Constitutionality of the Recent Amendment to the Bankruptcy Law

Albert K. Stebbins
CONSTITUTIONALITY OF THE RECENT AMENDMENT TO THE BANKRUPTCY LAW

ALBERT K. STEBBINS, LL.B.*

THE title "Solicitor General of the United States" is both high sounding and resonant but it may be suggested, with due humility, that "We the People of the United States," although unblessed with titles, "in order to form a more perfect union," have so often placed in commission the desires which frequently accompany the possessors of them, that in our scheme of government such titles have neither the high sounding transcendence nor the ex cathedra resonance with which they may attempt to glamour.

This fact has received recent emphasis in the halting by the Seventy-Second Congress, of a general revision of our bankruptcy law according to a plan proposed by the solicitor general; but, in the process, and at the behest of one even mightier than he, under the pretext of emergency legislation, certain amendments, not germane to the act amended, were rushed through the short session of Congress during its last hours of official grace, which, although presently on the books as statutes, should receive the thoughtful consideration of the American Bar.

Let us consider, briefly, the proposed revision and, more comprehensively, the so-called amendments which were finally enacted.

"The Congress shall have power ***. To establish *** uniform laws on the subject of bankruptcies throughout the United States." (U. S. Const. Art 1, Sect. 8.)

*Member of the Milwaukee Bar.
This is the delegation of power, and it is the only delegation bearing upon this general subject in the Constitution.

What meant the Fathers by this delegation? What did they conceive to be "the subject of bankruptcies"?

We must consider the general meaning of the terms and the sources to which the members of the Convention might go for further light.

In practically every instance, the words used in the Constitution carried with them their meaning in English, and where a technical legal word was used it found its meaning in the law of England as it then existed.

In English and in England the words "bankrupt" and "bankruptcies" had a thoroughly understood and definite meaning.

Every man has a status in the community in which he resides or perhaps, more accurately, several status and it is from these that he finds his place in society.

He may be bond or free, married or single, minor or major, solvent or insolvent, bankrupt or non-bankrupt.

From these various status the convention selected those who were "bankrupt" and subjected them to the discipline and favors of such "bankruptcy" laws as Congress might enact. The distinction between "insolvents" and "bankrupts" was well known, and the grant related to "bankrupts" alone.

If we had not learned from other sources that Henry VIII during his reign had many causes for concern other than domestic infelicities, that fact would clearly appear from an Act of Parliament enacted in 1542 entitled "An Act against such persons as do make bankrupts" of which the preamble states the first definition in English of the term in the following language, "Whereas divers and sundry persons craftily obtaining into their hands great substance of other men's goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or restore to any of the creditors, their debts and duties, but at their own wills and pleasures consume the substance obtained, by credit, of other men, for their own pleasure and delicate living, against all reason, equity and good conscience: Be it enacted, etc."

Thus did the term "bankrupt" begin its legislative career in English.

Bankrupts were not merely "insolvents" but persons who being insolvent committed some affirmative act in derogation of the rights of their creditors.

From that date such has been the English concept of a "bankrupt;" the affirmative act, the something else, the act of bankruptcy, varied through the years but that an insolvent must do that "something else" before becoming "bankrupt" has continued until the present time and
RECENT BANKRUPTCY AMENDMENT

it is in that sense that the word "proceedings in bankruptcies" is used in the Constitution.

As was quite customary in the England of that age criminal or quasi-criminal proceedings were joined with proceedings in rem against the property of the criminal. The bankrupt was not considered to be a person entitled to favors, rather was he one who merited punishment, but the gist of the law was that, the commission of the act of bankruptcy being shown, the property of such a person might be sequestered in a judicial proceeding and ratably distributed among his creditors.

That has always been and is now in English the essential characteristic and determining factor of a bankruptcy law. To this early law the filing of a voluntary petition as an affirmative act of bankruptcy and such incidents as composition and discharge were unknown, but the essentials of a bankruptcy law were fixed and determined.

Subsequent legislation, particularly the Statute of 13 Elizabeth, clarified the several questions as to what constituted acts of bankruptcy, but the right to a discharge from debts was not known until 1705, during the reign of Queen Anne, when it was enacted that bankrupts who had complied with all of the provisions of the law be discharged from all debts owing when they "did become bankrupt."

