THE CURRENT CONFLICT BETWEEN THE COURT OF CHANCERY AND THE BANKRUPTCY COURT

Our governmental system of dual sovereignty creates difficulties of administration in certain instances where the appropriate fields of Federal and State action overlap. The Constitution expressly reserves to the States, or to the people, those powers not delegated to the United States. The difficulties are in determining the extent of the delegation. There is a steady clamor that the Federal Government is encroaching upon the domain of the States.[1]

The Courts have been careful, insofar as is humanly possible, to preserve the rights of the respective sovereignties, putting many of their decisions on the broad ground of comity. The conflict has been sharp in connection with the administration of bankrupt or insolvent corporations, especially in the State of New Jersey.

New Jersey early developed a corporate law which attracted to the State the leading corporations of the nation. With the ebb and flow of economic tides some of these corporations became financially involved or insolvent and required refinancing and reorganization. New Jersey kept pace with economic conditions and developed an elastic Corporation Act which for speed and ease in winding up and reorganizing insolvent corporations is in the main far superior to the tedious provisions of the Bankruptcy Act.

Conflict between the State and Federal Courts over the administration of the affairs of insolvent or bankrupt corporations became inevitable. It manifested itself early in *Gallagher* v. *Asphalt Co. of America*[2] and in *Singer* v. *National Bedstead Manufacturing Co.*[3] After an interval there followed *Cavagnaro* v. *Indian Tire & Rubber Co.*[4] and *Cudahy* v. *New Jersey Dairy Products Co.*[5] and more recently *Shachat* v. *Standard Auto Supply Co.*[6] The gage was flung down in earnest and

[1] For an interesting account of the general conflict see Warren, *Federal and State Court Interference*, 43 HARV. L. REV. 345 (1930).
[2] 65 N.J. Eq. 258 (Ch. 1903).
[3] 65 N.J. Eq. 290 (Ch. 1903).
[4] 90 N.J. Eq. 532 (Ch. 1919).
[5] 90 N.J. Eq. 541 (Ch. 1919).
[6] 106 N.J. Eq. 105 (Ch. 1930).

in recent years the New Jersey Court of Chancery has carried the battle directly to the Federal Courts. The Court of Chancery in granting orders to show cause why receivers should not be appointed for an alleged insolvent corporation, has incorporated in these orders extraordinary restraints.

In *Albert & Kernahan* v. *Monitor Park Theatre Co.*[7] the Court ordered:

> "That all persons stockholders of the defendant and firms or corporations including sheriffs and marshals and their officers, agents, attorneys, representatives, servants and employees, whether creditors or claiming to be creditors or having or claiming to have any right, title or interest of, in and to any property or properties of the defendant corporation, be and they hereby are enjoined and restrained from instituting or prosecuting or continuing the prosecution of any action instituted under and by virtue of the United States Bankruptcy Act, and the various amendments thereof and supplements thereto, without first giving the receiver herein appointed at least five days' notice of the institution, prosecution or continuing the prosecution of any such action, and at the same time serving upon the said receiver copies of petitions, affidavits, orders and other pleadings intended to be presented or used thereon."

An analysis of this case reveals the following situation. The suit is by a creditor against a New Jersey corporation praying that the statutory injunction issue against the defendant corporation restraining it from exercising its privileges and franchises and, incidental thereto, that a receiver be appointed to take charge of its assets to the end that they be sold and the proceeds distributed among its creditors. The procedure under the statute is not an application for a receiver. It is in the nature of a *quo warranto* proceeding.[8] The Court may grant the statutory injunction, yet it may withhold the appoint-

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[7] Albert & Kernahan, Inc. v. Monitor Park Theatre Co., Docket 70 page 352 in the office of the Clerk of the Court of Chancery, Trenton, New Jersey.
See also C. F. Albert Lumber Co. v. Kenvil Lumber & Store Co., Docket 76 page 16 for a similar order.

[8] See note (2) *supra.*

ment of a receiver if there are no assets to be administered. The Court may refuse to grant the injunction, and will then be jurisdictionally unable to appoint the receiver even though the corporation has assets.

