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NOTES AND COMMENTS

SUSPENSION OF STATE INSOLVENCY LAWS BY OPERATION OF THE FEDERAL BANKRUPTCY ACT. The Supreme Court of Washington in the recent decision of *Armour & Co. v. Becker et al.*,[1] has again raised a question mooted since 1819, as to the effect of the existence of a Federal Bankruptcy Act on the operation of a State Insolvency Law. Under present conditions, the problem of the availability of liquidating devices becomes peculiarly important, and warrants an analysis of the existing law on the subject. In the instant case, the plaintiff sought to recover the sum of $293.14 for goods and merchandise delivered to defendant, who was running a meat market and purchased goods until December 18, 1929, when he became insolvent. Defendant then made an assignment for the benefit of his creditors to one Beeson, which assignment was made, under stipulated facts, strictly in accord with the insolvency statute of Washington.[2] Plaintiff received a check as his pro rata share under this assignment, but did not negotiate it, and then brought this action for the original sum due, against both the defendant market owner and his guarantor, on the ground that the Federal Bankruptcy Act[3] had rendered the assignment void or voidable, and that any creditor not having received payment in full would be entitled to ignore the assignment and proceed to collect his claim against the debtor and guarantor. The Supreme Court in affirming a judgment for the plaintiff, relied on the two cases of *Interna-*

[1] 67 Wash. Dec. 179, 9 Pac. (2d) 63 (1932) Since this note went to press the Washington Supreme Court has followed the holding of the instant case in *Tacoma Grocery Company v. Doersch*, 68 Wash. Dec. 516 (1932).
[2] Rem. Comp. Stat. 1086 et seq., Pierce's Code, 2854 et seq.
[3] USCA, Title 11.

tional Shoe Co. v. Pinkus,[4] and *Re Tarnowski.*[5] The Washington court said.

> "It was there distinctly held [in the *Pinkus* case] that the passage of the Bankruptcy Act superseded the state law, at least in so far as it relates to the distribution of property and discharges to be given."

At the outset, it must be noted that the question dealt with here is concerned only with state insolvency acts, and not with common law assignments for the benefit of creditors. It seems there is a direct conflict as to what constitutes an insolvency law. Some courts held that it must contain a provision for the discharge of a debtor.[6] Others, however, state that such a provision is not necessary, but that provisions similar to those contained in the bankruptcy act will be sufficient to make the law an insolvency code.

> "The elements of an insolvency law are insolvency, surrender of property, its administration by a receiver or trustee, distribution of the assets among the creditors,and a provision for priorities or other matters not permissible in the absence of such statute. A provision for the discharge of the debtor from the unpaid balance of his debts is not essential to make it an insolvency law."[7]

Probably all courts would agree that if a provision for discharge of the debtor is present in the act, it is an insolvency statute.[8]

It is possible in reviewing the cases covering the principal question involved, to divide the jurisdictions into three main classes. The first class holds that during the existence of a national bankruptcy law, all proceedings under a state insolvency law are null and void for all purposes. The reasons for this doctrine are succinctly stated in *International Shoe Co. v. Pinkus,*[9], where it is said

> "The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount The purpose to exclude

[4] 278 U. S. 261, 73 L. ed. 318, 49 S. Ct. Rep. 108 (1928). For comments on this case see 27 Mich. L. Rev. 696, 29 Col. L. Rev. 519.

[5] 191 Wis. 279, 210 N. W 836, 49 A. L. R. 686 (1926).

[6] *In Re McElwain*, 296 Fed. 112 (1924) where it is said: " but we think that the gist of a bankrupt act is first to make a statutory distribution of the assets of an insolvent to all his creditors, and, secondly, to grant a statutory discharge." *Pelton v. Sheridan*, 74 Ore. 176, 144 Pac. 410 (1914) *Greene v. Rice*, 32 Idaho 504, 186 Pac. 249 (1919).