Composition and voluntary petitions had not as yet appeared.

This was the state of the English law at the time of the Constitutional Convention.

When the term "bankruptcies" is used in the Constitution it must therefore mean proceedings against persons who, being insolvent, have done something else in derogation of the rights of their creditors, the nature of the proceedings themselves and of the acts which would make "bankrupts" out of "insolvents" being granted to Congress to determine.

At this point a definition may be hazarded substantially as follows: a potential bankrupt is a person who, being insolvent, commits some act which sets him apart from all other insolvents and places him in a class subject to certain proceedings, limited to persons similarly situated, known as proceedings in bankruptcy, but he does not actually become a bankrupt until a petition in bankruptcy has been filed in court and he has been formally adjudicated as such; the initiatory filing of a petition and other acts necessarily performed prior to the adjudication, being nevertheless "proceedings in bankruptcy," are directed solely to the end of an adjudication and are within the terms of the constitutional grant.

It is in this sense that the Judicial Code, at an early date, delegated to the District Court, "Jurisdiction * * * of all matters and proceedings in bankruptcy."
The first exercise of the constitutional grant by Congress was in 1800, and the law of that year closely followed the English pattern. Discharges, under stated conditions, were allowed; but no provision was made for voluntary proceedings or composition with creditors and the law was repealed in 1803 as one of the results of the general repudiation of the John Adams administration.

The law of 1800 restricted its operations to certain classes, against whom only bankruptcy proceedings might be instituted, but in 1841 Congress again passed a bankruptcy law, which developed the theory of American bankruptcy and was made effective for all insolvents who committed stated acts of bankruptcy and contained a new provision permitting the filing of a voluntary petition.

As a matter of first impression a voluntary petition might be thought to be an anomaly, but upon reflection it is apparent that the filing of such a petition constitutes merely a new and separate "act of bankruptcy," the commission of which subjects the insolvent debtor to adjudication, changing his status from a mere "insolvent" to a "bankrupt."

A man by giving a preference or making a voluntary assignment commits one of the designated "acts of bankruptcy"; he may by reason of that act be forced to become a "bankrupt" and the law, in order to save time, trouble and expense, permits the insolvent to commit the act directly in the court of bankruptcy rather than by indirection. Without this provision an "insolvent," desirous of becoming a "bankrupt" would be required, for example, to make a voluntary assignment, usually under the supervision of a State Court, and then procure some friendly creditor to institute, technically, adverse or involuntary proceedings.

This new act of bankruptcy is in accord with the well established American habit of permitting direct action, without idle subterfuge, whether it be a conveyance of real estate from husband to wife or availing oneself of the "uniform laws on the subject of bankruptcies," but in no way affects the status of the debtor, as a "bankrupt," immediately upon his adjudication.

This law of 1841 was in many ways a model bankruptcy act but was never given a fair trial and was repealed in less than three years, not because of the weakness of the act but rather because a majority in Congress was unwilling to extend, in any way, the jurisdiction of the general government over the people of the several states, it having been held at an early date in the case of Sturgis v. Crowninshield, 4 Wheat. 122 (1819), that a national bankruptcy act superseded all state laws upon that subject.
Not until after the Civil War did Congress again attempt to legislate "on the subject of bankruptcies." In 1867 the third bankruptcy act was passed and for eleven years remained in force. This act followed generally the plan of the 1841 law, however with numerous exceptions not here material, except that provision was made for compositions in bankruptcy.

A composition was a novelty; under the provisions a person by or against whom a petition in bankruptcy had been filed might stay all proceedings for the purpose of making an offer of settlement to his creditors collectively, and if such offer was accepted by a majority of his creditors in number and amount and approved by the court, he was relieved from further proceedings in bankruptcy, remaining in possession of his estate, but if the offer was rejected by his creditors or disapproved by the court the bankruptcy proceeded in its regular course.

The objection was made that a composition was foreign to the theory of bankruptcy, but the answer was the obvious one that proceedings in composition were merely a new form of administration in bankruptcy; they could not be proposed unless a petition in bankruptcy had been filed and the jurisdiction of a court of bankruptcy attached, or, as it was held in Wilmot v. Mudge, 103 U. S. 217 (1880), "the composition proceedings arise from the bankruptcy proceedings" and, as such, provision for them was within the competence of Congress. Upon this theory the validity of compositions was sustained.