The cases in New Jersey hold that a statutory receiver, as distinguished from a custodial receiver, cannot be appointed for a corporation unless there is a statutory injunction disabling the corporation from exercising its privileges and franchises. The order granting this statutory injunction is, therefore, a condition precedent to the appointment of a receiver under the Corporation Act.[9] The proceedings under the statute have also been described as being in the nature of a probate proceeding—that is to procure the forfeiture of the corporate franchise—the legal death of the corporate entity.[10] As the Court said:

> "On the other hand, our statutory action puts the defendant corporation practically to death and then begins, and then only can begin, to distribute the assets of the practically defunct corporation among its creditors."[11]

Yet in such a *"quo warranto"* or "probate proceeding" between creditors or stockholders on the one hand and the corporation on the other, a great Court steeped in splendid judicial traditions enjoins without notice—"All persons * * * including sheriffs, marshals * * * whether creditors or claiming to be creditors * * * of the defendant corporation instituting or prosecuting or continuing the prosecution of any action instituted under or by virtue of the United States Bankruptcy Act * * * without first giving the receiver herein appointed at least five days' notice of the institution, prosecution or continuing the prosecution of any such action."[12]

The restraining order is objectionable on many grounds. First, the creditors and stockholders are not parties to the suit. This type of suit is strictly *inter partes*. It is an action *in rem*. It is a contest between the complainant and the defendant corporation. Again it may be considered improper, from the view-

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[9] Gallagher v. Asphalt Co. of America (note 2 *supra*).
[10] Singer v. National Bedstead Manufacturing Co. (note 3 *supra*).
[11] Ibid 65 N.J. Eq. at page 290 (note 3 *supra*)
[12] See note (7) *supra*.

point of strict equity pleading, in a proceeding by a creditor or stockholder to restrain a corporation from exercising its franchise, to join as parties therein the creditors of the defendant corporation for the purpose of enjoining them from bringing suits against the corporation. Such a bill might be considered multifarious.[13]

The order in the *Monitor Park* case in enjoining creditors from "continuing the prosecution of any action instituted under or by virtue of the United States Bankruptcy Act" is indefensible because it is subversive of all the decisions relating to courts of concurrent jurisdiction. This type of order in effect restrains a creditor from prosecuting a bankruptcy proceeding although commenced prior to the filing of the creditors bill in the Court of Chancery. It will be shown hereafter that in the administration of the affairs of a bankrupt corporation the Federal Courts in Bankruptcy have paramount jurisdiction. But even if the Federal Courts had only concurrent jurisdiction with the State Court this part of the order could not be sustained.

The Supreme Court of the United States in *Harkin* v. *Brundage*[14] announced the rule concerning the exercise of concurrent jurisdiction as follows:

> "As between two courts of concurrent and coordinate jurisdiction, the Court which first obtains jurisdiction and constructive possession of property by the *filing of the bill* is entitled to retain it without interference and cannot be deprived of its right to do so, because it may not have obtained prior physical possession by its receiver of the property in dispute."[15]

In *O'Neill* v. *Welch*[16] the Court said:

> "While the two courts have concurrent jurisdiction in the sense that each has the same jurisdiction, it is the policy of the law that the jurisdiction of both

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[13] Bull v. International Paper Co. 84 N.J. Eq. 6 (Ch. 1914); Pierce v. Old Dominion Smelting Co. 67 N.J. Eq. 399 at 414 (Ch. 1904). (In this case Stevenson, V.C., intimated that a bill should not join an application for a receiver under the statute with an application for a receiver under the general equity power of the Court.)

[14] 276 U.S. 36, 72 L. Ed. 457 (1928).

[15] Palmer v. Texas 212 U.S. 118 (1909); Empire Trust Co. v. Brooks 232 Fed. 641 (C.C.A. 5th, 1916).

[16] 245 Fed. 261 (C.C.A. 3rd, 1917).

> shall not be concurrently invoked and exercised; hence it is a well settled rule that as between two courts having concurrent jurisdiction of the subject of an action, the Court which first obtains jurisdiction has the right to proceed to its final determination without interference from the other. In our mixed system of State and Federal jurisprudence, such a rule is found not only desirable but necessary."[17]

Guided by these rules, the *Monitor Park* order is unsound because, even assuming the jurisdiction were only concurrent, the Chancery Court had no power over the corporate assets once the Federal Court had seized them, since the filing of a bankruptcy petition, just as the filing of a bill in the Court of Chancery, places the property of the corporation in *custodia legis*.[18] The only thing the New Jersey Court of Chancery could legally do in such a situation would be to enjoin the corporation from exercising its privileges and franchise since the Bankruptcy Court does not deal with the franchise of the corporation; and if necessary, appoint a receiver to take back from the trustee in bankruptcy for the benefit of stockholders the assets of the corporation remaining after paying the creditors in full as was done in *Unger* v. *Newlin Haines*.[19]

The order is further objectionable in that it enjoins creditors from filing a petition in bankruptcy against the corporation. The jurisdiction of the Federal Court in bankruptcy proceedings is not co-ordinate with the State Courts. It is a superior, a paramount jurisdiction. It is derived from the Constitution of the United States. The Constitution provides that "the Congress shall have power to establish * * * uniform laws on the subject of bankruptcies throughout the United States."[20]

Congress has enacted various Bankruptcy Acts, the most

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[17] Pitt v. Rodgers 104 Fed. 387 (C.C.A. 9th, 1900); Amusement Syndicate v. El Paso L.I. Co. 251 Fed. 345 (D.C.W.D. Texas 1918); Ward v. Foulkroyd 264 Fed. 627 (C.C.A. 3rd, 1920); Taylor v. Taintor 16 Wall 370 (1873); Farmers Loan & Trust Co. v. Lake St. R.R. 177 U.S. 51 (1900); McKinney v. Langdon 209 Fed. 300 (C.C.A. 8th, 1913).

