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INSOLVENCY IN BANKRUPTCY: A SYNTHESIS

G. STANLEY JOSLIN†

Insolvency as now generally defined in our Bankruptcy Act came into being in 1898.1 Section 1(19) of the Bankruptcy Act provides that a person shall be deemed insolvent “whenever the aggregate of his property . . . shall not at a fair valuation be sufficient in amount to pay his debts.”2 Before this creation of 1898 the common law,3 equity4 and traders,5 defined insolvency as an inability to pay debts as they mature, or words of simpler import. Since that definition prescribed by the Bankruptcy Act, the world outside of bankruptcy has largely ignored this divergence and has continued the original meaning without apologies, as evidenced by the Uniform Fraudulent Conveyance Act,6 the Uniform Sales Act7 and the Uniform Commercial Code.8 All of these include in their definition of insolvency an inability to pay debts as they become due. The Bankruptcy Act itself found a greater use for the status of insolvency as a determinative factor and so finds its sections monotonously repetitive of the provision “insolvent or inability to pay debts as they mature.”9 To be sure, its own restrictive definition is alone applicable in certain instances,10 but whether that is desirable is questionable. At least, the complete abandonment of the “liabilities exceeding assets” concept of insolvency would work no havoc.

Because at the present time the two concepts, i.e., the balancing of

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3. GLENN, CREDITORS' RIGHTS AND REMEDIES § 370 (1915).
6. UNIFORM FRAUDULENT CONVEYANCE ACT § 2.
7. UNIFORM SALES ACT § 76(3).
8. UNIFORM COMMERCIAL CODE § 1-201(23). It should be noted that the Code includes in its definition of insolvency the words “within the meaning of the federal bankruptcy law.” Ibid.
assets against liabilities and the ability to pay debts, are very important stati in determining substantive and procedural rights in bankruptcy and because of the frequent requirement that one or the other of the stati be found to exist, it seems desirable that each concept be designated with a single surname so that they may be quickly and concisely distinguished without the confusing jargon so often encountered wherein the terms insolvency in the bankruptcy sense, or in the common law sense, or as understood by merchants, or in the equity sense, or by the "balance sheet" test, are indiscriminately bantered about. Therefore, the following names will be used to express these general concepts, and they will be used hereafter: (1) **Balance Insolvency**: that status wherein the debts exceed the value of property; (2) **Inability Insolvency**: that status wherein one is unable to pay his debts as they mature. Certainly there are subordinate problems, such as a determination of what property may be counted in computing the balance, and the weight to be given an actual default on a due obligation as determinative of inability, yet the area itself is unmistakably delineated by these names and discussion may proceed with assurance of clarity.

**THE QUESTION OF RE-DEFINING**

The present balance insolvency concept, created over sixty years ago and firmly entrenched in the thinking of the bankruptcy practitioners and those engaged in its administration, could not and should not be changed except as part of a general and far-reaching revision of the Bankruptcy Act. In such event, however, it is suggested that one of two alternatives could be the basis for change. Either of these would be desirable, but one more far-reaching in its scope than the other. First: If both balance insolvency and inability insolvency are to be used as an alternate status for determining a matter, with their present frequency in the Bankruptcy Act, the definition of section 1(19) should be changed to include both. Thus it would not be necessary to continually restate the words "insolvent or unable to pay his debts as they mature," as the word insolvent would encompass both. If in certain sections of the act it is desirable to continue a single economic status as the base for determination, that single status should be set out in the section of the act wherein it is to be applied, and in these sections the particular type of insolvency desired would be stated as applying to that particular situation. Again the suggestion here is not that this change in the Bankruptcy Act wording be made as a piecemeal amendment, but that these changes be considered if the whole Bankruptcy Act is revised and if the present concepts of insolvency be continued in the new act.
Second: It is contended that there should be only one base for insolvency used in the Bankruptcy Act and that should be "inability insolvency." Or, in other words, the use of "balance insolvency" should be completely abandoned and omitted from the Bankruptcy Act. Not only do these varying concepts of insolvency assert themselves in myriad places in the present act, but they also have inconsistent play on the same problem. For example, under section 3(a)(5) inability insolvency may be the basis for an act of bankruptcy and under section 3(c) balance insolvency proved as a defense, or under sections 130, 131(5) and 133, where a stockholder is attempting to answer a petition under chapter X, it may be necessary to prove balance insolvency after inability insolvency has been established. Unless a justifiable need can be shown for retaining balance insolvency as an economic status for determining rights in bankruptcy it should be abandoned, leaving inability insolvency as the sole determinative status. If this be the conclusion, the definition section of the act would be changed to define insolvency as the inability to pay debts as they mature and the balance concept omitted.

