type of creditor. The process of effective financial rehabilitation can best be furthered by a recognition of the applicability of the *Boyd* case to this situation and by the development of expeditious administrative procedures which will facilitate the liquidation of claims. There can be no doubt that the general equity powers are sufficiently flexible to meet the requirements of the situation.