[18] Bailey v. Baker Ice Machine Co. 239 U.S. 268 (1915); Capital City Cap Co. 251 Fed. 664 (D.N.J. 1918); Hammer v. Israel 89 N.J. Eq. 481 (Ch. 1919); Stanton v. Metropolitan Lumber Co. 107 N.J. Eq. 345 (Ch. 1930).

[19] 94 N.J. Eq. 458 (E. & A. 1923).

[20] Section 8 Constitution of the United States.

[21] Section 9 U.S. Compiled Statutes (1910) page 11,007.

recent of which is the Bankruptcy Act of 1898[21] and that Act creates the United States District Courts as Bankruptcy Courts. The Act provides that "Courts of Bankruptcy shall include the District Courts of the United States and of the Territories * * * ."[22]

The Bankruptcy Act permits the filing of a voluntary petition by a corporation and the filing of an involuntary petition by creditors against a corporation. The order therefore, insofar as it prohibits a creditor from pursuing his remedy against his debtor is violative of that creditor's right which has been given to him by the Constitution of the United States and the Bankruptcy Act. It may even be argued that depriving him of that right without notice may be depriving him of property without due process of law.[23] The cases which have demonstrated that the jurisdiction of the Federal Court is paramount are legion.[24] Indeed the Federal Courts have held that a Bankruptcy Court is powerless to surrender its control of the administration of the estate.[25]

It is thus apparent from the cases dealing with this phase of the problem that a State Court has no power to restrain creditors from filing a petition in bankruptcy against a bankrupt corporation and certainly has no power to restrain creditors from continuing with the prosecution of a bankruptcy proceeding already begun.

In *Tappen & Indruck Co. et al* v. *Delpark, Inc.*[26] an order to show cause contained the following *ad interim* restraint:

> "And it is further ORDERED that the said corporation, its officers, servants and agents are hereby restrained and enjoined from taking any corporate action for the purpose of having a receiver appointed for the defendant company in any other cause."

An analysis of the creditors bill filed in the *Delpark* case

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[22] Bankruptcy Act of 1898 Section 1, sub-division (8).

[23] American & British Mfg. Co. 300 Fed. 849 (D. Conn. 1924).

[24] Sturges v. Crowninshield 4 Wheat 122 (1819); International Shoe Co. v. Pinkus 278 U.S. 261 (1929); *In re* Watts 190 U.S. 1 (1903); Isaacs v. Hobbs Tie & Timber Co. 282 U.S. 734 (1931); Straton v. New 283 U.S. 318 (1931); Lion Bonding & Surety Co. v. Karatz 262 U.S. 640 (1923); May v. Henderson 268 U.S. 111 (1925); Lazarus v. Prentice 234 U.S. 263 (1914); Bryan v. Bernheimer 181 U.S. 188 (1901); Galbraith v. Vallely 256 U.S. 46 1921).

[25] U.S. F. & G. Co. v. Bray 225 U.S. 205 (1912).

[26] Docket 85 p. 470 Clerk of Court of Chancery, Trenton, N. J.

reveals the fact that the defendant was a New York corporation. The manifest purpose of this restraint was to prevent the directors of the corporation from passing a resolution either authorizing the filing of a voluntary petition in bankruptcy or consenting to an adjudication in bankruptcy after an involuntary petition had been filed against it. In short it was an injunction in effect enjoining the corporation from exercising the privilege and franchise granted to it by the State of New York.

The Corporation Act of the State of New Jersey provides that as far as possible the provisions of the Act shall apply to foreign corporations.[27] The Court of Chancery of New Jersey has the power under the statute to appoint a receiver for the assets of a foreign corporation located in New Jersey.[28] This is essentially a sequestration proceeding. The assets are sold and distribution made *pro rata* among its creditors.[29] The Court of Errors and Appeals of New Jersey has held that the Court of Chancery has no power to interfere in such a proceeding with the internal affairs of the corporation. It cannot forfeit its franchise; it cannot assess the stockholders for unpaid stock subscriptions. That task is for the Courts of domiciliary jurisdiction.[30] The object of the *Delpark* order, despite the decision of the Court of Errors and Appeals, seems to have been to intimidate the directors by fear of a contempt proceeding from filing a petition in bankruptcy, thereby invading the constitutional rights of the corporation. It seems clear, therefore, that the injunction order in the *Delpark* case was erroneous.[31]

But in the case of a domestic corporation the Court not only has the power to enjoin the corporation from exercising its privileges and franchises but such injunction is a prerequis-

[27] Section 96 Corporation Act of N.J. 2 Comp. Stat. page 1592.