**Assets in Balance Insolvency**

Although it is normally not difficult to determine the assets which may be congealed when determining whether the aggregate of property shall be sufficient to pay debts, there are cryptic provisions in the Bankruptcy Act which present unsuspected variations in this area. The act states generally that the aggregate property, exclusive of that fraudulently conveyed, shall be the basis for determining insolvency. Thus, the act excludes from the balance computation any property which may have been conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay creditors. No exclusive reference is made concerning exempt property and there being no other section defining "property," exempt property is included in the assets to be fairly evaluated in determining insolvency. It seems that this question might be reconsidered, as the creditors could be in a totally inadequate position and yet not be able to show insolvency.

Apart from the general definition of insolvency in section 1(19) of the act, however, there are provisions in the act which, in specific instances, result in a different asset base to be used in determining solvency, and which also indirectly bring into play outside controls which

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11. See notes 9 and 10 supra.
have their own particular rules governing assets that may be included in this computation. Thus, for the specific purposes of determining fraudulent transfers which may be avoided if made within a year prior to the filing of a petition in bankruptcy, as specified in Section 67(d) of the Bankruptcy Act, exempt property is not to be counted in the computation to determine solvency.\(^\text{15}\) Furthermore, an indirect asset base may be interjected into bankruptcy computations whenever insolvency as determined under state law is made relevant. Thus, a transfer which is fraudulent under any state law is null and void as against the trustee.\(^\text{16}\) This brings into consideration by the bankruptcy court the treatment of insolvency extended by the applicable state law and that law will determine the assets which will be considered in determining balance insolvency. If the state, for example, has the Uniform Fraudulent Conveyance Act and the trustee is attempting to set aside a fraudulent conveyance under section 4 of that act, which section makes voidable certain transfers by one “who is or will be thereby rendered insolvent,” he must prove the insolvency defined in the Uniform Act. Under the Uniform Fraudulent Conveyance Act, exempt assets are not included in the computation to determine fair value for insolvency purposes.\(^\text{17}\) It is very possible, then, that in the course of a bankruptcy, several different balance insolvencies will be required to be proved and each with a different asset computation. An act of bankruptcy under section 3(a)(3) requires a balancing which includes exempt property in the assets but excludes property fraudulently conveyed,\(^\text{18}\) while later in the same proceeding it may be necessary to prove insolvency wherein exempt property may not be included in the computation but fraudulently conveyed property will be included.\(^\text{19}\) Any generalization, then, as to the assets which will be included in determining insolvency in a bankruptcy proceeding is impossible. 

When insolvency becomes an issue in partnership bankruptcy the asset computation may become quite difficult, especially if the partners live in several states and the varying laws of those states become applicable. In cases where the petition is involuntary,\(^\text{20}\) or where the voluntary petition is filed in behalf of the partnership by fewer than all of the

\(^{15}\) Bankruptcy Act § 67(d), 11 U.S.C. § 107(d) (1958). The proposed amendments to the Bankruptcy Act would change § 1(19) to exclude exempt property in determining solvency. See Proposed Amendments to Section of the Bankruptcy Act Relating to Partnership Administration, 34 Ref. J. 87 (1960).


\(^{17}\) Uniform Fraudulent Conveyance Act §§ 1-2.


\(^{20}\) See Bankruptcy Act § 3(b), 11 U.S.C. § 21(b) (1958).
general partners, the issue of balance insolvency becomes pertinent. Although there has been some inconsistency in the past, it is generally accepted now that a determination of insolvency requires the compilation of both the assets of the firm and the personal assets of the general partners. There has been considerable criticism of this inclusion of the partners' assets in determining partnership insolvency, and strong sentiment favors balancing only the property of the partnership against the partnership obligations. Professor Kennedy, however, after a careful consideration of the whole problem of insolvency in partnership bankruptcies, concludes that to determine the solvency of a partnership the separate property of the general partners should be excluded unless the partnership could prove that the separate non-exempt property of the general partners was sufficient to pay the separate debts and any deficiency in the partnership assets. Under this proposal the determination of insolvency would be expedited as the initial insolvency could be quickly shown on partnership records, and the burden of showing assets available for all creditors would be on those who have that information.

