Bankruptcy—Jurisdiction of Bankruptcy Court to Enjoin Arbitration Proceedings—"Unusual Circumstances" Doctrine.—Fattick v. Kehr

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result from the tremendous administrative expense of conducting separate audits. This expense, which of course would not be present if the assets were merged, was estimated to be at least two hundred thousand dollars, a substantial part of which would be allocated to Seatrade. Given the allowance of intercorporate debts, it is highly unlikely that Chemical could recover more than seventeen cents on the dollar if merger were not ordered. This figure of seventeen cents is what Chemical claims would result if merger were ordered. Hence, there has been a failure to prove prejudice, since it can make little difference to Chemical whether it receives seventeen cents by one method of liquidation or by another.

The Kheel case presents a complex and unique situation in which the equities of the parties are not readily apparent. Because the fact situation in Kheel is unique, the possible ramifications of the court's holding and reasoning are limited. The case nevertheless raises significant questions as to the equities of creditors of affiliated corporations in a bankruptcy proceeding. If there is error by the court, it is the lack of a definitive statement and resolution of the conflicting equities which arise from the facts of the case. This alleged shortcoming can only confuse future courts and practitioners and make obscure what is undoubtedly a most equitable result.

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Bankruptcy—Jurisdiction of Bankruptcy Court to Enjoin Arbitration Proceedings—“Unusual Circumstances” Doctrine.—Fallick v. Kehr. —In October 1964, Harry Kehr instituted an action in the Supreme Court of New York against his partner, Lowell Fallick, alleging that Fallick had misappropriated partnership funds. Pursuant to a clause in the partnership agreement which provided for submission of all controversies between the partners to the American Arbitration Association, Fallick moved in the state court for an order compelling arbitration. As a result of that motion, Kehr abandoned his state court action and commenced arbitration proceedings. In January 1965, Fallick filed a voluntary petition in bankruptcy, and an order was entered under Section 11(a) of the Bankruptcy Act, staying all proceedings (including the arbitration) pending resolution of the bankruptcy action.

2 Section 11(a) provides:
A suit which is founded upon a claim from which a discharge would be a
Fallick was subsequently discharged in bankruptcy, and the stay lapsed according to its terms. Kehr then attempted to reinstitute the arbitration proceeding, but Fallick immediately petitioned the bankruptcy referee for an order permanently enjoining arbitration and for a ruling that Kehr's claim had been discharged. The referee denied Fallick's petition; the district judge for the Southern District of New York affirmed that order in a memorandum decision. Both the referee and the judge recognized their power to enjoin the arbitration proceeding, but declined to do so absent unusual circumstances. Fallick had contended that such circumstances did exist since the dischargeability of Kehr's claim would be decided by an arbitrator, who, unlike a judge, was not bound to follow the law and whose errors of law could not be reviewed.

The Second Circuit Court of Appeals, Judge Friendly dissenting, affirmed the district court's decision. HELD: the fact of imminent arbitration of the issue of dischargeability does not, as a matter of law, require equitable relief to be granted. Moreover, since the other facts in this case are insufficient to warrant a finding that unusual circumstances are present, the bankruptcy court did not abuse its discretion in refusing to enjoin the arbitration proceeding. Judge Friendly argued that no action could be more "unusual" than the relegation of the dischargeability issue to the unreviewable decision of an arbitrator. Accordingly, he concluded that with respect to this issue, the arbitration agreement was tantamount to consenting in advance to waive the benefits of a discharge and hence was void.