[28] Minchin v. Bank, 36 N.J. Eq. 436 (Ch. 1883).

[29] Atwater v. Baskerville 89 N.J. Eq. 121 (Ch. 1918); Island Heights v. Brooks 88 N.J. Law 613 (E. & A. 1916); Goff v. Goff Electric Pneumatic Brake Co. 89 N.J. Eq. 258 (Ch. 1918); Albert v. Clarendon Co. 53 N.J. Eq. 623 (Ch. 1891); National Trust Co. v. Miller, 33 N.J. Eq. 155 (Ch. 1880).

[30] McDermott v. Wodehouse 87 N.J. Eq. 615 (E. & A. 1917); Baldwin v. Berry Automatic Lubricator Co. 99 N.J. Eq. 57 (Ch. 1926).

[31] The orders to show cause in practise are prepared by the attorneys and many are presented *ex parte*. In the press of business it is almost impossible for the Courts to read every line thereof.

In the Delpark case a petition in bankruptcy was filed in New York. The Company consented to an adjudication and no contempt proceedings were brought in New Jersey against the directors.

ite to the appointment of a receiver. What, then, is the consequence if after the statutory injunction has been ordered the directors meet and pass a resolution authorizing the filing of a voluntary petition in bankruptcy, or consenting to be adjudicated bankrupt after creditors have filed an involuntary petition? Are the directors guilty of contempt of court?

In *Cavagnaro* v. *Indian Tire & Rubber Company*[32] the facts were as follows: A bill was filed against a domestic corporation. A statutory injunction was ordered disabling the corporation, its officers and agents from exercising its privilege or franchise. A receiver was then appointed who took possession of all the assets of the defendant corporation.

The directors, with knowledge of this injunction, then held a meeting in New Jersey, passed a resolution authorizing the filing of a voluntary petition, removed the minute book and corporate seal from the possession of the State receiver and filed a petition in bankruptcy. The Court of Chancery found the directors guilty of contempt of court and held, among other things, that they had violated the statutory injunction.

In *Yaryan Naval Stores Co.*,[33] a broad injunction had been entered by the State Court enjoining, among others, the directors of the corporation from interfering with the property of the receiver and from instituting suits against the compapny. The directors met and passed a resolution consenting to be adjudged a bankrupt in the United States District Court. The State Court receiver thereupon moved to vacate the adjudication in the Federal Court on the ground that the adoption of the resolution was a contempt of the State Court, and that the directors were powerless to act for the corporation. This contention was similar to the conclusion reached by the New Jersey Court of Chancery in the *Cavagnaro* case.

The Federal Court held that the right to become a bankrupt was vested in the corporation by the bankruptcy act and could be taken away only by the power that created the right. As a result of the provisions of the Constitution and the Acts of Congress thereunder the jurisdiction of the Federal Court in bankruptcy is paramount. The Court then went on to state that the injunction order of the State Court would be inter-

[32] Note (4) *supra.*
[33] 214 Fed. 563 (C.C.A. 6th, 1914).

preted in the light of the Bankruptcy Act and from that viewpoint the Federal Court could find nothing that "would indicate an intention to prohibit an application to the appropriate bankruptcy court." The Court refused to vacate the adjudication in bankruptcy.

The *Yaryan* case is the best reasoned decision in this troublesome field of jurisdiction and has been followed in a host of later cases.[34] It is applicable to all the New Jersey injunctive orders of this type with the exception of the *Monitor Park* order, which clearly manifests the Court's idea of preventing access to the Federal Courts by an injunction order explicit in terms.[35]

The reasoning of the Court in the *Cavagnaro* case is based upon the idea that once the statutory injunction has been entered the corporation is dead and all of the directors have *ipso facto* been removed from office. The court believes that corporate action by the directors is thereafter impossible because they are no longer directors. All corporate action must thereafter be by the receiver for he is the corporation sole.[36] This reasoning is the logical step forward from *Gallagher* v. *The Asphalt Co.*[37]