The question of asset balance insolvency in partnership bankruptcies also may arise under the fraudulent conveyance section of the Bankruptcy Act, Section 67(d) where there is a singular definition of insolvency, or may arise under section 70(e)(1) wherein the relevant state laws on insolvency may become applicable, as discussed herein above.

LIABILITIES IN BALANCE INSOLVENCY

In determining balance status for insolvency purposes the liability side must also be congeried. The provision "aggregate of debts," in Section 1(19) of the Bankruptcy Act is more specifically defined as including "any debt, demand, or claim provable in bankruptcy." Although this is the background upon which most computable liabilities are

23. See Kennedy, A New Deal or Partnership Bankruptcy, 60 Colum. L. Rev. 610, 612 (1960).
24. Id. at 652-53.
27. Bankruptcy Act § 1(19), 11 U.S.C. § 1(19) (1958). An initial problem may arise as to whether a relationship is one comprising an asset or a liability. In Hoppe v. Rittenhouse, 279 F.2d 3 (9th Cir. 1960), an enforceable agreement to exchange notes held against a corporation for stock converted the relationship to one of subscriptions to stock, thus resulting in an asset rather than a debt.
determined in bankruptcy, the same problems are presented as are encountered in determining assets which will be permissible in computation. For specific purposes the Bankruptcy Act requires the liability side to be computed from a broader background, requiring the inclusion of liabilities not recognizable under the more generally applicable liability base. Thus, as in computing the asset balance, the Bankruptcy Act imposes a different liability base in the area of fraudulent conveyances. Section 67(d)(1)(b) defines "debt" as "any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent." The inclusion of tort and contingent claims in this classification results in a significant broadening of the liability base. Likewise, section 70(e)(1) of the act may bring into consideration a basic determination of insolvency under state law when a fraudulent conveyance is asserted under that law.

In this liability context the merry-go-round, provable—not allowable—not provable concept comes to mind. Contingent debts and contingent contractual liabilities are provable, but they may be disallowed if no reasonable estimation can be made. If such is the case, the claims, once provable, are rendered not provable. It is established that provable claims are to be compiled to determine the liability side. The next question is whether a provable claim which is not allowable and so not provable ends up in or out of the liability compilation for insolvency purposes. The need for this circuitous provable—not provable—metamorphosis arises out of the desire to avoid the delay of the judicious handling of the bankrupt's estate caused by the extreme uncertainty of the dollar value of certain liabilities. In view of this fact, it seems that such claims should not be considered when the question of balance solvency is in issue. It does seem, however, that because the question of insolvency may be the initial determinative factor upon which jurisdiction in bankruptcy itself depends, and because the entire proceeding will be held up until the solvency issue is determined, the decision to include the contingent claim as a liability or exclude it as not provable.
should be limited strictly to the one purpose of solvency determination so that at a later time when claims can be more carefully analyzed, the issue of provability and allowability may be reconsidered for purposes of participation in the distribution and discharge.

An improbable but interesting problem in regard to liabilities in balance insolvency may arise as a result of Section 63(a)(9) of the Bankruptcy Act, which provides that certain real estate lease claims are limited in their allowability to one year's rent. Since the entire claim on these unexpired leases of real property is provable, it seems that this total claim would be computed in determining a question of balance insolvency. Moreover this shift from full provability to fractional allowability is not doubled back to remove the provability status as is the provable contingent claim which is disallowed and thus rendered non-provable. It is possible, then, that a debtor insolvent when the provable real estate lease claim is included in the balance computation would be solvent if the allowable lease claim were used in the computation. Certainly the provability of the entire real estate lease claim should continue for purposes of dischargeability, but should its full weight be taken into count when the question of balance insolvency is in issue? For example: If the assets total $150,000 and the liabilities, not including the lease claims, total $140,000 and the entire breach of lease claim is $15,000, the debtor is clearly insolvent, but if the allowable annual rent of $4,000 is used as a basis, the debtor is clearly solvent. This problem would be accentuated in a situation where a debtor is trying to ward off bankruptcy by proving he was solvent at the crucial times, when insolvency constitutes an element of an act of bankruptcy, or by asserting as a defense solvency at the time of the filing of the petition.