In 1934, in the famous case of Local Loan Co. v. Hunt, the Supreme Court of Illinois held that the assignment of wages after bankruptcy was enforceable, despite the discharge of Hunt. This decision was later overturned by the United States Supreme Court in Local Loan Co. v. Hunt. The case is significant for its examination of the interaction between bankruptcy and arbitration, and the role of equitable relief in such situations.
Court ruled for the first time—and so far the only time—on the question of the bankruptcy court's "paramount jurisdiction" to protect the discharge rights of a bankrupt. In that case, it was held that as courts of equity, bankruptcy courts retained ancillary jurisdiction to permanently enjoin creditor enforcement suits in a state forum and thereby to determine and preserve the effect of their own discharge decrees.8 Having broadly established the paramount authority of the bankruptcy court, however, the Supreme Court cautioned against the exercise of such jurisdiction absent unusual circumstances rendering the debtor's remedy in the state forum inadequate.9

In Local Loan, such circumstances were found in the fact that the highest state court of the jurisdiction had previously resolved the issue of dischargeability against another bankrupt, and in a manner "destructive of the purpose and spirit of the bankruptcy act."10 Thus, if the bankruptcy court had not intervened, the bankrupt would have been required to pursue a long and expensive course of litigation through the state court hierarchy and then to the United States Supreme Court in order to reach a forum whose judgment on this federal question would not be predetermined against him.11 Since the amount of the claim was small, the Court felt that such a remedy was entirely inadequate "to meet the requirements of justice," considering the disproportionate "trouble, embarrassment, expense, and possible loss of employment" which would be involved.12

In the three decades since Local Loan was decided, the problem of what constitutes unusual circumstances has been a troublesome one for the federal courts. The confusion derives from the fact that Local Loan was an extreme case involving a rare combination of circumstances, and thus presents a standard which is difficult to apply in less aggravated cases.13 As

petitioned the bankruptcy court to enjoin the state enforcement suit. A permanent injunction was granted and the Supreme Court affirmed.

8 292 U.S. at 239-41. Prior to 1934, it was generally held that the federal bankruptcy court had no jurisdiction to pass upon the effect of a discharge which it had granted. Nadler, Bankruptcy § 809, at 677 (2d ed. 1965). Rather, this issue was reserved for determination by any forum (usually a state court) in which a creditor sought to enforce his claim against the bankrupt. See, e.g., Tesheft v. Kessler, 206 Fed. 472-74 (3d Cir. 1924). Even today, however, the traditional procedure of having the bankruptcy court grant a discharge and the state court pass upon its effect is followed in the great majority of cases. The broad issue concerning the utility and desirability of this procedure has been the subject of frequent and exhaustive commentary and is beyond the scope of this note. See generally Boroff, The Proper Forum for the Determination of a Discharge in Bankruptcy, 34 Ref. J. 81 (1960); Glenn, Effect of Discharge in Bankruptcy: Ancillary Jurisdiction of Federal Court, 30 Va. L. Rev. 831 (1944); Smedley, Bankruptcy Courts as Forums for Determining the Dischargeability of Debts, 39 Minn. L. Rev. 651 (1955) [hereinafter cited as Smedley]; Smedley, Determination of the Effect of a Discharge in Bankruptcy, 15 Vand. L. Rev. 49 (1961).

9 292 U.S. at 241.

10 Id. at 245. Prior to Local Loan, the lower federal courts, as well as the courts of most states, had consistently held that enforcement of future wage assignments was barred by a discharge in bankruptcy.

11 Id. at 241.

12 Id. at 241-42.

13 "[I]t is unfortunate that [Local Loan] . . . was the the case in which the Supreme Court affirmed the existence of ancillary jurisdiction after discharge. Few
a result, the circuit and district courts have disagreed with respect to the circumstances under which ancillary jurisdiction should be exercised. In cases denying injunctive relief to the bankrupt, the courts usually affirm their power to act but decline to do so, emphasizing the restraint with which that power should be exercised under Local Loan. The thrust of these decisions is that the bankrupt's remedy in a state forum is adequate "if theoretically available—even if not practically available—and that the rule does not apply unless the state courts in which the bankrupt is sued would erroneously deny the dischargeability of the obligation." These cases have been criticized on the ground that an overly narrow construction of Local Loan serves only to "straight-jacket" the doctrine of unusual circumstances.