The difficulty with accepting this conclusion *in toto* is that the statutory injunction does not put the corporation to death and does not even destroy the privilege or franchise granted by the State.[38] Nothing short of an actual dissolution of the corporation destroys the franchise granted. This the Governor of the State may do for failure to pay franchise taxes,[39] or the Court of Chancery may enter a decree of dissolution or forfei-

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[34] Bartlett Oil & Gas Corp. 44 F(2d) 607 (D.C. Okla. 1930); *Re* Conservative Mortgage & Guaranty Co. 24 F(2d) 38 (C.C.A. 6th, 1928); Petition of Shortridge 20 F(2d) 638 (C.C.A. 9th, 1927); City of Holland v. Holland Gas Co. 257 Fed. 679 (C.C.A. 6th, 1919); Commercial T. & S. Bank v. Busch-Grace Produce Co. 228 Fed. 300 (C.C.A. 8th, 1916); Blair v. Brailey 221 Fed. 1 (C.C.A. 5th, 1915); *Re* Standard Shipyard Co. 262 Fed. 522 (D.C.Me. 1920); Struthers Furnace Co. v. Grant 30 F(2d) 576 (C.C.A. 6th, 1929); see also *Re* Drake 16 F(2d) 142 (C.C. Tenn. 1923).

[35] Note (7) *supra.*

[36] Hitchcock v. American Pipe & Con. Co. 89 N.J. Eq. 440 (Ch. 1918) *rev'd* in 90 N.J. Eq. 576 (E. & A. 1919). *Cf.* Linn v. Dixon Crucible Co. 59 N.J. L. 28 (Sup. Ct. 1896).

[37] Note (2) *supra*

[38] Kilpatrick v. State Board 57 N.J.L. 53 (Sup. Ct. 1894).

[39] Section 140 Corporation Act of New Jersey, 2 C.S. p. 1592.

ture of the franchise after the statutory injunction has been made.[40]

Furthermore, under the statute, if the corporation provides for the payment of its debts and obtains sufficient capital to enable it to resume its business, the Court may direct the receiver to reconvey to the corporation all of its property and franchises.[41] Under this section of the Corporation Act the property is not conveyed to a new corporation but to the old corporation. The persons who provide for its debts and capital are persons interested in the welfare of the corporation, its stockholders, directors and, possibly, its creditors. Their contributions are in behalf of a living corporation whose activities had been temporarily enjoined. The proceedings, therefore, are not strictly probate, but are more nearly the equitable equivalent of *quo warranto*. It is only in the distribution phase of the receivership, which is merely an incident of the injunction restraining the right to exercise the franchise, that the procedure is in the nature of a probate proceeding.

That the receiver is not the corporation sole is manifest from the recent trend of the decisions of the Court of Errors and Appeals. In the administration of the estate the receiver may become aggrieved at a decision of the Court of Chancery affecting the corporation's assets. If he is the corporation sole he should be permitted to appeal to the Court of Errors and Appeals as a matter of right, and not of grace, because his property rights have been affected by the adverse decree. The Courts have held, however, that the receiver may not appeal as of right, but may do so only with the permission of the Court that appointed him.[42]

The result of the *Cavagnaro* case may, however, be justified on the narrow ground that, without any authority, the directors removed from the possession of the receiver of the State Court the minute books and seal of the corporation. This was an interference by the directors with the possession of the receiver

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[40] Section 69 Corporation Act of New Jersey, 2 C.S. p. 1592.
[41] Section 69 Corporation Act of New Jersey, 2 C.S. p. 1592.
[42] Crown v. Regna Construction Co. 106 N.J. Eq. 192 (E. & A. 1930); Mortgage Security Corp. of N.J. v. Townshend 108 N.J. Eq. 268 (E. & A. 1931); Seidler v. Branford Restaurant 97 N.J. Eq. 531 (E. & A. 1925) (as to the status of a receiver).

of property of the corporation and constituted a contempt of court.[43]

In the case of *"Bankshares Corporation of the United States"*[44] we find this interesting situation. Bankshares was a New Jersey corporation, but carried on its business and had property in New York. The Court of Chancery of New Jersey adjudicated it insolvent and appointed a receiver. Subsequently an involuntary petition was filed by creditors, and then the directors met in New York and passed a resolution authorizing the filing of a consent by the corporation to an adjudication in bankruptcy. The State Court receiver, under the authority of the *Cavagnaro* case, intervened in the bankruptcy proceedings pending in New York and challenged the consent that had been filed. The court held that the Chancery receiver had no standing to intervene in the Federal Court either as receiver or because he was vested with all the property of the corporation under the New Jersey Statute.[45] The Court held further that, assuming the injunction had the scope contended for by the *Cavagnaro* case, it was limited solely to the State of New Jersey and could have no extraterritorial effect. The Court refused to vacate the adjudication.