The solution of this question as to whether the provable claim for real estate leases or the allowable claim of one year's rent should be used in computing balance insolvency may require the classification of the creditors into real estate lease claim creditors and other creditors. If the real estate leases are not in default, it seems that the other creditors should not be permitted to force an adjudication of bankruptcy by including the entire provable real estate lease claim as a liability in the balance computation. On the other hand, if the real estate leases are in

40. See Bankruptcy Act §§ 57(d), 63(d), 11 U.S.C. §§ 93(d), 103(d) (1958).
42. See Bankruptcy Act § 3(c), 11 U.S.C. § 21(c) (1958).
default and only the allowable one year's rent is recognized in determining balance insolvency, the debtor may be found solvent and, unless he returned to bankruptcy on a voluntary basis, turned out to state law treatment where the total real estate rent claim would be recognized, with its disastrous results on the debtor and the other creditors. It seems that under its broad, equitable power, a bankruptcy court could refuse to use the total provable real estate lease claim, and use the allowable year's rent when determining balance insolvency, and that when the pressure is coming only from non real estate lease creditors and there is no imminence of breach of lease except that which would result from the bankruptcy, this computation should be used. This whole problem, of course, would be resolved by an abandonment of the balance insolvency concept in bankruptcy and a shift to the exclusive use of the "ability to pay as they mature" concept.

**Jury Determination of Solvency**

The function of jury trials in bankruptcy proceedings has not been complicated or challenged for many years. The person against whom an involuntary petition has been filed is entitled to a jury trial on the questions of solvency and of the commission of an act of bankruptcy. This, then, not only makes a jury issue of balance insolvency, if properly requested by the bankrupt, but also may bring up an issue of inability insolvency as a concomitant to the issue of whether an act of bankruptcy has been committed. Thus, if the jury issue is whether a person has, while insolvent or unable to pay his debts, procured the appointment of a receiver, which is an act of bankruptcy, the jury may have as an element for determination the question of inability to pay debts. Furthermore, the whole realm of variant and inconsistent economic concepts, including state law, from which insolvency is determined may be thrown into the lap of the jury if called upon to determine whether an act of bankruptcy consisting of a fraudulent conveyance has occurred. It is entirely possible, then, that a jury would be called upon to determine the existence of balance insolvency, inability insolvency or several different types of each in determining the single issue of whether an act of bankruptcy has been committed and whether the bankruptcy may proceed.

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45. Ibid.
row field of function than is first casually observed. If the right to have these matters of solvency determined by the jury is not asserted, the question will normally be determined by the court, but the court may submit questions of insolvency to the jury on an advisory basis. In cases where there is no right to a jury, questions of fact on insolvency may be submitted by the court to a jury.

The right of a person against whom an involuntary petition has been filed to a jury trial in respect to the question of his insolvency may be lost in an obscure and circuitous manner. A corporation which files a voluntary petition for reorganization under chapter X thereupon subjects itself to all the authority of that chapter, and thus under section 236(2) the matter may be adjudged one for strict bankruptcy and the proceeding may continue under the general provisions of the Bankruptcy Act. It has been held by the Court of Appeals for the Ninth Circuit that when the matter is sent down for basic bankruptcy continuation, even though the debtor objects, he is not entitled to raise the issue of insolvency, nor to a jury determination of the issue, on the grounds that he is deemed to have entered bankruptcy through the chapter X door and he has no basis for demanding the rights he would have had if forced in through another. As a practical matter, then, it may be said that a voluntary entrance into one sphere of bankruptcy, after which a reference is made to another, continues its voluntary status although the reference is contended. A strange result may be hypotheticated in a situation where the voluntary petitioner enters under chapter X on the grounds of inability insolvency and then is dragged against his will into straight bankruptcy, where he is not then entitled to raise the question of balance solvency and a jury determination. The court, it is suggested, was correct in its holding if it is assumed that when one seeks relief in bankruptcy, he is asking for the matter to be handled in the most efficient manner, and the court will properly determine that area of bankruptcy which will most effectively proceed with the particular debtor’s estate.