In cases granting equitable relief, the courts usually adopt a more liberal view and emphasize their duty to promote the policy of the Bankruptcy Act favoring a fresh start for the discharged bankrupt. Accordingly, the concept of "unusual circumstances" is not construed so narrowly as to limit the bankruptcy court's jurisdiction to cases where other remedies are completely unavailable. Instead, the practical difficulties of the bankrupt are held to be paramount, despite the possibility of a theoretically adequate

of the subsequent cases have involved so many circumstances adverse to the bankrupt." (Emphasis added.)

14 Boroff, supra note 8, at 81. Remington has taken the position that despite differences of phrasing and of emphasis in various opinions, there is actually very little conflict of authority in this field. Remington, Bankruptcy § 3258, at 95 (6th ed. 1955). In terms of sheer statistical results, a thorough analysis of cases involving the question of ancillary jurisdiction has been found by one writer to reveal an almost even division between decisions granting and denying relief. Smedley, supra note 8, at 660. A more recent case analysis is contained in Boroff, supra note 8, at 81-82 nn.10-17. However, some courts feel that the current trend favors more frequent exercise of this jurisdiction to protect the bankrupt. See, e.g., Matter of Forgay, 140 F. Supp. 473, 476 (D. Utah 1956).

15 Smedley, supra note 8, at 662. See, e.g., Csatari v. General Fin. Corp., 173 F.2d 798 (6th Cir. 1949); In re Devereaux, 76 F.2d 552 (2d Cir. 1935). A relatively recent case adopting this view is Briskin v. White, 256 F.2d 132 (9th Cir. 1961), in which the court emphasized that the bankrupt had failed to show "any decision of the California courts which would indicate that his contention would be resolved against him." Id. at 134. This decision appears to represent a retreat from the liberal view earlier expressed by the Ninth Circuit. See California State Bd. of Equalization v. Coast Radio Prods., 228 F.2d 520 (9th Cir. 1955); Holmes v. Rowe, 97 F.2d 537 (9th Cir. 1938).

16 See Herzog, Bankruptcy Law—Modern Trends, 36 Ref. J. 87, 89 (1962), which contains the following evaluation of Briskin v. White, supra note 15:

[M]y chief criticism . . . rests on its narrow interpretation of Local Loan to mean that only where the merits have been predetermined by the state's highest court, should the Federal court intervene. Harrassment can assume many forms and Local Loan does not attempt to delineate them. The prospect of ultimate relief in the state court does not make the remedy at law adequate.


18 See, e.g., Holmes v. Rowe, supra note 15 (failure to exhaust state court remedy held not to preclude injunctive relief). See also Matter of Forgay, supra note 14, at 476: "Circumstances under which the court should intervene are not limited to any given facts."
remedy in the state forum. Thus, the power to enjoin is exercised not only
where a potential conflict of state law and federal bankruptcy law exists,
but also where the remedy in the state forum would otherwise be practically
inadequate, or where there might be "extreme embarrassment" to the
parties.

Although the federal courts have often disagreed on the proper inter-
pretation and application of Local Loan, the Second Circuit has been particu-
larly noted for its narrow approach to the protective powers of the bank-
ruptcy court. In the frequently cited case of Ciavarella v. Salituri, for
example, that circuit characterized ancillary jurisdiction in purely negative
terms, stating that such jurisdiction is "exceedingly narrow" and, in fact,
nonexistent "except where special embarrassment arises." This conserva-
tive approach was also clearly manifested in the earlier case of In re Dever-
ceaux. There, the Second Circuit refused to reverse an allegedly erroneous
state court decision which held that enforcement of a pre-bankruptcy judg-
ment against the debtor was not barred by his subsequent discharge. The
circuit court justified this result on the ground that the bankrupt had an
adequate remedy in the state judicial system, even though it recognized
that avoidance of the small $500 judgment might require successive appeals
in the state courts and ultimate resort to the United States Supreme Court.

19 Smedley, supra note 8, at 664. This view was perhaps best explained in a dis-
senting opinion by Judge Paul in Helms v. Holmes, supra note 4, at 269-70.

20 See, e.g., In re Connors, 93 F. Supp. 149, 150 (ND Ind. 1950), in which the
bankrupt's remedy was held to be inadequate because of his financial inability to appeal
an adverse state court judgment.