The law of 1867 remained in force for eleven years, during which period various defects appeared; the expenses of administration were unduly great and in 1878 Congress decided that, the emergency following the Civil War having passed, it would be wiser to repeal rather than to amend and acted accordingly.

The financial panic of 1893 was followed by a period of depression which revived the thought that failing business might better be liquidated under a uniform system than by the disconnected and various rules prevailing in the several states, with the result that in 1898 "An Act to establish a uniform system of bankruptcy throughout the United States" passed both Houses and became effective on July 1, 1898.

This law has been amended by Congress in several particulars, both as to form and substance, but its general character has never been changed until the amendatory Act of March 3, 1933.

Provision was made for all of the mechanics required by a bankruptcy law; in many instances opinions differed upon particular subjects, such as acts of bankruptcy, preferences and discharges, but in general both the professional and business classes were content with the workings of the law, and, as through the years the text was
judicially and wisely interpreted, a sense of security accompanied the increasing certainty of the several requirements.

That defects existed was admitted, that certain abuses had developed was well known, but it was generally conceded that these might be remedied by amendments from time to time in matters of detail and there was no demand, either from the Bar or from business, for a general revision.

Interests, frequently undisclosed, were, however, at work to revamp the law, both for political and class purposes. At the meeting of the American Bar Association at Chicago in 1930 the Solicitor General in a lengthy address reviewed what he stated to be the faults of the law and indicated that certain research was then in progress for the purpose of revising the scheme of administration, but it is fair to state that the membership of the Association failed to grasp the significance of the address, receiving the suggestions politely and considering them merely as another subject for academic discussion.

Ultimately, the so-called Solicitor General's bill was introduced in both Houses during the first Session of the Seventy-Second Congress, and (Sen. 3866, H.R. 9188) was referred to proper Committees.

Very promptly most vigorous and practically unanimous criticism and active opposition developed throughout the Bar of the country. Within a few days, under the able initiative of Hon. Max Isaac, Editor of the Bankruptcy Review, there was created a nation wide organization to lead the opposition, known as the Association of Federal Practitioners, with a membership from every State and from practically every Judicial District. During the session Judge Isaac became almost a permanent resident of Washington, marshalling the opposition; at all critical moments members of the Association responded, at their own expense, and their united effort contributed largely to the happy death of the bill in Committee. The American Bar Association and the Commercial Law League overwhelmingly repudiated the bill at their annual meetings in the summer of 1932, and so far as the Bar was concerned the bill became of general disrepute.

Nevertheless it came perilously near to receiving a favorable report from the sub-committee of the Senate having it in charge.

It is not necessary here to review the objections so forcibly made to the pending bill. In general terms it may be said that it changed the historic character of a bankruptcy law to a law for the relief of all debtors, whether legally bankrupt or not; it diminished, almost to extinction, the judicial power, whether exercised by District Judges or Referees, for which it substituted a cleverly conceived and skillfully organized bureaucracy, with the Attorney General as its titular head, with a selected corps of political administrators and non-political exam-
RECENT BANKRUPTCY AMENDMENT

Iners as arms of strength, and the professional trustee, with his parasitical appraisers, as its humbler members.

Little progress was made at the first Session but continued committee deliberation extended into the short or "Lame Duck" session, and shortly after the first of the present year it became clear that it would be impossible to enact the proposed law before March 4 when the Seventy-Second Congress would pass out of existence.

Thereupon appeal was made for the enactment of an amendment, containing some of the features of the languishing bill, under the head of emergency legislation, and special messages were procured from the White House urging such action. The result was the passage of a bill, containing three amendatory sections to the old law, on March 1, 1933, which was approved by the president on March 3, a few hours before his retirement.

Let us consider these amendatory provisions.

In this connection it must ever be borne in mind that the jurisdiction of Federal Courts is strictly limited by the constitutional grant. In ordinary commercial litigation federal questions, as such, rarely arise, the sole grounds for jurisdiction being diversity of citizenship, and only in the event that a debtor becomes the subject for a bankruptcy proceeding and is actually adjudicated a bankrupt can controversies between citizens of the same state be determined in the Courts of the United States.