Because the issues most likely to be basic elements for proof in jury trials are issues of insolvency of one kind or another, the question as to whether the referee may conduct a jury trial becomes pertinent to a

50. Id. at 226.
54. In re Aqua Hotel Corp., supra note 51.
consideration of insolvency. The practice has developed, without being given much thought, wherein the judge conducts necessary jury trials. Eminent authorities have categorically stated without citation that "A jury trial is conducted by the judge, not by the referee." Recently, however, several jury trials have been conducted by referees and the matter has thus come forcibly to attention. The Judicial Conference has frowned upon this practice and has referred the matter to the Advisory Committee on Bankruptcy Rules for consideration. It is doubtful that the referees would welcome the added burden of conducting jury trials but it does appear that there is no mandate in bankruptcy law requiring the conduct of jury trials on bankruptcy issues such as solvency to be conducted by the judge. The present status of the matter is uncertain but in all probability jury trials will no longer be conducted by the referee unless some clarifying authority approving the practice is handed down.

**Proving Insolvency**

Most of the acts of bankruptcy which provide the justification for creditors forcing a debtor into bankruptcy have elements of either balance or inability insolvency, and the burden is upon the creditors to prove that status. In addition, when a trustee takes affirmative action to set aside fraudulent conveyances, preferences, or judicial liens, the burden is upon him to establish insolvency when it is in issue. The elementary principles of burden of proof apply to these and other situations where insolvency is an issue and are not meant to be treated here. However, certain shiftings of the normal burden must be noted, as well as the possibility of the application of foreign governing patterns.

Although the burden is upon the creditor to establish insolvency when it is an element of an act of bankruptcy, the fact of solvency if put as a matter of defense to a proceeding under the first act of bankruptcy must be asserted and the burden of proof carried by the alleged bankrupt. To aid the creditors in carrying the burden of proof of insolvency when in issue within the second (preferential transfer), third

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57. Reporter's Memorandum to the Advisory Committee on Bankruptcy Rules, Nov. 26, 1960.
60. See Bankruptcy Act § 60(b), 11 U.S.C. § 96(b) (1958).
(judicial lien) or fifth (appointment of a receiver) acts of bankruptcy, the debtor must give full cooperation by his appearance with books and accounts and give testimony on the matter of his financial situation. If he fails to give the necessary cooperation in this regard, insolvency will be presumed, thus relieving the creditors of this burden. From this point the burden of proving solvency rests on the debtor.\textsuperscript{63}

If the issue of insolvency arises and is an essential element in the recovery of preferences\textsuperscript{64} or fraudulent conveyances,\textsuperscript{65} the burden is logically on the trustee. This burden may be compounded by a requirement that not only insolvency at a time not formerly in issue be proven, but that a reasonable cause to believe in the insolvency of the debtor be shown.\textsuperscript{66} Moreover, a recalcitrant debtor cannot cause the burden to shift to the transferee as he can shift the burden to himself on other occasions.\textsuperscript{67} Certainly a transferee who is charged with receiving a preference avoidable by the trustee should not be charged with the uncooperative attitude of the bankrupt, and even though a preference is established by a presumption of insolvency raised by this recalcitrance, it should not be conclusive upon one charged with receiving a preference unless he was a full party to the original determination. Although the alleged preferential transferee should not be prejudiced by the attitude of the debtor in his giving of information on his financial status, it does not seem out of line, in establishing the necessary "reasonable cause to believe" that insolvency existed,\textsuperscript{68} that a presumption of this reasonable cause be raised when a debtor's records are confused, incomplete and unintelligible and the transferee has full knowledge of that condition. However, it has been held that the keeping of records in a "slovenly manner" or "unbusiness like manner," even if known by the transferee, does not establish the necessary reasonable cause.\textsuperscript{69}