21 Note, 32 Ind. L.J. 151, 164 (1957). The various factors held to constitute
unusual circumstances are outlined in Boroff, supra note 8, at 81-82. It is noteworthy
that judicial concern over the harassing techniques employed by some creditors (usually
small loan companies) against the bankrupt wage-earner has been a recurring theme in
many of the decisions in which injunctive relief has been granted. E.g., Matter of
Forgay, supra note 14. See California State Bd. of Equalization v. Coast Radio Prods.,
supra note 15, at 523. Moreover, the prevalence of these alleged abuses has furnished the
most common basis for arguments favoring a more liberal interpretation of the unusual-
circumstances doctrine or legislative reform of the Bankruptcy Act itself. See, e.g.,
Smedley, supra note 8, at 669-71. See also the discussion of small loan company abuses
in Boroff, supra note 8, at 84-86.

22 As one writer has observed:
[T]he Second Circuit has not seen eye to eye with most of the courts on the ques-
tion of whether the bankruptcy court, under any situation except one
conforming to a strict view of what constitutes "special circumstances" within
the intendment of the Supreme Court in the Hunt case, can grant a stay.

8 Remington, op. cit. supra note 14, § 3267, at 111-12.

23 153 F.2d 343 (2d Cir. 1946).

24 Id. at 344. The conservative language of this opinion led one bankruptcy referee
to conclude:

With this negative approach it is difficult to envision circumstances which would
persuade the court to assume jurisdiction. I do not see how Local Loan can be
so narrowly construed except by a court which is basically and philosophically
opposed to assuming jurisdiction at all in these cases.

Herzog, supra note 16, at 89.

25 76 F.2d 522 (2d Cir. 1935). See Greenfield v. Tuccillo, 129 F.2d 854 (2d Cir.
1942).

26 76 F.2d at 524.
In view of this past record, the Second Circuit’s consideration of the instant case assumes added significance as the most current expression of that court’s approach to the unusual-circumstances concept.

The fact situation presented in Fallick—namely, the determination of dischargeability by an arbitrator—is without direct precedent. Consequently, in support of his claim that such an issue should not be relegated to a non-judicial forum, the bankrupt relied heavily on two analogous cases decided by the Tenth Circuit: State Fin. Co. v. Morrow27 and Personal Industrial Loan Corp. v. Forgay.28 Both of these cases had previously been interpreted as supporting intervention by the bankruptcy court when creditors’ enforcement suits are brought in state courts of inferior standing “where judicial processes may be of questionable quality.”29

In Morrow, the court enjoined a suit brought before a justice of the peace on a promissory note which had been scheduled and discharged in earlier bankruptcy proceedings. The creditor alleged that the state suit was being prosecuted on a theory of liability for fraud in obtaining money with a false financial statement, and that therefore the debt was not dischargeable.30 The circuit court concluded, however, that since a justice-of-the-peace court was not a forum of record, it would be impossible to determine whether a judgment against the bankrupt was based on “the debt for which the rate was given [which was dischargeable] or the fraud which may have induced it [thus leaving him] . . . for all practical purposes . . . defenseless.”31 In Forgay, the creditor ignored bankruptcy proceedings and instituted suit in a nonrecord city court. The Tenth Circuit Court of Appeals enjoined the creditor from pursuing execution on a default judgment obtained in the city court, emphasizing that bankruptcy courts “should give special attention to small debtors to the end that they are not harrassed by being dragged through expensive state court proceedings.”32

While conceding that the reasoning in Morrow, and the result in both Morrow and Forgay, did lend some support to the bankrupt, the majority in the instant case distinguished both Tenth Circuit decisions on the ground that they involved the problem of harrassment by loan companies.33 The opinion in Morrow, however, did not specifically deal with that issue. Instead, emphasis was placed on the possible lack of expertise of a justice of the peace,34 and the absence of an adequate record for the bankrupt’s protec-