[7] *Re Weedman Stave Co.*, 199 Fed. 948 (1912). *Re Hall Co.*, 121 Fed. 992 (1903) *Re Salmon*, 143 Fed. 395 (1906) *Carling v. Seymour Lumber Co.*, 113 Fed. 992, 51 C. C. A. 1, 8 A. B. R. 29, certiorari denied 186 U. S. 484, 46 L. ed. 1261, 22 S. Ct. Rep. 943 (1902) *Harbaugh v. Costello*, 184 Ill. 110, 56 N. E. 363, 75 A. S. R. 147 (1900).

[8] *Boese v. King*, 108 U. S. 379, 27 L. ed. 760, 2 S. Ct. Rep. 765 (1882) *Stellwagen v. Clum*, 245 U. S. 605, 62 L. ed. 507, 38 S. Ct. Rep. 215 (1918) and see note in 49 A. L. R. 691.

[9] See note (4), *supra.*

> state action for the discharge of insolvent debtors may be manifested without specific declaration to that end, that which is clearly implied is of equal force as that which is expressed The general rule is that an intention wholly to exclude state action will not be implied unless, when fairly interpreted, an Act of Congress is plainly in conflict with state regulation of the same subject In respect of bankruptcies the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation. It is apparent, without comparison in detail of the provisions of the Bankruptcy Act with those of the Arkansas statute, that intolerable inconsistencies and confusion would result if that insolvency law be given effect while the National Act is in force."[10]

The attitude above stated probably represents a numerical minority of the cases, but as will be seen later, seems to be the modern trend of authority

The second view taken by some jurisdictions is that the Bankruptcy Act only suspends the action of the state insolvency laws, when the bankruptcy act is invoked, that is, when a petition in bankruptcy is filed within four months of an assignment under an insolvency act.[11] This doctrine, while in the minority, had much more support in earlier cases than at present. While it is said that until bankruptcy proceedings are actually instituted, no attack can be made against proceedings under state insolvency laws on the theory that the bankruptcy act is paramount, which would appear to be a refutation of the first view, it is clear that such an adjudication avoids, rather than decides, the principal question.[12] Under the bankruptcy act itself[13] any general assignment

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[10] See also, *Parmenter Mfg. Co. v. Hamilton*, 172 Mass. 178, 51 N. E. 529 (1898) *Thornhill v. Bank of La.*, Fed Cas. No. 13,992, app. dismissed, *Morgan v. Thornhill*, 11 Wall. 65, 20 L. ed. 60 (1870) *Littlefield v. Gay*, 96 Me. 422, 52 Atl. 925 (1902) *Martin v. Berry*, 37 Cal. 208 (1869) *Com. v. O'Hara*, 6 Phila. 402, 3 Pitts, R. 70 (1867) *Ketcham v. McNamara*, 72 Conn. 209, 46 Atl. 146, 50 L. R. A. 641 (1900) *International Shoe Co. v. Pinkus, supra*, note (4) *Johnson v. Chapman Milling Co.*, — Tex. Civ. App. — 37 S. W (2d) 776 (1931). For a commendation of this view see article by Samuel Williston in 22 Harv. L. Rev. 547.

The impression given by most of the cases listed in note 7 is that those courts if squarely presented with this view would follow it, and decide that insolvency laws are totally suspended by the mere passage of the Bankruptcy Act.

[11] *Boese v. King, supra*, note 8; *Carling v. Seymour Lumber Co., supra*, note 7 *Boston Mercantile Co. v. Ould-Carter Co.*, 123 Ga. 458, 51 S. E. 466 (1905) *Jensen-King-Byrd Co. v. Williams*, 35 Wash. 161, 76 Pac. 934 (1906) *Patty-Joiner & Eubanks Co. v. Cummins*, 93 Texas 598, 57 S. W 566 (1900) *Shaw v. Standard Piano Co.*, 87 N. J. Eq. 350, 100 Atl. 167 (1917) *Driver v. Garey*, 143 Ark. 112, 220 S. W 667 (1920). Cf. *Re Standard Fuller's Earth Co.*, 186 Fed. 578 (1911) *In Re Bankshares Corpn. of U. S.*, 50 Fed. (2d) 94, —— C. C. A. — (1931) In *Walker v. Emerich*, 300 Pa. 9, 149 Atl. 881 (1930), the case may be distinguished on the ground that the state insolvency act was little more than a common law assignment recording act; they state the rule, however.