The Federal cases require the conclusion that the Bankruptcy Court in the administration of the affairs of a bankrupt corporation is paramount, and that no State Court order, whether directed to the creditors, stockholders and directors of a corporation or to the corporation itself, will be effective in barring access to the Federal Court in a proper case by the corporation or its creditors.

II.

The determination that the Bankruptcy Court is paramount leads to an even more difficult problem. Has the State Court the power, after the filing of a bankruptcy petition, to fix the compensation of its receiver?

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[43] In the Cavagnaro case an application was thereafter made to strike from the files the bankruptcy petition in which the directors joined. The Court doubted its right to do so, but since all the parties desired liquidation in the State Court, and no one opposed, it dismissed the bankruptcy petition.

[44] 50 F(2d) 94 (C.C.A. 2nd, 1931).

[45] Section 68 Corporation Act L. 1896 Ch. 185 p. 299. 2 C.S. (1910) page 1644.

Here again the New Jersey Courts have blazed the trail as to state jurisdiction. No court has been more vigorous in asserting its right and its power to compensate its officers than the Court of Chancery of New Jersey.

This problem involves into several classes of cases:

(1) Appointment of a State Court receiver, conversion by him of all of the assets into cash, approval of his account, allowance of his fees and the payment thereof prior to the filing of the petition in bankruptcy. The rule applicable to this situation is clear. The receiver of the State Court in such a case is in the position of an adverse claimant of the fund and is entitled, if the trustee questions the amount of the fee, to have it determined by a plenary proceeding. The Bankruptcy Court has no jurisdiction to determine the matter by summary process.[46]

(2) Appointment of a State Court receiver, the conversion by him into cash of all of the assets of the corporation, and the filing of a petition in bankruptcy before his accounts have been approved and his allowances fixed.

(3) Appointment of a State Court receiver and the filing of a petition in bankruptcy before the receiver of the State Court has converted the assets into cash. The latter two cases present difficult problems for the Courts.

The most recent case on the subject, *Shachat* v. *Standard Auto Supply Co.*,[47] enunciates clearly the viewpoint of all of the State Courts on the subject. It collects the leading cases and attempts to justify its position by reference to decisions of the Supreme Court of the United States. The case itself falls within class two.

The Court holds, following the older cases,[48] that the receiver could not without the consent of the State Court submit his accounts to the Bankruptcy Court; that the receiver could not turn over the assets to the Federal Court until the accounts were passed and his allowances fixed; and that by doing other-

[46] Louisville Trust Co. v. Comingor, 184 U.S. 18 (1902). This phase of the paper is predicated upon the petition in bankruptcy being filed within four months of the filing of the State Court proceeding.

[47] 106 N.J. Eq. 105 (Ch. 1930).

[48] Cudahy Packing Co. v. N. J. Dairy Products Co. 90 N.J. Eq. 541 (Ch. 1919); Singer v. National Bedstead Manufacturing Co. Note (3) *supra.*

wise the state receiver himself would be in contempt of court.

The latest opinion in the Federal Courts dealing with this vexing problem is *Silberberg* v. *Ray Chain Stores, Inc.,*[49] an opinion by Judge Fake. In this case the conflict was between Federal Equity receivers on the one hand, and a bankruptcy trustee on the other. The problem, however, is the same as was presented in the *Shachat* case. Judge Fake held that the Federal Court on the equity side was without jurisdiction to fix the fees of its equity receivers after the filing of a petition in bankruptcy.

The Court analyzed the *Shachat* case carefully and pointed out that if, as the Vice Chancellor says, the language of Mr. Justice Brandeis in *Lion Bonding Co.* v. *Karatz*[50] is *dictum*, then the language of Chief Justice Fuller in the *Watts*[51] case relied on by the Vice Chancellor in the *Shachat* case is likewise *dictum.*

In the *Watts* case the Court said that the bankruptcy proceeding "operated to suspend the further administration of the insolvent's estate" in the equity court, but it remains for that court "to transfer the assets, settle the accounts of its receiver and close its connection with the matter." The State Courts have determined that the words "settle the accounts" mean also "and fix the allowances for the receiver." If the order of the words of the opinion means anything the duty of the State Court is to transfer the assets first.

Judge Fake traced the further developments of the *Watts* case and discovered that the State officials sought their allowances not from the State Court, but from the Federal Court, and were denied compensation by the Federal Court.[52]

The *Shachat* case refers to *Loeser* v. *Dallas,*[53] as holding that a receiver must obey the orders of the Court of which he is

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[49] Decided December 4, 1931 (not yet reported). An interesting feature of this case is that Judge Fake himself had appointed the Federal Equity receivers. He is thus in a position of deciding against his own appointees.