27 216 F.2d 676 (10th Cir. 1954).
28 240 F.2d 18 (10th Cir. 1957).
29 Smedley, Determination of the Effect of a Discharge in Bankruptcy, supra note 8, at 75.
31 216 F.2d at 680.
32 240 F.2d at 21.
34 216 F.2d at 680. Remington contends that Morrow represents a “misconstruction” of Local Loan, but he quotes the opinion at length as an example of “the uncertainty with which obtaining justice before a justice of the peace is regarded in some portions of these United States.” 8 Remington, op. cit. supra note 14, § 3262, at 101.
tion. Although recognizing that it should have a "rightful regard for state court proceedings," the Tenth Circuit pointed out that
the remedy afforded to the bankrupt by federal law is not merely a legal remedy in the form of burdensome litigation with successive appeals to reach a court of record. It is a remedy adequate to meet the full requirements of justice—a remedy which comports with the spirit and purpose of the bankruptcy act to secure to the bankrupt the full and complete benefit and advantages of his discharge.

In Forgay, however, decided two years after Morrow, the Tenth Circuit shifted its emphasis away from the practical deficiencies of the state forum, and castigated loan companies for bypassing the federal bankruptcy court and for resorting to harassing tactics to enforce their claims. This change of approach considerably narrowed the utility of Morrow as a precedent for cases in which the element of harassment is lacking, especially since the circuit court in Forgay indicated that concern over the use of abusive collection tactics also formed the underlying rationale of its decision in the former case.

Although distinguishing Morrow on its facts, the majority in the instant case nevertheless evaluated the adequacy of arbitration in terms of the factors stressed in that decision, i.e., lack of expertise and the absence of a reviewable record. With respect to expertise, the court pointed out that the issue of dischargeability raised by Kehr—whether the alleged misappropriation of funds was "willful and malicious" and therefore nondischargeable—was not particularly complex, and that arbitrators have frequently de-

Judicial distrust of "inferior" state courts is also evidenced by the dissenting opinion in Helms v. Holmes, supra note 4, at 269. See also Matter of Forgay, supra note 14, at 477.

["[T]he court in which the liability was asserted was not a court of record where issues of law and fact are defined with any degree of particularity . . . ."] 216 F.2d at 680.

Ibid.

See 240 F.2d at 20.

Id. at 20-21. Judge Murrah, who wrote the opinion in Morrow, was not sitting on the Tenth Circuit Court of Appeals at the time Forgay was decided.

The majority may have taken this approach because, despite the factual differences between Morrow and the instant case, the factors of expertise and reviewability become significant where there exists both a permissible and an impermissible ground upon which the state forum can resolve the issue of dischargeability. Since in this respect the cases are analogous, the majority probably felt compelled to discuss these two factors in conjunction with their analysis of the precise issue of dischargeability which the arbitrator would have to decide if they denied injunctive relief.

See note 3 supra.

Remington outlines the test of such an injury as follows: "There must be a wrongful act, intentionally done, without just cause or excuse, importing malice in the legal sense. But ill will or special malice toward the particular plaintiff need not appear." 8 Remington, op. cit. supra note 14, § 3328, at 192. In his memorandum opinion, the district judge observed that the discharge would not affect a misappropriation of funds unless it constituted "a mere technical conversion occurring through mistake or inadvertence," and that this was a question "well within contemplation of the arbitrator." Brief for Appellant, p. 9a (appendix). Four previous cases, dealing with the question of whether a partner's liability for misappropriation of partnership funds is discharged by his bankruptcy, resolved the issue of "willful and malicious injury" without difficulty.
decided questions of law presenting at least an equivalent degree of difficulty.42 In addition, it was noted that the arbitrator who was assigned to the case in this instance was in fact an experienced attorney,43 and that Fallick had the right to counsel at every stage of the proceedings.44 In view of these circumstances, and the absence of any policy in the Bankruptcy Act prohibiting arbitration of the effect of a discharge,45 the court refused to rule as a matter of law that the arbitral process should be the object of judicial distrust.