[12] See *Roberts Cotton Oil Co. v. F E. Morse Co.*, 97 Ark. 513, 135 S. W. 334 (1911).

[13] Sec. 3(a) (5) USCA, Tit. 11, sec. 21(a) 4.

for the benefit of creditors is an act of bankruptcy, and thus such decisions do no more than follow the bankruptcy act, rather than attempt to resolve the conflict between the two laws. Furthermore, this same section applies as well to common-law assignments as to assignments under an insolvency act, and since common-law assignments are generally held valid despite the bankruptcy act on the theory of contract rights and *jus disponendi* of the debtor[14] any distinction which should be made between the two is lost.

The third, and probably the majority opinion, is that the insolvency law of the state is suspended only in so far as it conflicts with the Bankruptcy Act. This attitude is certainly consistent with the normal interpretation of the conflict between any state and federal act, and raises a number of interesting and difficult questions. This conclusion was first reached in the leading case of *Sturges v. Crowninshield*,[15] in which Chief Justice Marshall held that the mere fact that the Constitution[16] gave Congress the power to promulgate a uniform system of bankruptcy did not prevent the states from passing insolvency laws, which would take effect in the absence of such an uniform system, and that only when the exercise of this power conflicted with the insolvency laws were the latter suspended. Naturally, such a decision opens a great field for judicial interpretation, but the ruling was affirmed in *Ogden v. Saunders*[17] and *Stellwagen v. Clum*[18] where the court said.

> "Notwithstanding this requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the State in certain particulars, although such recognition may lead to different results in different states Such recognition in the application of state laws does not affect the constitutionality of the Bankruptcy Act, although in these particulars the operation of the act is not alike in all features."[19]

Under the Bankruptcy Statute itself,[20] there are three different situations which arise, calling for the resolution of conflicts. In the case of municipal, insurance, railroad, banking corporations, or building and loan associations, neither voluntary or involuntary

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[14] *Boese v. King*, *supra*, note 8; *Pogue v. Rowe*, 236 Ill. 157, 86 N. E. 207 (1908) *Thompson v. Shaw*, 104 Me. 85, 71 Atl. 370 (1908) *Armour Packing Co. v. Brown*, 76 Minn. 465, 79 N. W. 522 (1899) *Patty-Joiner & Eubank Co. v. Cummins*, *supra*, note 11, *In re Sievers*, 91 Fed. 366 (1899) *Bell v. Blessing*, 225 Fed 750, — C. C. A. — (1915) *Mayer v. Hellman*, 91 U. S. 496, 23 L. ed. 377 (1876) *Downer v. Porter* 116 Ky. 422, 76 S. W S. W 135 (1903) *Binder v. McDonald*, 106 Wis. 332, 82 N. W 156 (1900) *McAvoy v. Jennings*, 44 Wash. 79, 87 Pac. 53 (1906) *Cadwallader v. Shaw*, 127 Me. 172, 142 Atl. 580 (1928).

[15] 4 Wheat. 122 (1819).

[16] Article I, section 8.

[17] 12 Wheat. 213 (1827).

[18] See note 8, *supra*.

[19] See also, *Hazelwood v. Olinger Bldg. Dept. Stores, Inc., et al.*, — Wis. — 236 N. W 591 (1931) *Re Tarnowski*, *supra* note 5, *Rayborn v. Reid*, 139 S. C. 529, 138 S. E. 294 (1927).