\textsuperscript{63} Bankruptcy Act § 3(d), 11 U.S.C. § 21(d) (1958).
\textsuperscript{64} See Bankruptcy Act §§ 60(a) (1), (b), 11 U.S.C. §§ 96(a) (1), (b) (1958).
\textsuperscript{65} See Bankruptcy Act §§ 67(a), (d), 11 U.S.C. §§ 107(a), (d) (1958).
\textsuperscript{66} E.g., the basis for involuntary bankruptcy may be insolvency at the time of a judicial lien under Bankruptcy Act § 3(a) (3), 11 U.S.C. § 21(a) (3) (1958), while the trustee in attempting to recover a preference must show insolvency at the time of the transfer alleged to be a preference under Bankruptcy Act § 60(a) (1), 11 U.S.C. § 96(a) (1) (1958), and reasonable cause to believe a debtor insolvent at the time of the transfer under Bankruptcy Act § 60(b), 11 U.S.C. § 96(b) (1958). Note also the necessity of proving knowledge or notice of insolvency in determining a proper set-off or counterclaim. Bankruptcy Act § 68(b), 11 U.S.C. § 108(b) (1958).
\textsuperscript{67} See Bankruptcy Act § 3(d), 11 U.S.C. § 21(d) (1958).
\textsuperscript{68} See Bankruptcy Act § 60(b), 11 U.S.C. § 96(b) (1958).
\textsuperscript{69} Dinkelspiel v. Weaver, 116 F. Supp. 455 (W.D. Ark. 1953). In the Dinkelspiel case the court stated that although a transferee knew that checks were being dishonored, this was the usual condition of the debtor and he was continuing to do his business in his ordinary "unbusinesslike manner," and thus one might reasonably assume that the debtor was merely short of ready cash, but that he was solvent. The court said further:
When the issue as to solvency is between the involuntary bankrupt and the petitioning creditors it would be justifiable to presume insolvency whenever records are abstruse, inadequate or incomplete, even though the debtor is unschooled and in good faith in his confusion. The contention that unjustified failure to keep records from which a financial condition and business transactions might be ascertained may result in a denial of discharge and that this is sufficient penalty is not valid. Discharge or no discharge is a crucial matter, whereas a shift of the burden of proof seems a minor penalty for the debtor’s original fault. As a result, there are situations which merit a shift of the burden of proof but not a denial of discharge.

A completely foreign basis for establishing the burden of proof may be introduced in situations where, under state law, a preference or fraudulent conveyance has occurred, and that law governs the substantive elements of proof in this insolvency area.  

**Time of Insolvency**

The determination of the solvency of the debtor must relate to a particular point in time and this point is not necessarily the same in every instance in which the law of bankruptcy deals with insolvency. Frequently the crucial instant is the time of a particular transaction. Thus, insolvency is in issue at the time of obtaining a judicial lien, the time of the appointment of a receiver, the time of a transfer challenged as preferential, the time of an alleged fraudulent transfer, and the time of a transfer asserted as a set-off or counter claim. In addition to the basic issue of the time of the making of the transaction, the Bankruptcy Act provides that in certain instances the time of the perfection of the transaction is also a determinative point for computing the solvency status. The point is also shifted by concrete definitions in the act of the time at which certain transactions take place. Thus, in determining the issue of solvency for the purpose of establishing a preference, a

"And, even if the defendant had knowledge of sufficient facts to put him upon inquiry, such an inquiry would have gained him nothing. The state of Davis’ books was such that neither the defendant nor anyone else could have ascertained his financial condition unless a complete audit was made, and even then the accuracy of the audit would be doubtful." *Id.* at 463.

transfer of personal property is deemed to have been made when perfected against a subsequent lien obtainable by judicial process, while a transfer of real property is made when perfected as against subsequent bona fide purchasers. The freedom of the underlying state law in regard to the perfection time pertaining to preferences is to some extent restricted by the imposition in the Bankruptcy Act of a 21 day relation back period. Similar dates of transfer are defined for fraudulent conveyances.

It may also be necessary to determine the solvency of the debtor at the time of the filing of the petition. For example, the alleged bankrupt may assert a complete defense to the first act of bankruptcy if he can prove solvency at the time of the petition. In some instances the insolvency issue must be ascertained at a point of time after the completion of a transaction, such as instances wherein the Bankruptcy Act finds certain transactions by a debtor "who is or will be thereby rendered insolvent . . ." to be fraudulent transfers.

Ordinarily, once the groundwork determining a basis for bankruptcy has been laid, any change in the economic status of the bankrupt estate will not remove the proceeding from the jurisdiction of the bankruptcy court as a matter of right, and therefore the question of solvency at a point of time after the petition will not arise. An exception, however, apparently exists in the set-off or counterclaim provision of the Bankruptcy Act. This section provides that a set-off or counterclaim which was purchased by or transferred to a debtor of the bankrupt after the filing of the petition with knowledge or notice that such bankrupt was insolvent shall not be allowed. The question may be somewhat academic, as the situation wherein a bankrupt becomes solvent after the filing of the petition is extremely rare. However, the possibility exists, for example, that affluent solvency would result during the first six months of bankruptcy under the provisions of the act which vest in the trustee bequests, devises or inheritance, contingent remainders or like interests.