The original draft of this "amendatory" law specifically repealed sections 12 and 13 of the old law, which regulate compositions in "bankruptcy proceedings," and it was the first impression of the Bar that this repeal had been accomplished, but it appears from the text as finally adopted that the repealing clause was omitted with the result that we have a complete bankruptcy law, untouched by this new legislation, and, being complete, there is no inherent reason for the necessity of amendments.

The new act begins with an affirmative declaration: "In addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors as provided in sections 74, 75 and 77 of this Act."

Thus, quite naively, the draftsman of the new Act places his subject definitely without the constitutional pale and if by its terms he has accomplished his declared purpose, the entire Act must be unconstitutional.

This relief is declared to be in addition to the relief for which provision is made by sections 12 and 13; it is something essentially different and the two measures for relief must not be confused, which
thought will materially aid in the interpretation of the amendments.

Section 74 provides for the relief of "debtors" by composition. All corporations are excluded from the benefits of the Act, but any other person may file an original petition, accompanied by schedules, stating that he is insolvent, is unable to meet his debts as they mature, and that he desires to effect a composition or an *extension of time* to pay his debts. A similar opportunity to negotiate with his creditors outside of the bankruptcy proceedings, as such, is afforded to a debtor against whom an involuntary petition has been filed but before adjudication.

The differentiation between a "debtor" and a bankrupt is consistently recognized and maintained by the provision that the person involved "shall be referred to under this section as 'debtor'."

The filing of the petition is the initial step; upon it the jurisdiction of the court depends. If it is approved by the court, the proposed composition proceeds; but if it is disapproved by the court, it is merely dismissed, and the petitioner remains simply an insolvent debtor, no provision being made for an adjudication of bankruptcy. The proposal is refused and the proceeding is at an end.

If the proposal is approved, typical proceedings in composition follow; a receiver may be appointed in the discretion of the court and on notice to creditors; meetings of creditors are held to which the plan of composition is to be formally submitted for approval or rejection; if accepted by the creditors and approved by the judge the proposal becomes effective and distribution made according to its terms among the creditors; it is further provided that upon an extension agreement the time of payment of either or both secured and unsecured claims may be extended. *Only in the event of the breach of the conditions and terms of an accepted proposal may the "debtor" be adjudicated a "bankrupt."*

The idea is clear that the "debtor" is to retain his status, as such, and in no event to be made a "bankrupt," not to be subjected to the stigma of being a "bankrupt," unless he fails to keep his promises, the distinction between the two classes being carefully preserved; as long as he remains in Court under the amendment he remains a "debtor," when and if he becomes a "bankrupt" he ceases to be subject to the amendment and passes under the provisions of the general bankruptcy law. The purpose of the law is to retain the status of "debtor"; it is not a "proceeding arising out of a proceeding in bankruptcy" but quite the reverse, the bankruptcy, if any results, being a proceeding arising out of a proceeding in composition.

Section 75 is entitled "Agricultural Compositions and Extensions"; as indicated it refers exclusively to farmers and is radically different
from any hitherto known proceeding. By this section provision is first
made for the appointment of a "conciliation commissioner" by the
court upon the petition of at least fifteen farmers resident in any
county, such conciliators taking the place of referees in bankruptcy
in all matters relating to debtor farmers desiring to avail themselves of
the amendment. By this provision the very machinery of the amend-
ment is divorced from that of bankruptcy and thereby emphasis is
placed upon the distinction between a "debtor," being a farmer, and a
"bankrupt" under the Constitution.

This may be known as the "Local Option Clause" of the Act. During
the last few years we have heard much of "Local Option"; it may be that, in the hysteria resulting from the gravity of the alleged
emergency, Congress confused the Bankruptcy Act with the Volstead
Act; but, however that may be, it is certain that in no other historic
instance has the operation of a general law of the United States been
made to depend upon County "Local Option," and even that option not
to be exercised by the electors at a regular election but by any fifteen
farmers in a county who may decide to file a petition. In this case Con-
gress has not delegated its powers to a co-ordinate branch of the gov-
ernment or to any known political unit but, expressly, to any fifteen
persons, being tillers of the soil, who may take it upon themselves to
exercise the power.