[20] As amended Feb. 11, 1932 [Public—No. 27—72d Congress]: "Sec. 4. who May Become Bankrupts.—(a) Any person, except a municipal, rail-

bankruptcy is allowed. This immediately raises the question as to the policy of Congress in making such a provision. Was it to deprive these entities of the benefits of any form of insolvency proceeding, or was it merely considered that state proceedings would be more beneficial in such cases? It is possible for the courts to take two views, either that by the mere fact that the bankruptcy act mentions these persons, they are covered by the bankruptcy act, and thus any provision in the insolvency act as to them is suspended, or that since the benefits of the act are not extended to them, they may come under provision of the insolvency acts. In the particular case presented no decisions are found bearing out the first possibility, except, of course, those that support the rule that all proceedings under insolvency statutes are null and void. But the attitude under the second theory is well expressed in the case of *U S. vs. People's Trust Co. et al.*:[21]

> "While it is commonly said that the Bankruptcy Law of 1898 supersedes the Insolvency Act, this is true only so far as the two acts conflict. Banking corporations are expressly excepted from the operation of the federal act. Therefore the 'complete system of insolvency law' under which the affairs of a state bank may be liquidated remains in full force."

Another problem arises in the cases of wage-earners, or persons engaged chiefly in farming or the tillage of the soil, who are allowed to become voluntary bankrupts, but not involuntary bankrupts. Again the same principles are involved. The recent case of *Adrian State Bank of Adrian v. Klinkhammer*[22] says.

> "We are convinced that, while the National Bankruptcy Act is in force, Chapter 90 of the General Statutes of 1913 is in abeyance and inoperative as to farmers, because it attempts to act within the field appropriated by Congress under the National Bankruptcy Act. To hold otherwise would result in endless confusion and would circumvent the purposes of the act of Congress which evidently intended to protect the farmer from involuntary bankruptcy proceedings. If we were to hold that Chapter 90 might be invoked for the purpose of distribution for assets alone,

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road, insurance, banking corporation, *or a building and loan association*, shall be entitled to the benefits of this act as a voluntary bankrupt.

"(b) Any natural person, except a wage-earner, or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, *or a building and loan association*, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this Act.

"The bankruptcy of a corporation *or association* shall not release its officers, directors, or stockholders, as such, from any liability under the laws of a State or Territory or of the United States."

Italics indicate the amendment made in 1932.

[21] — N. H. — 155 Atl. 191 (1931).

[22] 182 Minn. 57, 233 N. W 588 (1930).

and that only the provision for release of debtors is to be inoperative during the time that the National Bankruptcy Act is in effect, the Insolvency Act could be used for the purpose of forcing farmers to take voluntary proceedings under the National Bankruptcy Act, thus accomplishing indirectly what Congress evidently did not intend to permit."

While on the other hand, a majority of other courts which have passed on the question follow the reasoning as expressed in *Old Town Bank v. McCormick*.[23]

"He [defendant] says it is true that while class [farmers] is not included in, and is expressly excepted from, the voluntary feature of the system, yet it is included in the voluntary feature, and therefore it is within the scope of the national system. We cannot approve of this method of reasoning, not only because it would seem to be a 'contradiction in terms to say that cases excepted from the operation of the most important part of the act are included in its scope,' but because it would seem to involve the proposition that the federal power can render inoperative the state insolvent laws applicable to involuntary insolvency, without establishing a genuine bankrupt law to take the place of the state law. As we have already seen, it has been held from an early day that it is only to the extent that Congress has actually legislated upon the subject that the statutes of the several states are suspended by its legislation. How, then, can it be said that a failure to legislate—in other words, an express exclusion—raises a conflict? it seems to us, that the position taken by the defendant must necessarily lead to the conclusion that if the Congress of the United States can, by including this class in the voluntary part of the system, and excepting it from the involuntary part, withdraw it from the operation of our state insolvent law, it can do the same in regard to any two or more classes (as, for instance, merchants, traders, and corporations), and the result would be that, in spite of the failure on the part of Congress to establish a bankrupt law (that is, to actually exercise the power conferred by the constitution to pass a genuine bankrupt law)[24] state legislation would become inoperative, and creditors would be deprived of a remedy to which they are fairly entitled."[25]

[23] 96 Md. 341, 53 Atl. 94 A. S. R. 577, 60 L. R. A. 577 (1903).

[24] See *Sturges v. Crowninshield*, *supra* note 15.