78. Ibid.
85. Ibid. MacLachlan argues that the qualification concerning knowledge or notice does not apply to assignments after the petition. MacLachlan, Bankruptcy § 290, at 341, n. 7 (1956). Collier, however, treats the knowledge of insolvency as applicable to a transfer after the petition. 4 Collier, Bankruptcy ¶ 68.12, at 763 (14th ed. 1960).
in property which vest or become assignable within that period. At any rate, the purpose here is not to discuss the general set-off question in this situation, but to present the possibility that the time at which solvency is required to be ascertained may be a point of time after the petition is filed.

**POTPOURRI**

In synthesizing insolvency's myriad contacts with bankruptcy, some interesting minor problems suggest themselves. The Bankruptcy Act provides that the court shall grant a discharge unless satisfied that the bankrupt "has failed to explain satisfactorily any losses of assets or deficiency of assets to meet liabilities. . . ." The words "deficiency of assets to meet his liabilities" have been characterized as "insolvency" and the problem analyzed as such, but no reference is made in the provision to "insolvency" as such. It is arguable, therefore, that the term as defined in the Bankruptcy Act does not govern the problem presented here. The troublesome problem again may arise as to what assets and liabilities are to be included in the computation under the "deficiency of assets to meet his liabilities" provision. Should, for example, exempt property or fraudulently transferred property be included in this computation? On the other hand, the ease with which the cognomen of insolvency has attached to this problem suggests the acceptance of the bankruptcy definition as controlling. If such is the case, clarity would result in a rewording which would use the word insolvency in the place of "deficiency of assets to meet his liabilities."

Another interesting but obscure problem concerning insolvency arises under Chapter X of the Bankruptcy Act. A petition for corporate reorganization under this chapter, whether voluntary or involuntary, must state that the corporation is insolvent (balance insolvency) or unable to pay its debts as they mature (inability insolvency). However, no stockholder may controvert the allegations of a petition unless the debtor is solvent (balance insolvency). If the basis for the petition is balance insolvency, and it is raised by the stockholder, both issues are determined together, i.e., the right to object and the right to relief under

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88. See 1 COLLIER, BANKRUPTCY ¶ 14.60, at 1435 (14th ed. 1960); MACLACHLAN, BANKRUPTCY ¶ 106, at 96 (1956); Herzog, Failure to Satisfactorily Explain Loss of Assets or Deficiency of Assets to Meet Liabilities, 34 Ref. J. 100, 101 (1960).
chapter X. But if the basis for the petition is inability insolvency, balance solvency must first be shown to enable the stockholders to controvert the petition. The logic here is not challenged, as it is evident that stockholders should have little to do with corporations in a balance insolvency condition. In this regard it is also of interest to note that stockholders share in the acceptance of a plan for reorganization if the debtor has not been found insolvent, and that plan must provide for stockholders except when the debtor is insolvent.

Suggested Changes

Several major changes in the insolvency provisions have been suggested in recent years. Professor Kennedy suggests that exempt property be excluded in the balance computation and that a special provision relating only to partnerships be added. Professor MacLachlan suggests a sweeping change in the area of involuntary proceedings. He sets forth a carefully drafted proposal which would abolish the use of balance insolvency in this area and apply only the inability concept. He then sets forth a detailed itemization of situations which are to be conclusive evidence of such inability. This would be a step in the direction of the simplification and conciseness needed in an over-all appraisal of the insolvency problem.

Although a generalized change in the insolvency definition could not be made without a careful analysis to ascertain its effect upon the many points of reference in the act, an over-all shift to the concept of inability insolvency and the discontinuance of the use of the balance insolvency concept, except in special areas, would be desirable. Inability insolvency can be more quickly and easily established since it is free from the difficult and time consuming asset and liability computations. This increased efficiency would prevent the rapid deterioration of the position of the bankrupt, which is likely to occur during a slow and difficult determination of solvency.

93. It was the intent of Congress to restrict the stockholder’s right to answer the petition to those cases in which the petition is based upon inability insolvency, but not to authorize an answer where the petition is properly founded on balance insolvency. See In re Hudson & Manhattan R.R., 138 F. Supp. 195 (S.D.N.Y. 1955).
97. MacLachlan, Bankruptcy 436 (1956).