It may be constitutional, but, if so, then it is constitutional in cari-
cature.

After the petition has been filed and the conciliator appointed, for
the next five years, any farmer within the particular county may file
a petition for a composition or an extension.

Such petition must allege that the farmer is insolvent and that it is
desirable to effect a composition or an extension; it must be accom-
panied by schedules, and the filing subjects "the farmer and his prop-
erty, wherever located, to the exclusive jurisdiction of the Court." It
is further provided that if such petition is filed, "an order of adjudica-
tion shall not be entered except as provided hereinafter in this section." Curiously enough said section, neither "hereinafter" nor in any other
place makes any provision for an "adjudication" and there is no pos-
sible method under the section by which a petitioning farmer may be
adjudicated a bankrupt. Its divorce from all "proceedings in bank-
ruptcy" is complete.

After the jurisdiction of the court attaches, if it ever does attach,
proceedings are similar in kind, although differing in detail, to those
provided under section 74 and, for the purposes of this article, are
not presently material.

Section 77 is however the crowning glory of this act and is entitled
"Reorganization of Railroads Engaged in Inter-State Commerce."

We here are not concerned with the problem of whether or not certain railroads should be reorganized or whether in such case reorganization should be effected by some proceeding in some court, the question here being the constitutionality of an attempt to include such subject in a bankruptcy law enacted under the powers delegated in the Constitution.

The remedies which this section attempts to make available for railroads and the procedure regulating the same are frankly foreign to "bankruptcy" and there is not the slightest suggestion that, under any circumstances, the railroad may be adjudicated a bankrupt. The section creates a most novel proceeding, totally non-germane to the "subject of bankruptcies," and endeavors to extend the jurisdiction of the Federal Courts by forcibly making it a part of the bankruptcy law.

Any railroad corporation may file its petition alleging that it is either insolvent or unable to meet its debts as they mature and that it desires to "effect a plan of reorganization."

This petition must not only be filed in the District Court of territorial jurisdiction, as therein defined, but also with the Inter-State Commerce Commission. Again, by this section, "the railroad company shall be referred to in the proceedings as a 'debtor,'" and that is about all that the unfortunate railroad company is.

The plans allowed for reorganization are very broad and permit practically any form of reorganization which any railroad corporation might reasonably require, but the details of these permissible plans and their wisdom or lack of wisdom are not here material.

Upon the approval of the initial petition, the court entering the order "shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located."

The section contains elaborate provisions for the methods to be adopted in formulating the desired plan but, before the plan is submitted to the creditors and stockholders for approval, the Inter-State Commerce Commission, not the District Court of "exclusive jurisdiction," is required to hold a public hearing at which the railroad corporation must submit its plan and the creditors of the debtor or the trustees may submit a different plan, following which hearing the Inter-State Commerce Commission shall render a report in which it shall recommend a plan, "which may be different from any which has been proposed," but such plan shall not finally be approved by the Commission until certain acceptances have been secured from creditors and stockholders.

After the plan has been developed by this method by the Inter-
State Commerce Commission, the District "Judge shall confirm the plan" if satisfied that it complies with the requirements of the section. The judge having "exclusive jurisdiction" may stamp with his approval the plan as submitted to him by the Commission or he may, for stated reasons, reject it, but he can in no event approve another or different plan.

Imagine a United States Judge standing humbly at the door of an executive bureau, anxiously awaiting to be told what form of judgment he will be permitted to enter in a cause pending in his court and of which he has been given "exclusive jurisdiction."

This section does not pretend to regulate proceedings in bankruptcy, arising out of proceedings in bankruptcy, or which can by any possibility lead to proceedings in bankruptcy; it delegates judicial power to an executive Commission in cases where complete and exclusive jurisdiction has been granted to a duly established court. If such an act is within the "subject of bankruptcies" then the probate of the wills of insolvent testators or divorce proceedings against an insolvent husband may with equally good reason be included in that subject.

That the entire Act of March 3, 1933, fails to relate to "bankrupts" or bankruptcies is declared by its introductory section, hereinbefore noted; such declaration is fully supported by an analysis of its text, and it is submitted to the American Bar that the Act is unconstitutional, that it is not "the law of the land."