[50] 262 U.S. 640 (1923). Even where the Court which appoints a receiver had jurisdiction at the time, but loses it, as upon supervening bankruptcy, the first Court cannot thereafter make an allowance for his expenses and compensation.

[51] 190 U.S. 1 (1903).

[52] *Re* Zier & Co. 127 Fed. 399 (D.C. Ind. 1904) *aff'd* 142 Fed. 102 (C.C.A. 7th, 1905).

[53] 192 Fed. 909 (C.C.A. 3rd, 1911).

an officer "and so obeying, it follows that to it alone must he account." An examination of the *Dallas* case, however, shows that the conflict there was between a trustee in bankruptcy and an ancillary receiver in bankruptcy. It was a conflict between officials of Courts of the same general jurisdiction. It was not a struggle between superior and inferior jurisdictions.

The Court in the *Shachat* case quoted with approval the following language from an earlier case:

> "I am aware that there may be found statements of federal judges to the effect that judgment of State Courts as to fees, etc., may be reversed by Courts of Bankruptcy, but I know of no instance in which such assumed power has been exercised."

The Federal Courts have reviewed fees allowed by State Courts, and in many instances have refused to accept the view of the State Courts and have disallowed such fees as to priority and amount.

Hume v. *Myers*,[54] presented a situation within class three. The Equity Court in directing its receivers to surrender the assets to the bankruptcy receiver undertook to fix the fees of its receivers. The Bankruptcy Court held that the order of the Federal Court on the equity side was not binding, as *res judicata*, on the Court of Bankruptcy. The Court intimated that it would not recognize an intention by a State or Federal Equity Court to fasten a lien on the property turned over to the trustee for the services rendered by the equity receiver. This is an extension of the doctrine of *Muller* v. *Nugent*[55] which holds that the filing of a bankruptcy petition is a *caveat* to the world, and that thereafter no new liens can be created as against the prop-

[54] 242 Fed. 827 (C.C.A. 4th 1917). In this case the Federal Court in bankruptcy reviewed the fees allowed by the Federal Court in Equity, which fees had been fixed in the order directing the receivers to surrender the assets to the Bankruptcy trustee. Quemahoning Creek Coal Co. 15 F (2d) 58 (D.Pa. 1926). In this case the State Court allowed fees over the objection of the trustee in bankruptcy who alleged lack of jurisdiction in the State Court to fix the fees after bankruptcy had intervened. A proof of claim was filed in the Bankruptcy Court claiming priority for the fees. The Referee disallowed it as a priority and his order was partially affirmed. The Court held the state order fixing fees was not *res judicata* in the Federal Court. See also Block v. Block, 86 N.Y. Supp. p 47 (Sup. Ct. 1903) which seems to give a proper interpretation of Watts v. Sacha *supra* note 51.

[55] 184 U.S. 1 (1902). *Re* Williams 240 Fed. 788 (D. Ohio 1917); In re Capital City Cap. Co. 251 Fed. 664 (D.N.J. 1918); Bailey v. Baker Co. 239 U.S. 268 (1915); Standard Fullers Earth Co. 186 Fed. 578 (D.Ala. 1911).

erty of the bankrupt. The Court in *Hume* v. *Myers* further said:

> "When the Court of Equity has not reduced the property to money, it is not in possession of that definite knowledge of the value of the property which is an important factor in finally fixing compensation."

The proponents of the doctrine that the State Court has the right to fix the fees of its officers in any event rely in the main on *Louisville Trust Co.* v. *Comingor*.[56] But a careful reading of that case discloses that the Court merely held that, as to fees retained by an assignee out of the bankrupt's estate for services rendered *prior* to the filing of the petition in bankruptcy, the assignee was in the position of an adverse claimant; and that the bankruptcy court could not proceed against him in a summary manner. The Court said: "Comingor insisted that the sums had been paid by him to his counsel while they were acting for him *before the bankruptcy proceedings were commenced.*" There was no claim that the moneys were paid for services rendered to the assignee *after* the petition had been filed.

This is borne out by the case of *Gailbraith* v. *Vallely*[57] where the Court again followed the *Comingor* case and said:

> "The principle of the Comingor case has never been departed from in this Court. It establishes the right of an assignee for the benefit of creditors, to the extent that he asserts rights to expenses incurred and compensation earned under an assignment in good faith, *before the bankruptcy proceedings* * * * *to have the merits of his claim determined in a judicial proceeding* suitable to that purpose, and not by a summary proceeding where punishment by contempt is the means of enforcing the order."

