RECENT CASES

Bankruptcy Reorganization—Right to Set off under § 77 of the Bankruptcy Act—[Federal].—The trustee of a railway corporation which had filed a petition under § 77 of the Bankruptcy Act sued to recover the amount of the railway corporation's bank deposit. The defendant bank attempted to set off bonds of the corporation which it owned. *Held,* since reorganization proceedings themselves do not accelerate unmatured obligations the bonds were not mature and the bank was not entitled to set off. Set off of unmatured debts will not be allowed unless the debtor is insolvent and it appears that liquidation rather than reorganization will ensue. *Lowden v. Northwestern Bank and Trust Co.,* 84 F. (2d) 847 (C.C.A. 8th 1936); *certiorari* denied, 57 Sup. Ct. 109 (1936).

Although no case as yet has held that reorganization proceedings themselves accelerate unmatured debts, the court might easily have found that the bonds were accelerated. § 77n provides that unless it would be inconsistent with the provisions of § 77, the rights of the creditors shall be the same as if there had been an adjudication of bankruptcy on the day when the petition under § 77 was filed. 47 Stat. 1481 (1933); 11 U.S.C.A. § 205 (l) (1935). The majority rule is that a petition in bankruptcy which results in adjudication accelerates unmatured claims. *In re Portage Rubber Co.,* 296 F. 289 (C.C.A. 6th 1924); *Central Trust Co. of Ill. v. Chicago Auditorium Ass'n,* 240 U.S. 581 (1916). Similarly, a petition for reorganization might also be held to accelerate unmatured debts. The fact that unmatured claims are provable under § 77 would render questionable a finding that the application of the bankruptcy rule of acceleration would be inconsistent with § 77 since the provability of a debt rather than its maturity should determine whether it can be set off.

The more interesting question raised by the court's opinion is whether § 68 of the Bankruptcy Act is inconsistent with the provisions of § 77 and hence inapplicable under § 77n. See 47 Stat. 1481 (1933); 11 U.S.C.A. § 205 (l) (1935). The allowance of set off may be considered inconsistent with the purpose of § 77 because it will reduce the amount of cash at the disposal of the reorganized enterprise and hinder its rerehabilitation. Such a reduction of cash may have a more undesirable effect than the reduction of assets caused by the allowance of set off in liquidation proceedings because it may defeat not only the interest of creditors in equal distribution, but it may also defeat or endanger the interest of the enterpriser and the community in having the failing enterprise reorganized. Security interests, however, are protected under § 77 although they indirectly reduce the available cash by reducing the amount of property that can be used as security for new loans. Thus, complete disregard of the right of set off is hardly justified by the fact that its exercise will reduce the amount of cash. Moreover, set off was allowed in equity receivership proceedings out of which proceedings under § 77 developed. *Central Appalachian Co. v. Buchanan,* 90 Fed. 454 (C.C.A. 6th 1898); Clark, Receivers § 661 (1921). The equity practice in this regard might well be followed since it is not clear that it is modified by § 77.

Perhaps the decision was prompted in part by a conviction that set off as administered in bankruptcy proceedings is socially undesirable. The chief justification of set off would seem to be that the creditor has relied on the debt owed by him as security for the debt owing to him. See *Hawkins v. Freeman*, 2 Eq. Abr. 10, pl. 10 (1723); *cf.* Glenn, Liquidation § 544 (1935). But the existence of any reliance is questionable and even when it is present, several objections may be advanced against the recognition of set off in insolvency proceedings. It is a secret security device not easily discoverable by other creditors. When it is resorted to by a bank creditor from which a debtor may withdraw his deposits at will, it resembles other security devices which have been stricken down on the ground that the debtor has reserved excessive domination over the security. *Cf. Benedict v. Ratner*, 268 U.S. 353 (1925). These objections may justify a change in the Bankruptcy Act. In the absence of such a change, however, a complete disregard of the right of set off in proceedings under § 77 is justifiable only as an attempt to whittle away at a bad rule.

It is possible that the claims of a creditor with a right to set off will not be completely disregarded even though the trustee is permitted to collect the debtor's chose. The court may stay the enforcement of liens and mortgages. 47 Stat. 1474, 1481 (1933), 11 U.S.C.A. § 205(a), 205(j) (1935); *Continental Illinois National Bank v. Chicago R.I. & P. Ry. Co.*, 294 U.S. 648 (1934). Staying the enforcement of the security, however, does not mean that preferential treatment will not be given to the secured creditors in the reorganization plan. Similarly, here it is possible to treat the debt owed by the creditor as security and to deny set off when the trustee seeks to collect the debt and yet, in effect, to allow it by giving the creditor special protection in the plan. Such an arrangement would give some recognition to the right of set off without reducing the amount of cash immediately available for the use of the reorganized enterprise.

Bills and Notes—Insanity as Defense to Indorser against Holder in Due Course—[Federal].—During a Florida real estate boom, the defendant payee indorsed a note to the plaintiff in payment for real estate bought by the defendant and subsequently sold by him. When the note became due the maker defaulted and the security had become worthless. In this action the defendant alleged that he was afflicted with manic-depressive insanity, and that at the time of the assignment he was in the manic phase, which tended to make his hopes for future profit from the transaction inordinately rosy. *Held*, the defendant can not escape liability. The plaintiff did not know of the insanity. The deal was consummated at what was then a fair valuation of the property. There were no facts—considering the premises—which should have led the plaintiff to question the defendant's sanity. *Beale v. Gibaud*, 15 F. Supp. 1020 (N.Y. 1936).

The decision that an insane person can not avoid liability under a contract, where restoration of the *status quo* is impossible, unless the bargain was unfair or the other party acted in bad faith or with knowledge or notice represents in this case a successful reconciliation between two conflicting policies: the one, that of protecting a holder in due course of commercial paper; the other, that of protecting an insane contractor. These two policies have had an independent development and have frequently been in conflict. The present resolution of the conflict gives as much protection as possible to the holder in due course without depriving the insane assignor of any necessary safeguard.