[25] Accord: *Lace v. Smith*, 34 R. I. 1, 82 Atl. 268, Ann. Cas. 1913E, 945 (1912) *Rockville Nat. Bank v. Latham* et al., 88 Conn. 70, 89 Atl. 1117 (1914) *Pitcher v. Standish*, 90 Conn. 601, 98 Atl. 93, L. R. A. 1917A, 105 (1916) *In re McElwain*, *supra* note 6. Under the original act of 1898 (30 U. S. Stat, at Large 544) which read before the amendment of 1910: "Sec. 4. Who May Become Bankrupts.—(a) Any person who owes debts, except a corporation, shall be entitled to the benefits of this act as a voluntary bankrupt," raising the same problem as above, the following cases are in accord: *State National Bank of Denison v. Syndicate Co. of Eureka Springs et al.*, 178 Fed. 359 (1910) *Roberts Cotton Oil Co .v. F E. Morse &*

A similar situation is presented where the debts of the insolvent are not sufficient to allow him to be put into involuntary bankruptcy, and the question then arises, whether this situation being covered by the bankruptcy act prevents the creditors from taking advantage of a provision of the insolvency act, in order to wind up the debtor's estate. The same typical conflict is found, some courts holding that such a debtor may come under the provisions of the insolvency act,[26] others holding that the bankruptcy act has covered the situation and supersedes all insolvency laws on the same subject.[27]

Having the various rulings before one, it is apparent that the cases holding under the third class that the Bankruptcy Act having actually mentioned a certain class, has superseded the insolvency laws as to them, may as easily be placed in the first category, namely, among those courts which believe the Bankruptcy Act has immediately suspended the working of all insolvency laws. In result, at least, this is the case, although the language in most of the cases will not support that premise.

What will be the result in Washington and in what class does the principal case fall? A study of the cases on the principal question reveals that a majority of courts have always followed the ruling of the Supreme Court of the United States almost implicitly when treating this question. It is very possible, of course, that state courts may interpret such decisions differently, but in the main, the results are about the same. From *Sturges v. Crowninshield*[28] to *International Shoe Co. v. Pinkus*[29] the court of the United States has shown a complete change of reasoning. The latter case if given an unstrained construction, both from the standpoint of result reached and the argument used, would seem to support the view that all insolvency laws are superseded, due to the need for uniformity throughout the United States. This construction is borne out by the few state cases following it.[30] However, the principal case also cites with approval the Wisconsin case of *Re Tarnowski*,[31] which holds that though the discharge provision of the act is suspended, the regulatory features are still in effect. There seems to be a radical difference between the two cases. While it may be justly argued, that from a practical standpoint, the result of the Wisconsin case should be reached, it hardly seems probable that in view of the United States case it will be reached, and at least, if the Washington court holds that the regulatory features of our act are still in effect, it may serve as a ground for appeal to the Federal system.

ARTHUR GRUNBAUM.

Co., *supra* note 12; *Keystone Driller Co. v. Super. Ct. of San Francisco*, 138 Cal. 738, 72 Pac. 399 (1903) *Dille v. People*, 118 Ill. App. 426 (1905) *Rogers v. Boston Club et al.*, 205 Mass. 261, 91 N. E. 321, 28 L. R. A. (ns) 743 (1910) *Landis Machine Co. v. Cooper* 53 Pa. Super. Ct. 416 (1913) and under former acts, *Simpson v. City Savings Bank*, 56 N. H. 466, 22 Am. Rep. 491 (1876).

[26] Shepardson's Appeal, 36 Conn. 23 (1869).

[27] *International Shoe Co. v. Pinkus*, *supra* note 4; *Johnson v. Chapman Milling Co.*, *supra* note 10; and the principal case, *supra* note 1.

[28] *Supra*, note 15.

[29] *Supra*, note 4.

[30] *Supra*, note 27, but see *Straton v. New*, 283 U. S. 318, 75 L. ed. 1060, 51 S. Ct. Rep. 465 (1931).

[31] *Supra*, note 5.