In this case the issue was, as the Court points out, "as to moneys expended and retained by the assignee *prior* to the bankruptcy proceedings for administering the estate." This is also in accord with the later opinion of the Supreme Court in *May* v. *Henderson*.[58] The case does not hold that the assignee

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[56] See note (46) *supra*.
[57] 256 U.S. 46 (1921).
[58] 268 U.S. 111 (1925).

may retain any moneys for work done subsequent to the filing of the petition in bankruptcy and prior to the surrender of the assets by the State receiver to the Bankruptcy Court.

It might well be argued, however, since the language of *Muller* v. *Nugent*[59] is to the effect that a petition in bankruptcy is an attachment and an injunction, that the assignee would have no right, in the face of such an injunction of which he has notice, even to retain moneys not yet expended for services rendered prior to the injunction. At best the *Comingor* case protects a State Court official for moneys actually earned or expended in connection with the estate *prior* to the institution of the bankruptcy proceedings.

We may, therefore, conclude from the cases covering this vexing problem:

I. That the State Court receiver may retain moneys expended *prior* to the filing of the petition in bankruptcy, and that if the bankruptcy trustee desires to reach this fund he may do so only by a plenary proceeding.[60]

II. That where a petition in bankruptcy is filed on the heels of a State Court proceeding the State Court receiver must turn over the assets to the Bankruptcy Court, and the State Court has no power to affix, and the Federal Court will refuse to recognize, any lien imposed by the State Court on these assets for the compensation of State officers. The State receivers will have to apply to the Federal Court for compensation, and will be compensated insofar as they have preserved or benefitted the estate.[61]

III. That where the State Court has converted the estate into cash prior to bankruptcy, but has made no allowances prior to bankruptcy, the State Court is without power to fix and order the allowances paid after a petition in bankruptcy has been filed; and the Federal Court in bankruptcy has the power by summary process to compel the State Court receiver to turn

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[59] See note (55) *supra*.

[60] This disposes of the class of cases discussed in Louisville v. Comingor (Note 46 *supra*), Galbraith v. Vallely (Note 57 *supra*), and May v. Henderson (Note 58 *supra*).

[61] Randolph v. Scruggs, 190 U.S. 533 (1903); Hume v. Myers (Note 54 *supra*); Quemahoning Creek Coal Co. (Note 54 *supra*); Cudahy v. N. J. Dairy Products (Note 48 *supra*); *Re* Williams 240 Fed. 788 (D. Ohio 1917).

over the entire fund to the Bankrutcy Court, which will then award compensation to the State receivers.[62]

It is regrettable that there has been this bitter struggle between the Courts in our dual government. It was hoped, after the decisions of the United States Supreme Court in *U. S. F. & G.* v. *Bray,*[63] *International Shoe Co.* v. *Pinkus,*[64] *Isaacs* v. *Hobbs,*[65] *Straton* v. *New,*[66] that the State Courts would recognize that in the field of bankruptcy the Federal Court is paramount. It seems, however, that the ultimate solution of the problem must await an authoritative decision from the United States Supreme Court that the determination of fees to be allowed State receivers after bankruptcy has intervened is within the province of one Court or the other. Then only may be concluded this unseemly chapter in the history of the controversy between Federal and State Courts.[67]

Newark, N. J.

SAMUEL KAUFMAN.

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[62] *Re* Diamond 259 Fed. 70 (C.C.A. 6th, 1919). This seems to be the best reasoned opinion on this subject. *Cf.* however *re* Stolkin 42 F(2d) 829 (C.C.A. 2d, 1930) which while it seems to be contra is nevertheless properly decided since it refers to moneys expended and retained prior to the filing of the petition in bankruptcy. See the Referee's opinion 14 A.B.R. (N.S.) 596 (1929). The case is within Louisville Trust Co. v. Comingor.

[63] See note (25) *supra.*

[64] 278 U.S. 261 (1929). This case held the Bankruptcy Act superseded the State Law insofar as it relates to the distribution of property.

[65] See note (24) *supra.*

[66] See note (24) *supra.*

[67] See Benjamin v. Up-to-Date Laundry Service, Inc. Docket 88, page 25 in the office of the Clerk of Chancery, Trenton, New Jersey. This case falls within problem three *supra.* On December 10th, 1931, the New Jersey Court of Chancery stated its position as to its power to fix compensation by entering the following order—"That the receiver herein until such time as the further order of this Court, retain in his possession all of the assets of said alleged bankrupt and do not surrender said assets to any trustee or receiver appointed in any Court of bankruptcy or to any officer of any other court or any person whomsoever without first having presented his report and account to this Court and having his account passed by this Court and his compensation fixed, the said receiver being authorized to retain said assets in his own right as an adverse claimant and in the right of this Court." It is an attempt to get within the Comingor case on facts wholly alien.