With respect to the lack of a record and the possibility that an unreviewable error of law might be made by the arbitrator, the court pointed out that, under the rules of the American Arbitration Association, a complete record of the proceedings could be made if one of the parties requested it and agreed to bear the expense.46 Moreover, the court suggested that on the basis of that record, a renewed application might be made to the bankruptcy court after arbitration to enjoin enforcement of the award; the test of review in the event of such an application was expressly left open.47

Traditionally, the scope of judicial review of arbitration awards has been narrow; intervention is usually limited to questions of procedural fairness and arbitrability, and the court avoids considering the merits of the arbitra-

42 2 Bankr. L. Rep. at 71570. As a primary example, the majority cited Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959), cert. denied, 364 U.S. 801 (1960), in which the question for arbitration concerned the existence of fraud in the inducement of a contract.

43 2 Bankr. L. Rep. at 71569. One of the sharpest criticisms of the arbitration process is based on the argument that as nonjudicial officers, arbitrators “not only lack a duty to apply the rigors of the law, but frequently are unqualified to do so.” Symposium —Arbitration and the Courts, 58 Nw. U.L. Rev. 466, 547 (1963).


45 In his dissenting opinion, Judge Friendly relied on Wilko v. Swan, 346 U.S. 427 (1953), to support his argument that the agreement to arbitrate the issue of dischargeability constituted an advance waiver of the benefits of a discharge and, therefore, was contrary to the policy of the Bankruptcy Act and void. In that case, the Supreme Court held that an agreement to arbitrate future controversies between securities brokers and their customers constituted a “stipulation” binding the buyer to waive compliance with the Securities Act and therefore was void. Basic to this determination, however, was the Court’s belief that the Securities Act was drafted with the unequal bargaining position of such buyers in mind, and thus provided them with a wider choice of courts and venue than participants in other business transactions. For this reason, the Court held that the buyer’s right to select the judicial forum could not be waived. The majority in the instant case distinguished Wilko by noting that since the traditional procedure in bankruptcy cases is to litigate the effect of a discharge wherever the creditor chooses to bring suit, it could not be argued that an agreement to arbitrate violated any policy of the Bankruptcy Act with respect to the choice of forum. 2 Bankr. L. Rep. at 71571.

46 Id. at 71572. The fact that the expense of the record must be paid by the party requesting it was stressed only by Judge Friendly. The cost factor, however, should not constitute an onerous burden for the bankrupt in view of the other conceded economies of arbitration procedure.

47 Id. at 71572 n.13.
tor's decision.48 In recent years, however, a number of courts have taken the position that matters of "public policy" may constitute added grounds for vacating arbitration awards.49 In a proper case, therefore, the bankruptcy court might vacate or modify an award considered destructive of the legislative policy of the Bankruptcy Act, even though the policy favoring promotion of arbitration might thereby be frustrated.50 This process of balancing conflicting policies finds its analogue in cases where federal courts have intervened on behalf of a discharged bankrupt even after final judgment has been rendered in a state court proceeding.51 In such cases the doctrine of res judicata is either ignored or set aside, apparently on the theory that "the bar which res judicata would ordinarily create is obviated by the necessity for intervention to prevent circumvention of the orders of the bankruptcy court and frustration of the purposes of the Bankruptcy Act."52

In any event, it seems that since the parties in the instant case agreed to arbitrate their differences, they should be estopped from disputing the arbitrator's interpretation of the law unless it is grossly erroneous or unfair.53 In addition, by instituting a suit to compel arbitration, Fallick, in effect, forced the choice of forum and barred Kehr from resorting to a state court of record. Under these circumstances, it would be eminently unfair to allow the bankrupt to subsequently rely on the alleged deficiencies of the arbitration process as a ground for intervention by the bankruptcy court.

In view of all of these factors, the court could only conclude that the bankrupt in this case did have a remedy which was adequate to meet "the full requirements of justice." His remedy was theoretically adequate because, as the majority indicated, "arbitration of the issue of dischargeability with its speedy and economical procedures seems no less appropriate than litigation in a state court."54 His remedy was also practically adequate because of the absence of any aggravated factors requiring the intervention and protection of the bankruptcy court.55 Moreover, although refusing to rule that arbitration of the issue of dischargeability requires injunctive relief as a matter of law, the court intimated that arbitration could constitute unusual circumstances if used as a weapon of harassment by unscrupulous creditors.56

Despite the result of the instant case, which is consistent with the Second Circuit's previous decisions, the majority opinion evidences concern

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48 Symposium, supra note 43, at 545. Apparently, it is felt that if an award is vacated or modified by the courts, arbitration thereby becomes less acceptable to the parties, and the policy favoring arbitration is frustrated. Id. at 546.
49 Id. at 545.
50 Idem. for this type of judicial intervention is found in the belief that as guardians of the public interest, the courts "must properly consider all relevant legislative and judicial policies when called upon to enforce arbitration awards." Id. at 547.
51 E.g., Holmes v. Rowe, supra note 15.
52 Smedley, supra note 8, at 76.
53 This argument is applicable to almost all cases where the finality of an arbitration award is in issue. See Symposium, supra note 43, at 550.
55 Id. at 71362. The majority emphasized that "there could not be a less appealing occasion for singling out arbitration for special treatment by announcing an inflexible rule that the issue of dischargeability may never be decided in that forum."
56 Ibid.
for the protection of the discharged debtor and a clear recognition of the
duty to evaluate fully the practical adequacy of his remedy in the state
forum. Consequently, \textit{Fallick v. Kehr} represents not only a reaffirmation of
the protective policy of the Bankruptcy Act, but also a prospective warning
to creditors who abuse their traditional right to have the issue of discharge-
ability determined in the forum of their choice.

\textbf{Frederick S. Lenz, Jr.}

\textbf{Corporations—Stockholders' Personal Liability—Application of Agency
or Undercapitalization Theory to \textit{"Pierce Corporate Veil."}—Walkov-
szky \textit{v. Carlton}.—Seon Cab Corporation consisted of two taxicabs, each
heavily mortgaged, each with the minimum \$10,000 liability insurance re-
quired by New York law.\textsuperscript{2} Carlton and two others were the organizers and
principal stockholders of Seon Cab and of nine other cab corporations, each
with similar assets. Plaintiff Walkovszky alleged that he sustained personal
injuries when he was struck by a taxicab owned by Seon Cab. Since the
corporate assets of Seon Cab were insufficient to cover plaintiff's damages,
he attempted to gain the deficiency by joining as defendants the nine other
corporations and the stockholders, in addition to the driver and Seon Cab.\textsuperscript{3}
The trial court's ruling, which had dismissed the complaint against the
stockholders, was reversed by the New York Supreme Court, Appellate
Division.\textsuperscript{4} They therefore appealed to the Court of Appeals which HELD:
The complaint is dismissed for failure to state a cause of action against
the individual defendants,\textsuperscript{5} since in New York a stockholder is not personally
liable for the torts of his corporation unless there is a showing that he was
conducting its business in his individual capacity without regard to the
corporate entity.\textsuperscript{6}

The holding of the Court of Appeals follows a long line of New York
decisions based upon the precepts of Judge Cardozo in \textit{Berkey v. Third Ave.
Ry.},\textsuperscript{7} wherein he stated:

\begin{quote}
[T]he corporate entity will be ignored when the parent corporation
operates a business through a subsidiary which is characterized as
an "alias" or "dummy." . . . [T]he essential term to be defined is
the act of operation. Dominion may be so complete, interference
\end{quote}

\begin{footnotes}
\item[3] This action was also brought against two other corporations, not important to
the outcome of this case.
\item[5] The claim against Seon Cab and the other cab corporations is still pending.
Natelson \textit{v. A.B.L. Holding Co.}, 260 N.Y. 233, 183 N.E. 373 (1932); Quaid \textit{v. Rat-
kowsky}, 183 App. Div. 428, 170 N.Y.S. 812 (Sup. Ct. 1918), aff'd, 224 N.Y. 624, 121
N.E. 887 (1918).
\item[7] 244 N.Y. 84, 155 N.E. 58 (1926).
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